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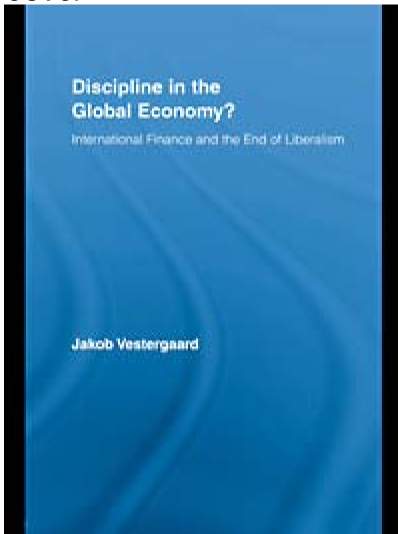

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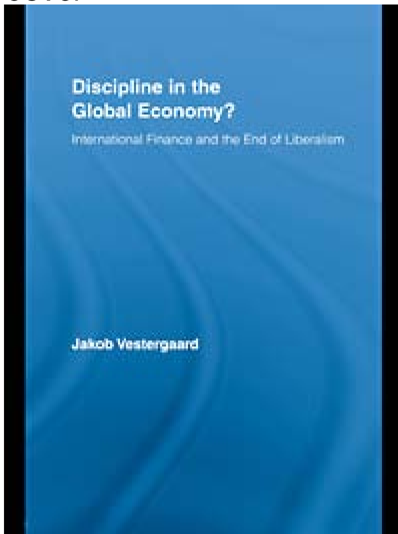

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International Finance and the End of Liberalism

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Even when cowardliness is mistaken for sagacity, with a generally esteemed common sense that secretly is selfishness, even then it is at first mistaken for pride – that is, in the sense that being wise about the world and one's own advantage in this way is something great.

Soeren Kierkegaard1

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Jakob Vestergaard
Danish Institute of International Studies

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1
Introduction

A GLOBAL FINANCIAL CRISIS

After a series of financial crises in the 1990s,1 a period followed with only two major financial crises: in Turkey and Argentina in 2001 and 2002. In neither case did these crises spread to other countries, as had been the case with many of the crises of the 1990s. The lower frequency of financial crisis was to many a sign that efforts by the international community to strengthen the 'international financial architecture' (IFA) had been successful. In early August last year large-scale turmoil in financial markets resurfaced, however. With fears of a global liquidity crisis on the rise, central banks joined forces in an exceptional intervention, injecting $120bn of cheap liquidity into banks, hoping to "shore up confidence in the global financial system" (Milne and MacKenzie 2007). Whether this intervention would prove to be enough to calm nervous financial markets at the time was the "$64bn question" (Tett and Beales 2007). Paul de Grauve commented that although the large-scale bail-out of banks might calm markets here and now, they would likely be "sowing the seeds" for a full-scale financial crisis in the not too distant future (de Grauwe 2007). "The global economy looks resilient enough" now, said *The Economist*, but warned that the ongoing financial market turmoil might be "a dress rehearsal for the real crisis that will emerge when the economy is in poorer shape" (The Economist 2007:63).

A year later, in July 2008, the global economy appeared indeed to be considerably more vulnerable. "It is now almost a year since the US subprime crisis went global", Martin Wolf noted:

Many then hoped that the repricing of risk would be no more than a brief interruption in the progress of the US and world economies. Such hopes have been disappointed. The woes of Fannie Mae and Freddie Mac [two large US mortgage lending companies], the tumbling stock markets and the climbing oil prices make clear how far the turmoil is from its end. It has, in all likelihood, not even passed the end of its beginning. (Wolf 2008a)

Fears that we had only seen the beginning of a deep financial crisis were indeed spreading. "The current market turmoil in the world's main financial centres is without precedent in the post-war period", the Bank of International Settlements (BIS) noted in its annual report, released on June 30:

With a significant risk of recession in the United States, compounded by sharply rising inflation in many countries, fears are building that the global economy might be at some kind of tipping point. (BIS 2008:137)

A couple of months later, by mid-September, the US government had stepped in to rescue first Fannie Mae and Freddie Mac and then the American Insurance Group (AIG). In between those two interventions, the world's fourth largest investment bank, Lehmann Brothers, had collapsed and filed for bankruptcy. On September 16, central banks around the world injected more than $200bn of liquidity in an effort to prevent a larger collapse of the international financial system.

At first, there was a tendency to explain the collapse of each of these financial institutions by some 'exceptional' cause, rather than as related to systemic issues. Thus, Fannie Mac and Freddie Mac, for instance, was seen to have collapsed because of their being 'quasi-public' entities with an 'implicit government guarantee' (Lando 2008); Lehman Brothers, at the end of the day, collapsed because of the hubris and stubbornness of its CEO, Dick Fuld, who in the course of the past year had failed to undertake the necessary adjustments in a timely manner (Gapper 2008). The collapse of the AIG was not foreseen because it was regulated and supervised by a state agency rather than a national or global regulator (FT 2008a). Despite large-scale government bail-outs and repeated extraordinary liquidity injections by the Fed and other central banks, financial turmoil persisted. Eventually, 'exceptionalist' explanations gave way to more systemic ones: commentators now talked about the end of investment banking (Gapper 2008b, Roubini 2008a), a crisis of capitalism (Buiter 2008; Plender 2008; Rosner 2008; Stephens 2008), and so forth. Explanations often remained somewhat simplistic, however. Now commentators typically attributed the 'systemic' crisis to either greed (Weitzman 2008), moral hazard (Authers 2008), short-selling (Mackintosh 2008), or deregulation (Ferguson 2008). But perhaps most disturbingly, there was a widespread tendency to grossly underestimate the *regulatory crisis* implied in the financial crisis. This was evident not just in much financial press coverage of the crisis but also in government interventions such as the US government $700bn rescue plan. As noted by Paul Krugman, the plan assumed the crisis to be a liquidity crisis confined to the US mortgage market, as opposed to a general financial crisis involving substantial solvency issues (Krugman 2008). It was as if the regulatory response in the US and elsewhere assumed that if the US mortgage market mess could be sorted out and confidence among large banks could be restored then the crisis would be resolved. The assumption seemed

to be that apart from massive government bail-outs of financial institutions worldwide, all that was needed to deal with the crisis was a few temporary measures (notably a ban on short-selling) and one single longer-term measure: a raising of capital adequacy requirements for banks, as the 'catch-all' regulatory response (FT 2008b). But as the stocks of banks kept deteriorating—irrespective of government bail-outs, vast liquidity injections and the passing of the US rescue plan—sentiment seemed to move more and more in favour of one further regulatory change: to subject the hitherto unregulated credit derivatives industry to regulatory oversight (Tett, Davies and van Duyn 2008).

At the time of writing, it looks as if major, longer-term changes to financial regulation will indeed be confined to capital adequacy ratios and to subjecting the credit derivatives industry to oversight. Such a response would, unfortunately, represent a gross underestimate of the regulatory crisis implied by the financial crisis. Now is not a time to scramble for easy answers and quick responses, however. On the contrary, there is a need to examine thoroughly the regime of financial regulation of the past decade which has failed so spectacularly. A new approach to financial regulation should be anchored in a solid understanding of the reasons why its predecessor failed. If financial regulatory reform is limited to more or less marginal adjustments, the next financial crisis will be an accident waiting to happen.

The current regime of financial regulation was launched in response to the financial crisis in the East in 1997–1998. Understanding the debate on the Asian crisis and the regulatory regime that was developed in the wake of it is of paramount importance if we are to deal adequately with the current predicament.

THE ASIAN CRISIS

The Asian crisis represented a situation of rupture and reversal not only in financial and socio-economic terms, but also in discursive terms. Economies that had been praised as 'showpieces of capitalism' were now suddenly sad examples of 'crony capitalism'. The image of East Asian economies was turned upside-down from one day to the next. No more 'Tiger economies'; now the talk was instead about the 'vulnerable' and 'weak' economies of East Asia. No more East Asian 'miracle'; now suddenly the contention was that the Asian model of capitalism had in fact for long been doomed to fail. "It is amazing what an economic crisis can do to international perception", said Frank-Jürgen Richter:

In the late 1980s, it was normal to criticise the Anglo-American tendency to ignore longer-term corporate prospects while focusing on quarterly profit reports. The Anglo-American fascination for the ability of well-functioning markets to allocate resources efficiently, was

increasingly questioned throughout the 1980s and the first years of the 1990s. Now [after the Asian crisis], again, the talk is about the virtues of the market, the importance of competition, and the horrors of nepotism (Richter 2000:3).
Through the debate on the Asian crisis, Asian economies were construed as representing an 'improper' form of capitalism. Thus, when Thailand approached the IMF in August 1997 requesting a large financing package, the commitment to "address the *fundamental* causes of current financial difficulties" was stressed (Thai Central Bank and Finance Ministry 1997, emphasis added). Indeed, the Thai authorities in their Letter of Intent to the IMF pledged to adopt "any additional measures that may be necessary" to address these 'fundamental causes' (ibid.). In the words of the IMF, the reform programs subsequently adopted rested on the recognition that "fundamental improvements in the regulatory and supervisory framework in the crisis countries would be required to ensure that financial institutions would start operating on a *sound* basis" (IMF 1999a: 70, emphasis added). The IMF stressed that the structural reform strategy in these programmes was "exceptionally comprehensive"—according to the IMF it "had few precedents in depth and breadth" (IMF 1999a: 18). This reflected the conviction that such comprehensive reforms were necessary to get to "the *heart* of the weaknesses in financial systems and in governance", which were seen to be "at the *root* of the crisis" (IMF 1999a: 18, emphasis added). The main components of the structural reforms were the following:
Reforms to promote governance and competition in the program countries included dismantling state-sponsored monopolies and cartels; privatising state enterprises that had served as vehicles of 'crony capitalism'; strengthening competition laws; improving corporate disclosure requirements and increasing accountability to shareholders; increasing the transparency of economic and financial data; and restructuring or dismantling corporate networks that had limited the transparency of intercorporate dealings. (IMF 1999a: 70–73)
The structural reform programmes launched by the IMF as a response to the Asian crisis strove to dismantle a form of capitalism that was considered improper. More specifically, the aim was to replace the Asian model of 'crony capitalism' with a model of capitalism based on the ideals of 'competition' and 'transparency'. Such fundamental reforms were, the IMF argued, a 'necessary response' to the Asian crisis.
The conditionalities of the loans offered to countries afflicted by the Asian crisis were 'exceptionally comprehensive', the IMF stressed. These 'comprehensive' regulatory ambitions soon caused unease among economists, however. In April 2001, the International Institute of Economics published a paper entitled 'IMF conditionality: How much is too much?'

(Goldstein 2001).2 A month later, an editorial in *The Economist* quoted Morris Goldstein contending that ongoing '[e]fforts to include in conditionality *everything but the kitchen sink* have brought about legitimate charges of "mission creep"' (*The Economist* 2001:78, emphasis added). Eventually, this drive for enhanced conditionality was rolled back, and charges of 'mission creep' receded. It is important to stress, however, that the mission creep itself did not disappear, it merely took a new form. For the core elements of structural reform programmes were soon generalized and universalized in the form of standards and codes of 'best practice', in and through the International Financial Architecture (IFA) initiative. Now economies were to be observed, measured, registered, and reformed in relation to a distinction between the 'proper' and 'improper' economies.

DISCIPLINE IN THE GLOBAL ECONOMY?

In the aftermath of the financial crisis in East Asia, Robert Rubin, then Secretary of the US Treasury, stressed the need to strengthen the 'architecture' of the international financial system. The term 'international financial architecture' (IFA) was soon widely adopted in the debate. If we are to believe James Wolfensohn, then President of the World Bank, the "proper governance of companies" was now as important and indeed crucial to the world economy "as the proper governing of countries".3 Wolfensohn's remarks were but one of many examples; the standards and codes launched through the IFA brought into being something new and remarkable: a norm for the 'proper' organization and regulation of economies. The governmental technologies devised to render this norm of 'proper' economy operational ranged from standards of accounting to standards of corporate governance and financial risk management. In and through the IFA, an international governmental programme had taken shape which—to paraphrase Michael Power—was "without precedent in its attempt to reach into the micro-managerial world" of banks and companies (Power 2005:583).

The IFA initiative marked a new vision for global economic governance. In the name of transparency and financial system stability, the IMF and the World Bank led efforts to promote global compliance with the standards of 'proper' economy. The focus was no longer on whether governments were pursuing a certain set of 'sound' macroeconomic policies or not, but on whether *economies as such* were seen to be 'proper' or not, notably, whether private companies and banks were operated and governed appropriately. This represented a fundamental shift in international economic governance. The IFA established a comprehensive system of supranational normalization, surveillance, and corrective reform, to *discipline* economies and ensure the formation of *docile* economies. It was a shift from the 'exceptional' disciplining of individual economies that were temporarily in balance-of-payments problems to generalized surveillance of all economies at all times,

measuring their degree of deviation from the norm of a 'proper' economy. This generalized surveillance required that a multi-dimensional international technocracy be built charged with continuously assessing deviations and providing guidance for countries in their efforts to subsequently reduce registered deviations and deficiencies.

By analysing the IFA as a system of disciplinary power along these lines it was clear, in other words, just how fundamental the shift from the Washington consensus to the Post-Washington consensus was.4 Most importantly, perhaps, analysing the IFA as a system of disciplinary power allowed one to see that there was much more at stake than a mere recognition that 'institutions matter'. It was a shift from requesting deregulation and 'sound' macroeconomic policy from countries that turned to the IMF for financial and technical assistance when suffering a balance-of-payments crisis, to a *generalized system of surveillance and corrective reform*, targeted at *all* economies, and evoking constant pressure to conform to a particular mode of organizing and regulating them.

Earlier this year, the *Financial Times* declared that the Washington consensus was dead (FT 2008c). This death of the Washington consensus was referred to a study on growth and development commissioned by the World Bank and chaired by a Nobel laureate, Michael Spence. "No single recipe will secure sustained and rapid economic growth in poor countries", the report was said to argue, and "active, pragmatic governments" are now seen as indispensable (ibid.). No more "stabilise, privatise, liberalise" dogma (ibid.). In proclaiming the death of the Washington consensus in this manner, the *Financial Times* neglects the rise of the Post-Washington consensus almost a decade ago. Understood as a deregulation doctrine, the Washington consensus has been dead since the launching of the IFA initiative and the good governance agenda of the Post-Washington consensus more generally. Though departing from the Washington consensus in a number of ways, it maintained its 'universalist' approach to development: the universal recipe of deregulation was replaced with a universal recipe of re-regulation. The vast 'institutional engineering' of the IFA initiative—promoting the global adoption of a particular mode of organizing, and regulating economies through standards of 'proper' economy—was a far more fundamental rupture with the deregulation doctrine of the Washington consensus than the alleged new 'pragmatism'. In terms of its overriding concern with deregulation, the 'Washington consensus' has been dead for a decade or so already, in other words. In countering universalistic thinking, the Spence report is no doubt an important contribution. But the extent to which development policy practice actually changes in this direction remains to be seen.

Despite the lofty ambitions of the IFA initiative and the substantial international bureaucracy involved, there is little reason to believe that it has increased the stability and resilience of the international financial system as envisaged. Understood as a regulatory approach endeavouring to prevent and/or reduce the frequency and severity of financial crises, the IFA initiative consisted in two main strategies: crisis prevention by encouraging

economies to become 'proper' economies, in and through the adoption of standards of 'best practice', and crisis prevention by means of increased 'market-sensitivity'. Whether in terms of 'early warning systems' operated by authorities, or in terms of new, more market-sensitive risk management practices of banks and other financial institutions, this increased 'market sensitivity' was intended to assist authorities and institutions in detecting signs of weakness and vulnerability as early as possible. Curiously, in the debate on the current financial crisis there is little if any scrutiny of these two strategies of the IFA. Instead, it seems as if confidence in this approach to financial regulation is unwavering; only marginal adjustments are considered. This untainted confidence in the IFA approach to financial regulation is little short of a disaster. The IFA is predicated upon three key presumptions about financial markets and their regulation. First, it presumes that there is a force, or mechanism, in operation which one may term 'market discipline', which rewards and punishes economies according to their degree of compliance with 'best practice'. Second, financial vulnerability may be detected, the IFA presumes, by assessing the 'financial soundness' of financial systems through an aggregation of measures of the financial soundness of individual financial institutions. Third, the IFA presumes that standardized, 'market-sensitive' risk management practices predicated upon sophisticated mathematical models promote the resilience of the international financial system. Each of these three presumptions are at odds, however, with the actual dynamics of financial markets. Whether in terms of historical analysis of the correlation between international capital flows and policy reforms, or in terms of quantitative studies of the correlation between compliance with standards and the cost of foreign capital, the evidence demonstrates that the notion that financial markets reward and punish economies according to their degree of compliance with 'sound policies' and standards of 'best practice' is an illusion. Evidence further suggests that the current approach to detecting financial vulnerability, whether at the level of the individual financial institution or in national or international terms, is inadequate and misleading, and that the promotion of 'market sensitive' risk management practices undermines rather than increases the stability and resilience of the international financial system.

The continued prevalence of this counterproductive approach to international financial regulation constitutes a substantial puzzle in and of itself, of course. Its persistent predominance is all the more puzzling, however, when one considers that it deeply violates neoliberalism, supposedly the dominant political rationality of the past two decades.

THE END OF LIBERALISM?

Michel Foucault's analysis of early liberalism suggests that a key aspect of liberalism is a certain *ethos*; always asking 'are we governing too much?' If judged by the prevalence of such an ethos, it seems that liberalism is

dead, or as good as. Although the period since the late 1980s has allegedly been the heyday of free-market capitalism and liberalism, this period has seen the development of a vast supranational bureaucracy endeavouring to promote the global adoption of standards of 'best practice' for the 'proper' organization and regulation of economies. Thus, today we have standards, recommended policies and appropriate modes of governance on a multiplicity of issues ranging from what constitutes an appropriate form of corporate governance to how banks should manage financial risk. Curiously, there has hardly been any problematization of this massive effort at the global homogenization of economies. The lack of contestation of this regime, in what is allegedly the heyday of neoliberalism, is a silence that is not easily explained.

The notion that a universal norm for the organization and regulation of economies should be developed and enforced globally by supranational authorities is at odds with key neoliberal ideals, such as the Ordo-liberal focus on countering homogenizing trends and Hayek's hostility towards any form of 'designed' social order.5 It not without irony that efforts to promote global financial integration—as a means to promote a global 'free market economy'—has led to the creation of a supranational governance regime predicated upon the three main enemies of 'true indvidualism' and 'market society' that Hayek identified: rationalistic individualism, its 'arrogant' belief in the possibility of human planning and design, and—as the 'inevitable' effect of these two—'totalitarian authoritarianism'.

Interestingly, contemporary neoliberals seem unconcerned with such Hayekian apprehensions. Instead, the *credo* of today's libertarians and free-market economists is to lament taxation and the size of the public sector. Thus, in the late 1990s, Milton Friedman asserted that in some senses "we are less free" than we were at the beginning of the 20th century (Friedman 1998:2). A major cause of this "loss of freedom", said Friedman, "has been the growth of government, and its increasing control of our lives", so that today, "government, directly or indirectly, controls the spending of as much as half of our national income" (ibid.). It is as if the predominance of neoliberalism over the past two decades has somehow led to its decay. The liberal *ethos* of problematizing government has been reduced to a mere dogma of anti-government expenditure dogma. In the course of the current financial crisis, there has been much bemoaning of government bail-outs, but no problematization of the IFA and the project of global homogenization undertaken in the name of the stability and resilience of the international financial system. As if to underline this pitiful state of affairs, it took $150bn dollars worth of *tax cuts* to make 'free-market' Republicans vote in favour of the $700bn bail-out of US financial institutions.

If we are to believe Gideon Rachman, we are witnessing not just the bursting of a financial bubble, but also the crashing of an ideological boom. A bust, that is, following "the bull run in conservative ideas that began with the Thatcher-Reagan revolution of 1979–1980":

The current financial crisis can be traced to three of the central ideas of the Reagan-Thatcher era: the promotion of home ownership, financial deregulation and a fervent faith in the market. Each of these ideas did sterling service for 30 years, increasing prosperity and freedom. But pushed too far—and combined—they have created a disaster. (Rachman 2008)

As a consequence, we are now seeing a decisive swing in the "intellectual cycle", Rachman argues (ibid.). The "rightwing ideas of the Thatcher-Reagan era" are denigrated and abandoned (ibid.). Notably, the formerly much praised and largely unregulated credit derivatives industry has come under "bitter attack" for its "perceived role" in causing the banking chaos of recent months (Tett el al. 2008). There is a growing sense among regulators that "what you choose not to regulate is what can blow up the economy" (ibid.). Important as such observations are, one must be careful not to overly simplify the issues. Indeed, the tendency to frame the regulatory debate as an issue of 'more' or 'less' regulation obfuscates more than it clarifies. What is needed is deliberation and comparative analysis of different *modes* of regulation. More specifically, it is important to realize that the IFA initiative, as well as the Post-Washington consensus more generally, by no means represented a *laissez-faire* approach to financial regulation. Rather, it was a complex configuration of deregulation and reregulation. To proceed in a diagnosis of the current predicament without fully appreciating this complexity is likely to lead to yet another set of 'quick responses'—and hence we will, again, miss the target.

Two of the main features of the last decade of international financial regulation—the institutionalization of government bail-outs of financial institutions, and the attempted global enforcement of a particular mode of organizing and regulating economies—are paradoxical occurrences in what is allegedly the heyday of neoliberalism. Only by revisiting the history of liberalism may we begin to understand the rise of a regime of global disciplining and institutionalized 'socialism for the rich' in this particular period. Only then may we begin to understand the curious 'silences' of our time, and hence open up a space for critical thought and contestation. And only then may we revive the ethos of liberalism, always asking 'are we governing too much', always endeavouring to avoid the 'twin dangers' of governing too much and governing too little.

A WAY FORWARD

"Right now there is huge uncertainty as to where risk resides", an anonymous international economic official noted August last year as the credit crisis started (Guha and Tett 2007). "We are in a minefield", commented Drew Matus, economist at Lehman Brothers; "no one knows where the

mines are planted and we are just trying to stumble through it" (Atkins et al. 2007). A year later, Lehman Brothers imploded spectacularly. The full impact of the damage done to other financial institutions, linked to Lehman through derivative contracts, remains to be seen. 'Huge uncertainty' with regard to where risk resides certainly remains a year later. Indeed, the week following the passing in the US Congress of a $700bn rescue plan—intended to calm the markets—saw global financial markets in full panic. "The world economy is now entering a major downturn in the face of the most dangerous shock in mature financial markets since the 1930s", the IMF observed, stressing that the situation was "exceptionally uncertain and subject to considerable downside risks" (Beattie 2008). It is safe to say that a regulatory regime that endeavoured to promote the stability and resilience of the international financial system by enhancing 'transparency' has failed astonishingly. If financial market turmoil is threatening the stability and resilience of not just the financial system but the global economy as such, perhaps a new approach to financial regulation is needed, rather than merely marginal adjustments?

A key conclusion drawn by the 'international community' on the basis of the Asian crisis was that capital account liberalization should be sequenced with a process of institutional upgrading of the financial sector to avoid 'excessive risk'. The current crisis thoroughly undermines, however, the notion that financial crises can be avoided by ensuring 'financial upgrading'. After all, financial upgrading meant the adoption of US financial and corporate governance institutions, institutions that did little to prevent a financial crisis in the US. Irrespective of this, the current debate carries little challenging of the belief in universal standards of 'best practice' as the way forward in international financial regulation. This is all the more unfortunate in that many of the standards of best practice contribute to a homogenization of investor behaviour in financial markets. This is the opposite of what is needed. Since the mid-1990s, a number of developments in the financial sector—including a rapid collapsing of information costs and pronounced market consolidation—have exerted a homogenizing effect on financial market behaviour (Persaud 2008:92–9). The appropriate role of regulation is to *counter* this tendency. Universal standards of best practice are not the solution, but a key part of the problem, in other words. Large-scale government bail-outs contribute to constructing a 'twisted' capitalism that allows financial markets, which have been enriched during the boom, to pass on the costs to taxpayers when the bubble bursts. "Let's face it", says George Soros:

When the financial system is endangered, the authorities must cave in. Whether they like it or not, institutions engaged in credit creation must accept the fact that they are being protected by the authorities. They must, therefore, pay a price for it. (Soros 2008:144)

If indeed government bail-outs are now an inevitable and institutionalized feature of the global economy, one must ask what consequences this should have for financial regulation more generally. A financial system in which profits are private but "risks [are] socialized" is clearly untenable, argued *The Economist*, stressing that "if you cannot let firms fail in a bust, then you must contain them in a boom" (*The Economist*, July 17, 2008). Saying the same thing in a slightly different manner, what is needed is a shift from modes of regulation that are procyclical to new ones that are counter-cyclical. Unfortunately, however, there is a rather strong tradition of rejecting counter-cyclical regulation.

Allan Greenspan, acting as Federal Reserve chairman at the time, famously proclaimed after the dotcom crash in 2002 that central banks had little power to stop bubbles inflating and then bursting. All central banks and policy-makers could do, Greenspan argued, was to "focus on policies to mitigate the fallout when it occurs" (cited in FT, May 15, 2008). However, central bankers are reexamining the 'hands-off approach' in the light of two major critiques. One type of criticism argues that ignoring bubbles as they build up and waiting to clean up the mess until afterwards is an expensive strategy in the sense that the implied monetary policy will eventually cause rising inflation. In the current situation, when massive government bail-outs and central bank liquidity injections are taking place in the context of a deepening economic recession, there is substantial risk that we need to start worrying about deflation rather than inflation (Muelbauer 2008, Roubini 2008). The point remains, however, that once things have gotten out of hand, authorities have little choice but to adopt whatever measures are necessary to rescue the financial system from collapse, even if those measures sow the seeds for different types of severe price instabilities in the medium- to long-term. It is of paramount importance, therefore, that regulation strives to dampen the economic cycle, to *prevent* things from getting as out of hand as they have currently. Another type of criticism contends that bubbles create 'misleading price signals' and thus will eventually divert productive resources to unproductive ends, cause high levels of macro economic volatility, and eventually, when the bubble bursts, threaten financial stability. "All central banks would like to find ways to avoid these threats", reports the *Financial Times* (ibid.):

But to do so requires overcoming two basic objections set out by Mr Greenspan and Mr Bernanke in 2002: first, that bubbles are in practice impossible to identify until they pop; and second, that even if central banks could identify bubbles, they need to find a tool with which to address the problem. (FT, May 15, 2008)

At the end of the day, despite all the talk of booms and busts, of 'leaning against the wind' and 'containing the boom', there is little confidence that such regulation is in fact feasible. But perhaps we should not confide too

much in the assertions of central bankers such as Greenspan and Bernanke on the matter of identifying new modes of international financial regulation. After all, the IFA initiative in all its complete ineffectiveness was devised by an 'international community' of central bank and finance ministry economists with, at best, limited knowledge of the dynamics of international financial markets.
Perhaps we need to look elsewhere to find modes of regulation that may lead to a more stable and resilient international financial system? The approach to a new mode of regulating international finance outlined towards the end of this book draws *inter alia* upon the contributions of Avinash Persaud, Michael Pettis, and George Soros, all of whom have a more than solid background as practitioners in financial markets.
The task is urgent. When it comes to devising a new approach to the regulation of international finance, today is better than tomorrow. Though the objective of fostering a stable and resilient international financial system for the 21st century was formulated in the late 1990s, little progress has been made so far. If the international financial system is more 'resilient' today than it was a decade ago, it is so *only in terms of its close connection* with central banks, treasuries and finance ministries, which let the financial sector profit unhindered on the upside of cycles, while stepping in to socialize the losses on the downside. In a world of increasing poverty and increasing inequality, nationally as well as globally, this 'socialism-for-therich' is deeply problematic.
To address adequately the task of devising a new regime of international financial regulation, one must first develop a thorough understanding of the current regime, and the ideas, past and present, which took part in shaping it. To contribute to the development of such understanding is the overall objective of this work. On the basis of this analysis, the essential elements of a new approach to the regulation of international finance are outlined in the final chapter of the book.
STRUCTURE
Part I: The Asian Crisis
The first part undertakes a comparative analysis of the narratives of four renowned economists, on the basis of a Foucauldean theoretical framework. More specifically, this part of the book summarizes and problematizes the narratives of Barry Eichengreen (Chapter 3), Paul Krugman (Chapter 4), Joseph Stiglitz (Chapter 5) and Robert Wade (Chapter 6). These four authors have been chosen not only because they are all highly esteemed experts in international trade and finance, but also because taken together they span the entire spectrum of variation in the debate. Taking a closer look at the debate on the Asian crisis is important in order to debunk the notion that structural reforms were somehow a 'necessary' response to the Asian crisis. Further, it is

essential to understanding the intellectual climate and the modes of reasoning that underpinned the IFA initiative. Before summarising the narratives and undertaking the comparative analysis (Chapter 7), the theoretical framework and methodology underlying this part of the book is developed (Chapter 2).

Part II: Discipline in the Global Economy

The IFA initiative subscribed to a range of disciplinary mechanisms and yet did not articulate them as such in any coherent or systematic way. To address that shortcoming, this part of the book sets out to analyse the IFA from the vantage point of a theory of disciplinary power. After explaining efforts to strengthen the international financial architecture, focusing on the Financial Sector Assessment Programme (Chapter 8), a detailed exposition of Michel Foucault's analysis of disciplinary power is given (Chapter 9), which then guides and informs the problematizations undertaken in the three chapters that follow. First, one chapter depicts the IFA as a system of disciplinary power, drawing upon the conceptual apparatus of Michel Foucault (Chapter 10). Next, I explore how the norm of a 'proper' economy launched in and through IFA standards may be further characterised. This includes a consideration of the extent to which IFA standards may be said to lead to the globalization of an Anglo-American model of capitalism (Chapter 11). Seeing that the FSAP epitomizes the IFA initiative, the next chapter thoroughly reviews the FSAP. The FSAP and the IFA have generated more heat than light, I argue: not only is it largely ineffective in its own terms, but further it tends to reduce rather than increase the resilience of the international financial system on account of a number of procyclical features of the regulatory measures it deploys (Chapter 12). The final chapter of Part 2 reconsiders the literature on the Post-Washington consensus in light of the Foucauldean analyses undertaken in the preceding chapters (Chapter 13).

Part III: The End of Liberalism?

The objective of this part of the book is to arrive at a point where it will be possible to problematize the IFA in the name of liberalism and neoliberalism. To do so, I explicate Michel Foucault's work on these issues, as well as the work of a number of 'neo-Foucauldean' scholars. Part 3 consists of four chapters. First, there is a chapter problematizing what liberalism is, from different perspectives, including that of opposing conceptions of liberty (Chapter 14). Then follows a chapter on Foucault's analysis of liberalism (Chapter 15) and a chapter on his analysis of neo-liberalism (Chapter 16). The last chapter of Part 3 mobilizes the preceding chapters to problematize the IFA and to reflect on the possibility of a reinvigoration of the *ethos* of liberalism, always striving to avoid the twin dangers of governing too little and governing too much.

Part IV: A Way Forward

The current mode of regulating international finance is futile, if not dangerous. But what is the alternative? How could international finance be more adequately and effectively regulated? These are the questions addressed in the final part of the book (Chapter 18).

THEORETICAL FRAMEWORK

The analyses in this book are to a large extent inspired by the work of Michel Foucault. This is so not only with regard to the analysis of the IFA as a system of disciplinary power (Part 3), but also to the comparative analysis of narratives on the Asian crisis (Part 1) and the analysis of liberalism and neoliberalism (Part 3) that serve the double purpose of problematizing the current regime of international economic governance and informing the efforts to outline a new mode of international financial regulation (Part 4). The theoretical framework guiding the comparative analyses of narratives is explained separately in Chapter 2, and likewise two separate chapters in Part 4 are devoted to an account of Foucault's analysis of liberalism and neoliberalism in Part 3. I confine myself at this point to making a few remarks on my use of Foucault's analysis of disciplinary power (Foucault 1941b) in my investigation and problematization of the IFA initiative.

Foucault's analysis focused on the recasting and generalization of disciplinary power that he identified with the emergence and maturation of the modern, liberal state from the seventeenth and eighteenth centuries onwards. His analysis emphasized how a range of disciplinary institutions—from the school and the factory to the hospital and the prison—were instrumental in the formation of docile bodies that were trained, disciplined and useful. The parallels to the current regime of global economic standardisation, surveillance and corrective reform are striking. Whereas Foucault investigated the formation of *docile bodies*, this research investigates the formation of *docile economies* through an analysis of the disciplinary mechanisms in place to measure, reform, and discipline economies in which institutions such as the private firm, the bank, and financial intermediaries become the objects and subjects of disciplinary power. However, investigating the standards of the 'proper' economy through the lens of Foucault's analysis of disciplinary power not only identifies a number of striking parallels but also helps reveal some of the shortfalls and weaknesses of the IFA. Deciding to analyse the global governance regime that has evolved around codes and standards of 'good practices' for the organization and regulation of economies through the lenses of Foucault's analysis of disciplinary power reflects two underlying choices.

First, it reflects the choice to analyse this economic *standardization* as part of a wider system for the *disciplining* of economies, rather than as part of a wider process of *quantification*. Theodore Porter (1994, 1995) has excelled in explicating the trend towards 'making things quantitative' in a wide range of domains, from "the control of air, water and ground pollution" to the use of GDP data by international lending agencies "to decide how effective a "'developing' country is absorbing foreign capital" (Porter 1994:390, 399). Like Bruno Latour (1988) and Ian Hacking (1983), Porter emphasises the "important *constructive* role" of quantification in making "new things, or at least transform old ones" (Porter 1994:398, emphasis added). Porter further notes that measurement and surveillance are central mechanisms to these processes of quantification, which entail, indeed, a "disciplining" of "people as well as instruments and processes" (Porter 1994:391). Since the objective here is not so much to emphasize the *process* of quantification-with its problems and omissions-but rather the embedding of economic standardization in a wider system of economic disciplining, Foucault's analytical framework is more expedient than frameworks such as those of Porter, Latour and Hacking.

Second, it entails the privileging of Foucault's analysis of disciplinary power over other analyses of discipline, such as those of a number of British historians (notably, Thompson 1967), as well as Karl Marx (1906), Max Weber (1947, 1950) and various strands of critical theory (Elias, Oestreich, Lukács, Adorno) for which "social discilining" and the "relationship among commodity form, rationalization and discipline" were key themes (Breuer 1989:237-39). Stefan Breuer observes that though Foucault's analysis was "strongly reminiscent of Max Weber" and bore "a certain affinity to that of Marx", he did not "positively acknowledge any of these forerunners" (*ibid.*).6 Thus, in choosing not to draw explicitly upon these other traditions in the analysis of disciplinary society, I commit the same mistake that Foucault himself has been accused of. Moreover, I do it for the same two reasons: "partly due to simple ignorance", and, "in greater part", to distance myself, as Foucault did, from "the compulsion to derive a comprehensive explanation for an entire epoch or society from a single, central structure" (Breuer 1989:238). More importantly, perhaps, my ambition is not to develop a comprehensive 'theory of present-day capitalism' or the like, but the more modest one of problematizing the emergence of a system of global disciplining—for the purposes of which Foucault's analysis of disciplinary power seems to me by far the most expedient analytical framework. This also goes to explain why I have chosen to focus exclusively on Foucault's original texts at the expense of an engagement with the huge body of literature interpreting, assessing or criticizing Foucault's analysis: my objective is not to 'legislate' on the accuracy of Foucault's cient detail so as to explain it in sufficient detail so as to be able to employ it in empirical analysis of the global governance regime for the disciplining of economies.7

CONTRIBUTIONS

In addition to the overall objective of problematizing the emergence of a system of global disciplining that subjects economies worldwide to generalized surveillance and constant pressure to restructure in the image of Anglo-American capitalism, the present research endeavours to make a contribution to three research areas: social studies of finance; international political economy; and economics-as-discourse.

SOCIAL STUDIES OF FINANCE

The past decade has seen the emergence and growth of a new field of research, called 'social studies of finance'.8 The present research endeavours to make a contribution to this field of research by pursuing a line of inquiry that shares key concerns with these scholars, yet approaches them differently. A brief comparison with the work of Donald MacKenzie (2006) may serve as illustration. MacKenzie's work is organized around the concept of 'performativity' and focuses on how financial models shape financial markets (MacKenzie 2006).9 MacKenzie applies the concept of performativity at the level of theories of financial economics and distinguishes between three levels of performativity. *Generic performativity* occurs when an aspect of financial economics (model, concept, etc) is used by participants in market processes, whereas what MacKenzie defines as *effective performativity* is a subset defined by such uses of financial economics that "make a difference", as when "it makes possible an economic process that would otherwise have been impossible" (MacKenzie 2006:18). The third and strongest form of performativity occurs when the practical use of an aspect of economics alters economic processes or their outcomes "so that they better correspond to the model" (MacKenzie 2006:19).10

"If academic pursuits are not to be narrow", MacKenzie explains, "they ought to seek to contribute to what Donald (now Deidre) McCloskey called the conversations of humankind" (MacKenzie 2006:25). To simply praise or denounce financial theory and financial markets, MacKenzie argues, will at best add nothing and at worst coarsen "those conversations" (MacKenzie 2006:26). However,

To try to understand how finance theory has 'aligned, transformed and constructed' its world—which is also everyone's world, the world of investment, savings, pensions, growth, development, wealth, and poverty—may, in contrast, contribute ... to conversations about markets (MacKenzie 2006:26).

A "nuanced and imiginative approach" to financial theory and markets is a "better option" than either "uncritical acceptance or downright rejection"—and one that is "badly needed", MacKenzie contends (ibid.).11

MacKenzie's approach to social studies of finance is informed by the mainly sociological literature on 'performativity' (Callon 1998, 2006). Michel Callon argues that investigations of the development of economics often account for it either as the result of intellectual evolution, or as reflecting developments in 'the economy'.12 Against these two main trends, Callon advocates studies that endeavour to "assess the contribution of economics to the constitution of the economy" (Callon 1998:2). From a Foucauldian perspective, however, one would seek to locate such 'performativity' in relation to "a wider discursive field in which conceptions of the proper ends and means of government are articulated", focusing on the political rationalities and governmental technologies that "render a realm into discourse as a knowable, calculable and administrable object" (Miller & Rose 1990:5).13 Thus, whereas this research shares with MacKenzie's the objective of broadening the 'conversation' on financial markets, it endeavours to do so in a different manner. Whereas MacKenzie focuses on the relationship between financial economics and financial markets, and particularly how the former 'performs' the latter, the present research endeavours to be broader in scope, in a double sense. First, it is not only financial theory and models, but economic discourse more broadly that is analysed and problematized, from explanatory accounts of the Asian crisis to key features of the epistemology of economics. Second, in terms of effects, it is not so much financial markets as the organization and regulation of economies more generally that is the focus. This is not to say, of course, that the Foucauldean line of inquiry that I pursue in the following is somehow 'more valid' than the approach pursued by Callon and MacKenzie. The point is rather to stress the existence of these two related approaches, and to suggest not only that the emerging field of 'social studies of science' could well accommodate more Foucauldian lines of inquiry, but also that this latter approach could well draw upon the former—much more so than I have been able to in this book.14

INTERNATIONAL POLITICAL ECONOMY

Governmentality studies have until recently only rarely focused on issues of *international* governance. This was stressed in the introductory chapter of a recent volume on *Global governmentality* (Larner and Walters 2004). "One of the most notable features of governmentality research has been", Larner and Walters argue, "its investigation of power 'beyond the state', that is, with the tactics, techniques and technologies which configure apparently 'nonpolitical' sites like the firm or the school as spaces of power" (Larner and Walters 2004:1). So far governmentality studies have, however, been "largely focused on political, social and economic life 'inside' nation-states", whereas questions "regarding the constitution and governance of spaces *beyond* the state have not been pursued as fully as they might" (*ibid.*). "A glance at the contents of the major collections in this area reveals", Larner and Walters observe, that only "a handful of contributions which consider the government

of processes beyond or across political borders" exist to date (Larner and Walters 2004:4–5). This "domestic orientation" is paradoxical, they argue, given that governmentality studies have "proliferated during the 1990s, precisely at a time when the fascination with globalization exploded across the social sciences", and given the fact that governmentality studies are by no means "conceptually committed" to nation-states (Larner & Walters 2004:5). "If the ambition of governmentality studies is to develop a 'history of the present'", they point out, then the "relative lack of attention to international and global topics is indeed a strange omission" (Larner & Walters 2004:5). The present research shares with Larner and Walters the overall objective of relating governmentality studies to the global, the international and the supranational. It also shares with these authors the attitude that endeavouring to counter this tendency by governmentality scholars to "neglect the global" is driven not so much by "reasons of balance and completeness" as by the contention that "the global is increasingly central to the way in which economic, political and social relations are thought out and acted upon" (ibid.).15

The "neglect of the global" by governmentality scholars may be part of a more general gap in social science scholarship: the low level of cross-fertilization between poststructuralism and international political economy (IPE). This gap was recently addressed in an edited book, which took as its starting point the contention that "engagements" between these two "fields of thought" have so far been "sporadic and antagonistic" (de Goede 2006:1). A key reason for this is, de Goede argues, that IPE scholars have been concerned that poststructuralist scholarship would "distract from the study of real material inequality" and imply a sort of "political relativism" (ibid.). To illustrate, de Goede cites Barry Gills, who expressed concern that poststructuralist analysis would displace political economy's "true subject matter—which is the political economy of … 'global capitalism'" (Gills, cited in de Goede 2006:1). Though Foucault himself rejected being categorised as structuralist, poststructuralist, or the like, the fact remains that his work is one of the key points of reference for scholars undertaking poststructuralist work in the human and social sciences. Indeed, in de Goede view, the "most promising" contribution of post-structuralism to IPE is "the study of technologies of truth" for which the "work of Foucault is crucial" (de Goede 2006:6). In deploying Foucault's analysis of disciplinary power, governmentality and liberalism in the present analysis of the Asian crisis and the global disciplining of the IFA, I hope to contribute, if only modestly, to countering the tendency towards what de Goede terms the "polarization" of post-structuralism and international political economy (ibid.).

ECONOMICS-AS-DISCOURSE

On the final page of *Economics as discourse* (Samuels 1990), one contributor remarked about the volume that it was "unfortunate that no attempt was

made to spell out the significance of [Foucault's] theory" (Puro 1990:256). Though there are some signs that the interest in Foucault is increasing, vast parts of Foucault's work remain unaddressed in economics and, more importantly, actual analysis drawing upon the work of Foucault is rare. A recent volume on postmodernism in economics (Amariglio et al 2001) has 20 entries for Foucault in the name index, as compared to two in Samuels (1990).16 When it comes to entries for 'Foucauldian ideas/theories' in the subject index, the number is down to five, indicating that the interest is still in its very early phases. And in terms of *actual analysis*, only one of the 23 papers in Amariglio et al. (2001) is inspired by the work of Foucault. In key journals dealing with the methodology and epistemology of economics—such as the *Journal of Economic Methodology* and *Cambridge Journal of Economics*—there are no hits for searches on Michel Foucault.17 On the few occasions that his work has been related to the discipline of economics, the focus has been on his early work, notably two books written in the latter half of the 1960s, *The Order of Things* (1994b) and *The Archeology of Knowledge* (1972).18 His work on disciplinary power (1991b), on the relation between the emergence of political economy, liberalism and the emergence of the modern state (1991a) has, to my knowledge, not been discussed at all. Particularly in the case of the latter this seems a strange absence—given that it offers a contextualised analysis of early liberalism and political economy, reflecting on the work of Adam Smith and Adam Ferguson, both canonized authors in the history of economic thought. Further, this work by Foucault features centrally an analysis of the work of Jeremy Bentham, another key figure in histories of economic thought. There is plenty reason, in other words, to endeavour to relate Foucault's work more explicitly to economic discourse. Importantly, Foucault's wrote his work on the generalization of disciplinary power in the eighteenth century not as an investigation into some distant past, long overdue, but as a 'history of the present'. Foucault endeavoured, in other words, to write about our present through the lenses of the past—rather than the other way around. Foucault's analysis remains, I claim, an important element in understanding present-day society—and in understanding what kind of social order liberal governmental rationalities produce and sustain.

Titles like *The History of Madness*, *Discipline and Punish*, *What is Enlightenment?* and *The Archaeology of Knowledge* signal not just a wide span in topics, but also an authorship that is not easily defined and categorised. I have no illusion that this book will provide an overall understanding of Foucault's *oeuvre*—nor that the analyses that I undertake, inspired by certain parts of his work, 'do justice' to his. This is a reflection also that the primary objective is to *use* his work to make sense of certain developments in international economic governance by which economies have become subjected to radically new modes of governing—not to undertake a 'wholesale' rewriting of the work of Foucault for economists. Thus, I have only drawn upon Foucault's work to the extent pertinent for my empirical analyses.19 To the extent that my explication and employment of

Foucault's work makes sense to economist readers, I have achieved a key objective of this research—to make Foucault's mode of analysis known to scholars in the discipline so far least (if at all) affected by it.20

In the economics-as-discourse literature, the work of Deirdre McCloskey has been a key reference (McCloskey 1994, 1998). McCloskey deserves credit for being the one who pioneered a contestation of the widespread belief among economists that their science is 'objective' as opposed to normative. Unfortunately, McCloskey herself went to the other extreme, that of relativism. This is central to understanding why rhetorical analysis never really compelled the economics discipline. "The reception of McCloskey's ideas within the economics profession has varied widely", Uskali Mäkinotes, and "doubtless many economists simply do not know what to make of her ideas" (Mäki 1995:1300). In Mäki's view, McCloskey's rhetorical programme has focused too much about *how* economists argue, and too little on what they argue *about* (Peter 2001:582). The mode of analysis pursued in this book subscribes not to relativism but to perspectivism, the notion that all knowledge implies a certain perspective on things and that juxtaposing different perspectives on phenomena such as the Asian crisis, bears the promise not only of illuminating key features of the current state of the discipline of economics, but also of identifying and problematizing the epistemological, political and moral issues otherwise silenced. In this regard, the book hopes to contribute to a reinvigoration economics-as-discourse studies by means of introducing a Foucauldean research strategy to the field. Foucauldean governmentality studies have had significant impact on other social sciences, but have not yet been applied to the field of economics. The present research adapts and applies this approach to the study of economic discourse, on the presumption that more attention to criticism will be paid when it is posed at the level of the actual *effects* of economic discourse, when actual moral and political effects of economic discourse are explicated and problematized.

AGAINST CERTITUDE

The aim of this book is not to take sides or draw up answers, but rather to raise questions, to *problematize*. In line with the general ethos of governmentality studies, the objective is to analyse *the field of problematization* which constitutes a problem in its full diversity, rather than engage in efforts to identify the 'only valid solution'. In Nikolas Rose's characterization:

What distinguishes these studies … is their power to open a space for critical thought … Perspectivism … [is] a matter of introducing a critical attitude towards those things that are given to our present as if they were timeless, natural, unquestionable: to stand against the maxim's of one's time, against the spirit of one's age, against the current of received wisdom (Rose 1999:19–20, emphasis added).

Such studies do not "partake in the relativism that has become so fashionable", but take a 'perspectivist' approach (Barry et al. 1996:5). From this perspective, the crucial issue becomes that of illuminating the perspectives underlying different bodies of knowledge—ultimately for the purpose of *comparing* these perspectives—thus allowing for a critical discussion of the vices and virtues of different perspectives. Such analysis inevitably identifies presumptions otherwise not explicated—and this is indeed a major objective in and of itself.

In pursuing this goal of problematization, I am not committed to any political position, ideology or the like. With regard to the question of 'political classification', I share Foucault's attitude:

I think I have in fact been situated in most of the squares of the political checkerboard, one after another, and sometimes simultaneously: as an anarchist, leftist, ostentatious or disguised Marxist, technocrat in the service of Gaullism, new liberal, and so forth … None of these descriptions is important by itself; taken together, on the other hand, they mean something. And I must admit I rather like what they mean (Foucault 1997c).

When I problematize aspects of present-day capitalism, the role of the IMF and the World Bank, or the role of economists, I endeavour to do so in the spirit of *dialogue*. One reflection of this is that I have sought to incorporate in this book not just my own voice, but a range of voices: those of Barry Eichengreen, Paul Krugman, Joseph Stiglitz and Robert Wade; those of Michel Foucault and Friedrich Hayek, and so forth. To some extent, at least, the book is, therefore, a dialogue. This is not to suggest that all voices are given equal emphasis—what it does mean, however, is that in undertaking this research and organizing its overall argument, I have considered it a virtue in and of itself to give space for voices other than mine, for voices that disagree.

In addition to writing in the spirit of dialogue, the only 'position' I commit to is that of being *critical*—of suggesting that there are aspects of the way issues of world economy are dealt with that are problematic, if not dangerous; that needs critical analysis and reflection. If it wasn't for this critical attitude, I wouldn't know why to do research in the first place. The analysis of the role of the IMF and the World Bank in this book should not be taken to imply that I disagree with the existence of these organizations. The engagement of these organizations in economic standardization, surveillance and corrective reform is but one of their many activities. Second, it would be too simplistic to assert that the World Bank, for instance, is committed wholesale to the global promotion of Anglo-American capitalism. In recent years, I have been involved in World Bank studies of higher education, innovation and industrial policy issues (in Colombia and Malaysia)—and in these studies it was the possible lessons from the examples of Finland, Korea and Taiwan that were highlighted. This type of international 'knowledge sharing'

may be considered, I believe, one of the positive aspects of 'globalization'.21 It only reinforces, however, my motivation for engaging in a critique of the codes and standards of the 'proper' economy. For such 'pragmatic' efforts at drawing lessons from a range of countries—including successful Asian and Scandinavian ones—are undermined by this regime of the 'proper economy', exerting a constant pressure on economies to reform themselves in the image of *one particular form of capitalism*, the Anglo-American one.

In pursuing this research, I have devoted myself to a working ethos akin to that depicted by Nikolas Rose:

I present [these analyses] with the hope that they may provoke others to do better, for to satisfy the demand that one might write without ignorance would not only make writing impossible; it would also deny that encounter with the unknown that carries with it the possibility, however slim, of contributing to a difference (Rose 1999:13–14).

"Convictions", said Nietzsche, "are more dangerous enemies of truth than lies" (Nietzsche 1996 [1878]: $483). If at the end of the day some of the presumptions questioned in this book appear less self-evident, if the reader is left less comfortable with regard to 'conventional' certitudes, I have more than accomplished the aim of this work.

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Toward a Problematization of the Asian Crisis

INTRODUCTION

In June 1997, foreign investors started withdrawing capital from Thailand. The Thai central bank, assisted by the IMF, bought large sums of Thai currency in an attempt to keep the Baht pegged to the US dollar. On July 2nd, the defence of the Baht was given up, however. The floating of the Thai Baht marked the beginning of what came to be known as 'the Asian crisis'. The Baht's sharp decline and the rising interest rates in the months following made it impossible for a large number of Thai banks and private sector companies to service their foreign debts. Hence, a surge of bankruptcies resulted, with severe consequences for the Thai economy. By October, similar events had occurred in a number of other East Asian countries, including Indonesia and South Korea, two of the world's largest economies. The resulting increase in unemployment and poverty in Asia made it "one of the worst calamities of the twentieth century" (Wade & Veneroso 1998:44). Worries developed that the crisis might spread further, possibly causing a general depression in the world economy (ibid.).

The contention common to most (if not all) observers was that massive foreign capital outflows, in the context of private sectors with high exposure to foreign capital, triggered processes of bankrupting debt deflation. Key issues in the debate then included the following:

• Was the retreat of foreign capital from Asia a 'rational' response to deteriorating 'fundamentals' of Asian economies or not?

• What caused the high exposure to foreign capital in the first place? Was it a result of 'crony capitalism', inadequate domestic financial regulation, or international excess liquidity?

• What would the appropriate policy response be? Should it involve a fundamental reform of Asian capitalism, 'upgrading' of financial regulation in Asian economies, or a fundamental reform of international financial regulation?

Instead of arguing why this or that account of the Asian crisis is, in my opinion, the most pertinent, and whether this or that policy response

seems to me the most reasonable, the perspective adopted in this research implies a different mode of analysis. The object of analysis is not *one* type of narrative, but the construal of an object of intervention—the Asian crisis—constituted in and through a number of competing narratives. The object of analysis is, in other words, *a field of problematization* consisting of several types of problematization to be investigated in both its variation and unity. In studying the debate on the Asian crisis, I draw upon Michel Foucault's notion of problematization, and his commitment to a mode of analysis that does not claim "to be a methodical examination in order to reject all possible solutions except for the valid one", but rather a mode of "critical analysis in which one tries to see how the different solutions to a problem have been constructed, as well as how these different solutions result from a specific form of problematization" (Foucault 1997c: 6). The objective of Part 1 is dual, in other words. The aim is both to explain *variation*—analysing 'how different solutions to a problem have been constructed'—and to demonstrate and problematize the *unity* underlying the variation, explaining the general form of problematization that the narratives share. The overall objective is to seek out those features of the debate that conditioned the construal of a crisis of Asian capitalism—and hence conditioned also the remarkable birth of the 'proper' economy.

This chapter explicates the Foucauldian theoretical framework (section 2) and the methodology (section 3) that guides these analyses of the debate on the Asian crisis. Further, an initial characterization of the debate is given (section 3) to provide some brief, general background for the subsequent chapters on the four narratives by Barry Eichengreen (1999), Paul Krugman (1998), Joseph Stiglitz (2002) and Robert Wade (1998a).

THEORETICAL FRAMEWORK

The overall objective of Foucault's authorship is often depicted as that of problematizing the human and social sciences with respect to the way these bodies of knowledge are implicated in the control and disciplining of individuals and populations in modern, liberal societies.1 In Foucault's perspective, modern liberal societies are societies governed "in the name of truth" (Gordon 1991:8)—and thus, every problematization of the exercise of power, of techniques of government, should eventually be a problematization of *science*. In Foucault's analysis, the bodies of knowledge that make up the human and social sciences are not characterized by being 'disinterested', or 'objective'. On the contrary, the very opposition of knowledge that is interested and knowledge that is not is rejected by Foucault. In Foucault's argument, scientific knowledge is not, and never could be, 'disinterested'. "Perhaps ... we should abandon a whole tradition", Foucault suggests, "that allows us to imagine that knowledge can exist only where the power

relations are suspended and that knowledge can develop only outside its injunctions, its demands, and its interests":

[T]here is no power relation without the correlative constitution of a field of knowledge, nor any knowledge that does not presuppose and constitute at the same time power relations (Foucault 1991b: 27).

Foucault's concern with power and knowledge is not intended to pose a critique of 'external powers' imposing themselves on science by making science its instrument. On the contrary, the idea that power is "a force which impedes the development of knowledge by repression and constraint"—the 'conventional' view on power—is rejected by Foucault (Philp 1985:74). The focus of Foucault's analyses is the interrelations of power and knowledge, the ways in which power and knowledge are constituted in and through their interrelation. Which 'power-effects', Foucault asks, are produced by the constitution of bodies of scientific knowledge and the dissemination of their norms and techniques? And how are the emergence and development of these bodies of knowledge related to processes of political power? These are key questions from a Foucauldian perspective. Further elaboration requires an explication of the Foucauldian concept of 'governmentality'.

GOVERNMENTALITY

The notion of governmentality stems from a neologism coined by Foucault, in his lectures on the 'governmental rationality' of liberalism (Gordon 1991).2 A basic premise of governmentality studies is that in modern liberal societies, power is exercised through knowledge. Foucault's concept of governmentality expresses a working hypothesis that power techniques and forms of knowledge are reciprocally constituted and that by implication it "is not possible to study the technologies of power without an analysis of the political rationality underlying them" (Lemke 2001:191). The relation between the discourses of the human and social sciences and the exercise of government is a reciprocal and mutually constitutive one, in other words. The exercise of government "depends upon these sciences for its languages and calculations", and the social sciences "thrive on the problems of government, the demand for solutions and the attraction of theories which have the plausibility of science and the promise of the rational disciplining and technologising of the social field", in the words of Peter Miller and Nikolas Rose (Rose & Miller 1992:182).

The aim of governmentality studies is to highlight the ways in which scientific discourse "plays a part in translating society into an object of government" (Barry et al 1996:13). One does not approach problems as something 'given', endeavouring to 'solve' them in a manner that takes them for granted. It is the invention of fields of intervention that makes possible the

articulation of problems that haunt them, and allow for them to be governed. "This way of investigating the exercise of political rule has a number of advantages", says Miller and Rose:

It draws attention to the fundamental role that knowledges play in rendering aspects of existence thinkable and calculable, and amenable to deliberated and planful initiatives … It suggests that the concerns that have occasioned and animated policy are not self-evident. The emergence of unemployment, crime, disease and poverty as 'problems' that can be identified and constructed as in need of amelioration, is itself something to be explained (Miller & Rose 1990:3).

In this perspective, the focus is on how scientific disciplines invent concepts, categories, and fields of intervention, thus making certain forms of political interventions thinkable and practicable. "Governing a sphere requires that it can be represented", Miller and Rose note, "in a way which both grasps its truth and re-presents it in a form in which it can enter the sphere of conscious political calculation":

The theories of the social sciences, of economics, of sociology and of psychology, thus provide a kind of *intellectual machinery* for government, in the form of procedures for rendering the world thinkable, taming its intractable reality by subjecting it to the disciplined analyses of thought (Rose & Miller 1992:182–83, emphasis in original).

More specifically, Miller and Rose advocate studying programmes of government in two dimensions: on the one hand, in terms of the technologies of government they mobilize and, on the other hand, in terms of the political rationalities through which they are conceptualised and justified. "If political rationalities render reality into the domain of thought", Miller and Rose argue, "technologies of government seek to translate thought into the domain of reality" and to establish "spaces and devices for acting upon those entities of which they dream and scheme" (Miller & Rose 1990:8).3

The political rationalities of programmes of government are constituted by a *moral form*, specifying the ideals of government and the proper distribution of tasks; an *epistemological character*, defining how the objects and subjects to be governed are to be conceived; and a *style of reasoning*, in the form of 'intellectual techniques' constituting domains that are amenable to reformatory intervention (Rose & Miller 1992:178–181, Rose 1996:42). With the emphasis on the technological dimension, Miller and Rose stress the importance of analysing the "actual mechanisms" that "shape, normalize and instrumentalize the conduct, thought, decisions and aspirations of others in order to achieve the objectives

[considered] desirable" (Miller & Rose 1990:8). "To understand modern forms of rule", Miller and Rose contend, "requires an investigation not merely of grand political schema, or economic ambitions, nor even of general slogans such as state control, nationalization, the free market and the like, but of apparently humble and mundane mechanisms which appear to make it possible to govern" (Miller & Rose 1990:8). "'Knowing' an object in such a way that it can be governed is more than a purely speculative activity", Miller and Rose note (1990:5). "It requires the invention of procedures of notation, ways of collecting and presenting statistics", not to mention "the transportation of these to centres where calculations and judgements can be made and so forth" (ibid.). At the end of the day,

It is through such procedures of inscription that the diverse domains of 'governmentality' are made up, that 'objects' such as the economy, the enterprise, the social field and the family are rendered in a particular conceptual form and made amenable to intervention and regulation (Miller & Rose 1990:8).

METHODOLOGY

It is not only 'programmes of government' that may be analysed in terms of their political and technological dimensions; social science narratives may be analysed in this way too. But what does it entail, more specifically, to undertake a governmentality analysis of scientific narratives? In the following, I put forward a methodology for these purposes, based on (but not confined to) the Foucauldian theoretical framework set out in the preceding sections.

What is proposed here is that scientific narratives be analysed in four dimensions. More specifically, the analysis should explicate the causality declared, the morality subscribed to, the epistemology enacted, and the policy evoked. In scientific narratives, accounts of *causality* play a key role. Often debates in and among interlocutors focus on disagreements about causality. It is important, however, that analysis sheds light on several other equally important dimensions of scientific narratives. Narratives addressing a societal problematic, such as the Asian crisis, usually in one way or the other tackle issues of innocence, blame and responsibility. The manner in which innocence and blame are attributed and responsibility assigned delineates the *morality* of a narrative. The *epistemology* of a narrative, on the other hand, is defined by the conceptions that structure the narrative, in terms of the conceptions of the key actors and objects involved. Finally, narratives often, to greater or lesser extent, address political issues (such as to whom the tasks and challenges

identified should be allocated), evoke a set of governmental technologies to be deployed for the amelioration of the situation, or problem, and allude to the overall values and ideals that should be pursued, defended or promoted. These characteristics constitute the *policy* of the narrative.

It is important to stress that *governmentality analysis*, in this rendition and context, is but one component in a wider methodology of *problematization analysis*. An analysis of the individual narrative is only interesting to the extent that the analysis is related to the wider field of problematization to which the narrative belongs.

"To one single set of difficulties, several responses can be made", Foucault notes. "Most of the time different responses actually are proposed", he continues, but we rarely look beyond this variety of responses to understand "what makes them simultaneously possible" (Foucault 1997c: 5). We should try to rediscover, Foucault argues:

[T]he general form of problematization that has made them possible—even in their very opposition; or what has made possible the transformation of the difficulties and obstacles of a practice into a general problem for which one proposes diverse practical solutions (Foucault 1997c: 5, emphasis added).

The task in relation to politics is, Foucault argues, "to ask politics what it had to say about the problems with which it was confronted", to "question it about the positions it takes and the reasons it gives for this" (Foucault 1997c: 3). Here we should understand 'politics' in a broad sense. In this perspective, narratives of the Asian crisis by economists belong to the realm of politics, concerned as they are with drawing up answers and solutions, evaluating and projecting interventions.

Instead of engaging in a "form of critique that claims to be a methodical examination in order to reject all possible solutions except for the valid one", Foucault advocates a mode of "critical analysis in which one tries to see how the different solutions to a problem have been constructed; but also how these different solutions result from a specific form of problematization" (Foucault 1997c: 6). Problematization analysis is a matter therefore not just of "diagnosing problems" and "certainly not of dictating solutions"—but rather of "the multiplication of further problems, so that we are constantly attuned to the tasks of an ongoing ethics of the problematic as a sort of critical virtue in itself" (Osborne 2003:14–15). Problematization analysis endeavours to "transform a given into a question" (Deacon 2000:8). The objective of problematization as a research strategy is, in the words of Henri Bergson, to "take us beyond the seeming obviousness of most contemporary problems", "not to *solve* problems but to *dissolve* them, in order to produce new, more productive ones" (Bergson, cited in Osborne 2003:7). This endeavour is particularly important, Gilles Deleuze noted, because the constitution of problems determines what solutions are available. The overall ambition of Michel

Foucault, and other scholars in this tradition, therefore is to "keep us aware of the limits of our explanations", "to hold us constantly open to new formulations, new problematizations, and problematics" and "to incite the openended provocation of the problematic" (Osborne 2003:9).4 Canguilheim and Foucault both stressed that the role of their studies was "not to *legislate* the sciences but to *hold open* the constant possibility of new problematizations" (Osborne 2003:12). Thus, Foucault's analysis of liberalism was not "a kind of sociology" but an "effort to investigate and make problematic—against the very obviousness of liberalism—the novelty and contingency of liberalism as a peculiar technology of freedom and problematic of government", thereby showing that there was "a positive governmental logic to that political rationality we call liberalism" (Osborne 2003:13).

In more specific terms, the methodology proposed for the study of social science debates consists of the following steps. First, the literature is screened for typologies of the debate, to provide an initial overview.5 Second, the identified typologies are juxtaposed. In juxtaposing typologies one should be careful not to take them at face value. If they are, one risks reproducing various forms of reductionism that a debate is likely to be encumbered with. Further, one should seek to combine typologies to articulate, if possible, a more nuanced or conceptually precise typology, and to define what *unites* these typologies; define, that is, what 'general form of problematization' they share. Third, a number of narratives are selected for further analysis. This selection is made so that the narratives both illustrate the variety uncovered in the analysis of typologies *and* 'stretches' these typologies in some way. The objective is, in other words, both to 'represent' the typology developed and to provoke it, ideally forcing an expansion of it. Fourth, each of the selected narratives is subjected to a governmentality analysis along the lines depicted above. Fifth, a comparative analysis of the governmentalities is undertaken, which identifies the key differences in each of the four dimensions—causality, morality, epistemology and policy—and which identifies the main lines of problematization that constitute the debate as such. Fifth, the relation between the narratives and the debate on the one hand and the actual, 'official' policy response—such as structural reforms, or the IFA initiative, in the case of the debate on the Asian crisis—on the other is addressed and problematized. Of particular interest here is which governmentality is mobilized in the 'official' policy response, and which are ignored, silenced, subjugated. Finally, on the basis of the preceding steps one endeavours to synthesize and reflect: what is particularly problematic about the debate?

TYPOLOGIES AND BEYOND

Before proceeding with the narratives of Barry Eichengreen, Paul Krugman, Joseph Stiglitz and Robert Wade in the following four chapters, it is pertinent to provide a brief overview of debates on the Asian crisis.

An effective means of obtaining an overview of key dividing lines in the debate is to examine one or more typologies suggested in the literature. In the following, I discuss two typologies, both of which are dichotomies, not only because this helps provide an overview over the debate on the Asian crisis, but also because juxtaposing them reveals that each collapses a major division in the debate. Juxtaposing them produces a trichotomy and provides a fuller account of the debate. Consider first the dichotomy suggested by Chang, Whittaker and Palma (1998):

The most contentious issue is whether the Crisis resulted primarily from institutional and structural weaknesses of the Asian economies, such as 'cronyistic' political economic structures, or from market failures which are characteristic of (or endogenous to) under-regulated and over-liquid international financial markets (Chang et al. 1998:649).

Here the dividing line proposed is between domestic causes ('institutional and structural weaknesses') and international causes ('under-regulated and over-liquid financial markets'. In the typology suggested by Robert Wade, on the other hand, a different dichotimisation is suggested:

Interpretations of the Asian crisis have coalesced around two rival stories: the 'death throes of Asian state capitalism' story about internal, real economy causes; and the 'panic triggering debt deflation in a basically sound but under-regulated system' story that gives more role to external and financial system causes (Wade 1998a: 1535).

In Wade's typology, one gets the sense that the main distinction is real economy causes versus financial system causes, rather than domestic versus international causes, as suggested by Chang and colleagues. In this sense, the categorisation proposed by Wade blurs a key dividing line in the debate. The category 'panic-triggering-debt-deflation-in-basically-sound-but-underregula ted-system' obfuscates a main divide in the debate by collapsing narratives focusing on *external* causes and narratives focusing on *domestic*, financial under-regulation causes into one category. Whereas there are two divisions at play in Wade's *phrasing*—external vs internal causes, and real economy vs financial system causes—only one of them is 'active' in terms of creating the dichotomy proposed. Unfolded, Wade's dichotomy becomes a trichotomy.

When comparing this trichotomy with the dichotomy suggested by Chang et al., one realizes that they two collapse a major dividing line in the debate, in the sense that they make no distinction between real economy causes and financial system causes. What emerges from the juxtaposition of these two dichotomies is, in other words, three main lines of problematization, and the insight that the two dichotomies—in each their way—collapses two of these into one.

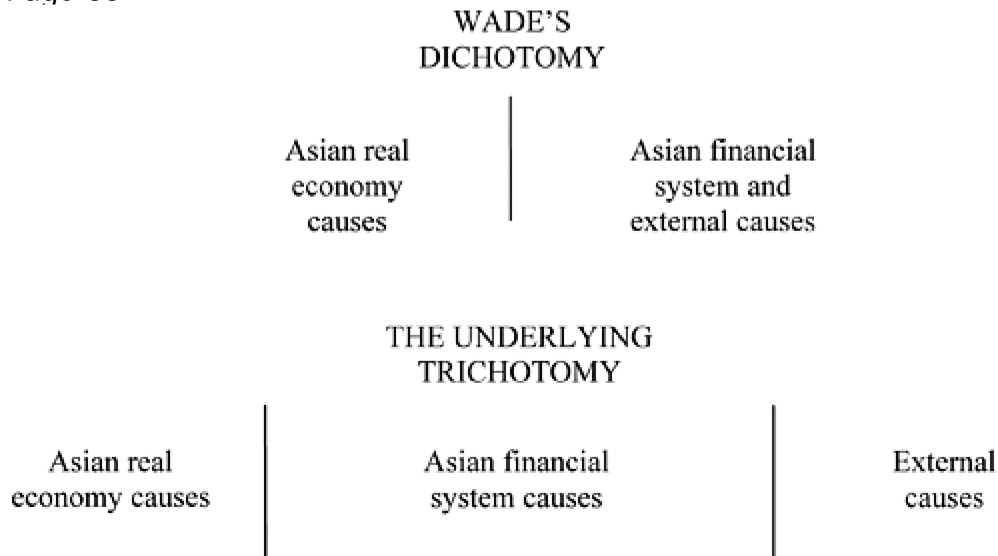

Figure 2.1 Wade's typology unfolded

With regard to the *general form of problematization* of these typologies, it is important to note that both typologies distinguish between narratives on the basis of *the type of causes* they focus on. This may at first seem trivial, if not simply 'natural', but as the analysis will demonstrate, it is in fact quite problematic: what in fact structures a narrative is much less its account of causality than its morality and epistemology (see Chapter 7).

3
Understanding Asia's Crisis

Barry Eichengreen starts his account of the Asian crisis by noting that it was "both complex and distinctive" since "the period leading up to it was characterized not by economic difficulties but by robust rates of economic growth" (Eichengreen 1999:143). Since "the early 1980s" rapid economic growth "was fuelled", Eichengreen argues, "by high rates of saving and investment …, sound macroeconomic policies, and outstanding rates of export growth" (Eichengreen 1999:143–44). In addition, he observes, "government budgets were in surplus, and economies were successfully restructured along exportoriented lines" (ibid.). Soon "references to the East Asian 'miracle' became commonplace" (ibid.). In retrospect, a year after the Asian crisis, it was possible, however, to "discern disquieting signs" (Eichengreen 1999:145). First, "growth of export revenues decelerated in 1996"; second, "current-account deficits were large in Thailand and Malaysia"; third, "equity prices declined"; and fourth, "Indonesia, South Korea, Thailand and Singapore had large amounts of short-term debt relative to foreign-exchange reserves" (ibid.).

This list, Eichengreen admits, is "wisdom after the fact" (ibid.). Thailand is an exception, though, for here the signs were clear. "Not only had Thailand's current-account deficit risen to an alarming 8 pct of GDP", Eichengreen observes, "but its export performance was disappointing" (ibid). A key problem for Thailand was, Eichengreen argues, its "pegging the baht to a basket with a heavy weight on the US dollar" (ibid). "While the currency-pegging was not limited to Thailand", he continues, "only there did the leading investment analysts expect a sustained slowdown in exports":

Reflecting these problems, Thai equity prices trended downward and the real estate bubble burst. With the country's finance companies heavily exposed to the property and stock markets, the decline in asset values posed an obvious threat to their solvency and, in turn, to the government's commitment to the maintenance of the currency peg (Eichengreen 1999:145)

Eichengreen stresses that the managing director of the IMF approached the Thai authorities, both by means of warning letters and by sending IMF

officials to Bangkok, to express their concern. "The markets, if not the Thai officials, took heed": "In the nine months up to its 2 July 1997 devaluation the baht was hit by three more speculative sell-offs" (Eichengreen 1999:148). However, even in Thailand, Eichengreen notes, there "was no indication that the market anticipated the severity of impending problems" (Eichengreen 1999:149).

COURSE OF THE CRISIS: THE TRIGGER AND THE SPREAD

Eichengreen (1999:149–150) describes how the crisis grew from being a Thai crisis, to being an South East Asian crisis (Indonesia, Malaysia), to being a crisis afflicting the major economies in Asia (Taiwan, Hong Kong, South Korea, Japan), but puts emphasis on depicting what he sees as the initial *trigger* of the crisis. His first observation here is that Thailand's difficulties were "palpable", compared to the "subtler problems of its neighbours" (Eichengreen 1999:150). At first, the Thai authorities "responded to mounting speculative pressure by intervening in the forward market rather than by attempting to correct the fundamentals" (ibid.). This strategy did not succeed in waving off speculative pressures, and thus, Eichengreen argues, the subsequent devaluation seemed "both unavoidable and fully justified" (ibid.). However, after the devaluation "the baht continued to depreciate at an alarming rate" (ibid.). By the end of July, the Thai government "approached the IMF for help" (ibid.). But again, the Thai government was unsuccessful:

Thailand's weak government was unprepared to take bold measures … Increases in gasoline taxes designed to raise revenue for use in recapitalizing the banking system were reversed in response to public protests, heightening uncertainty about the orientation of policy … The baht continued to decline, losing nearly 50 pct of its value against the US dollar by the end of the year despite the installation of a new government committed to the terms of the IMF agreement (Eichengreen 1999:150).

It was not until early 1998 that the baht began "to recover some of the ground lost previously" and the equity market stabilized, after a new government had "demonstrated its resolve by moving on the issue of bank restructuring" (ibid.).

With regard to the spreading of the crisis, Eichengreen notes that generally, "it was hard to see what the countries hit by the contagion had in common other than physical proximity", and that the "the virulence and scope of the contagion" was therefore, "except with the benefit of hindsight", "very much a surprise" (Eichengreen 1999:151). He does, however, stress that in the case of South Korea, "revelations through the

publication of leaked IMF documents" showed that "the country's short-term debt was significantly higher than previously thought" (Eichengreen 1999:152). In combination with "the government's reluctance to close troubled banks", this "undermined confidence among international investors" (ibid.). If there is a common denominator in Eichengreen's accounts of the spread of the crisis beyond Thailand, it is how economic difficulties, in combination with a reluctance of governments to take the appropriate, 'bold measures', undermined the "confidence" of international investors. On 2 July 1998, a year after the onset of the Thai crisis, "there were still few signs of … recovery", Eichengreen observes—and notes the contrast with the 1994–1995 peso crisis Mexico, where a recovery had emerged within the first six months of the crisis (Eichengreen 1999:153). Instead of rapid recovery as in the case of Mexico, what happened was that the crisis went global. Eichengreen describes how, after the Russian government devalued the rouble, the crisis "leapfrogged from Russia and Asia to Latin America", as the "devastating" impact on confidence ignited a "flight to quality" in terms of a "collective scramble out of risky assets in favour of safe havens such as US Treasury securities" (Eichengreen 1999:154). "The simultaneous collapse of prices of virtually all risky assets put institutional investors at risk", Eichengreen explains, and "precipitated the collapse of the US hedge fund Long Term Capital Management", which, in turn, created "fears" not only for "the stability of other hedge funds" but, indeed, for "a global recession, or even a depression" (ibid).

CAUSES

The Asian crisis is best understood, Eichengreen argues, "as a financial crisis with self-fulfilling features, afflicting countries whose governments lacked the economic and political wherewithal to defend their currencies" (ibid.). This weakness of the governments involved reflected, Eichengreen argues, "three sources of vulnerability" (ibid.), which he discusses further under the headings of (i) macroeconomic imbalances; (ii) financial sector weaknesses; and (iii) short maturity of debt.

With regard to macroeconomic imbalances, Eichengreen starts by noting that the rapid growth in the region had been "sustained in part by capital inflows" (154–55). By-products of this were, Eichengreen argued, "increasingly overvalued real exchange rates, accompanied in some cases by ballooning current-account deficits" (Eichengreen 1999:155). Though the appreciation of real exchange rates was not large compared to, for instance, Argentina and Brazil, "both the real appreciation and the current-account deficit" were nevertheless, Eichengreen argues, "sources of vulnerability" (ibid.). "They could be transformed into serious problems", he explains, "if foreign investors decided one morning that the deficit could no longer be financed" (ibid.). "If capital suddenly stops flowing in … foreign reserves are not sufficient to

provide capital", and thus high interest rates are necessary to attract "bridge financing", Eichengreen argues (ibid.). Moreover, to eliminate a large current account deficit "requires radically compressing demand, disrupting production", which will "almost certainly" induce a recession (ibid.).

In addition to these macroeconomic imbalances, Eichengreen observes that financial systems in the crisis countries "were in a delicate condition", and that high interest rates "served to compound their problems" (ibid.). Eichengreen quotes Rudiger Dornbusch to emphasize the dilemma in which the Asian economies found themselves:

To keep the money coming in … interest rates had to go up to reward foreign lenders for the risk, but that made real estate and banks go even worse. To keep banks alive, interest rates had to go down. The government could not have it both ways. They cut rates, made it free to speculate against the currency and that is what happened (Dornbusch, cited in Eichengreen 1999:155)

"In February 1997", Eichengreen observes, "the Bank of Thailand lent more then $8 billion to distressed financial institutions", and "speculators drew the obvious conclusion" (Eichengreen 1999:155–56).

On the issue of the short maturity of debt, Eichengreen observes that from the early 1990s to 1996/1997, more than 50 percent of capital inflows into countries such as Thailand and Korea "took the form of short-term borrowing" , with more than two-thirds of these loans maturing "in less than a year" (Eichengreen 1999:156). Asian economies had, in other words, not just "a flow problem", in terms of the "continued need to attract capital inflows to finance their current-account deficits", but also a "stock problem", in the sense that they "had accumulated large stocks of short-term debt denominated in foreign currency that needed to be rolled over regularly" (ibid.).

These three vulnerabilities—modest macroeconomic imbalances, serious banking sector problems, and mismanagement of maturity structure of the debt—"placed governments in an untenable position", Eichengreen explains (Eichengreen 1999:157). "Painful policies were required to sustain confidence if it were disturbed but financial systems could not bear the pain", he elaborates (ibid.). "Except in Thailand perhaps", Eichengreen argues, "there was nothing inevitable about the crisis", however (ibid.). On the contrary, "better luck (and better policies) might have enabled countries to grow out of their current-account deficits, lengthen the maturity structure of their debts, and strengthen their banking systems before a shock to confidence occurred" (ibid.). "As it turned out", however, "Thailand's devaluation disturbed investor confidence before its neighbours succeeded in escaping the zone of vulnerability" (ibid.). "The rest, as they say, is history" (ibid.).

After these observations on the trigger of the crisis, its spreading throughout Asia and beyond, and the brief depiction of the three sources of

vulnerability that made the governments of the afflicted countries weak, Eichengreen addresses what he considers the "deeper question" of "how the crisis countries allowed themselves" to get into this situation of vulnerability and weakness "in the first place" (ibid.). "The obvious answer is", he argues, "that their crucial blunder was failing to upgrade bank supervision and regulation when liberalizing their financial systems, a failure that left them unable to raise interest rates and mount a sustained defence of the currency" (ibid.):

The inadequacy of supervision and regulation allowed the banks to rely excessively on high-cost foreign funding, to over-commit to the property market and industry, and to saddle themselves with non-performing loans. Banks took on excessive short-term debt denominated in foreign currency because they were allowed to continue operating despite a weakened financial condition and the perverse risk-taking incentives it implied (Eichengreen 1999:157).

"What remains to be explained", Eichengreen argues, "is why the authorities were prone to these policy mistakes" (ibid.). More specifically, three questions beg an answer, in Eichengreen's view (ibid.):

- why did govennments fail to strengthen financial supervision and regulation?
- why did bank owners with their own capital at stake fail to manage risks to avert such disastrous outcomes?
- why were the markets so inclined to provide the short-term foreign funding that ultimately proved so disastrous?

"The answer to these questions"—all three of them—"is that banks enjoyed guarantees that promised to bail them out of *any and all* difficulties, which in turn encouraged them to take on excessive risk" (Eichengreen 1999:158, emphasis added). "Such guarantees were", Eichengreen argues, "part and parcel of an economic development strategy in which the banks were the instruments of industrial policy" (ibid.). In such bank-led financial systems, banks were simply "too big and too important to fail", Eichengreen observes, and thus, "knowing that they would not be allowed to fail, owners and managers had an incentive to take on additional risk" (ibid.). "One can see", Eichengreen stresses, "how this provided opportunities for *crony capitalism*" (*ibid.*, emphasis added).

Although "high-return investments had been exhausted" and "the period of extraordinarily rapid growth" had come to a close, "extension of preferential credits in disregard of market signals" continued, Eichengreen observes, and this "placed the solvency of the banks at risk" (ibid.). Using the metaphor of a ship in high water, he explains that the fundamental problems of the bank-led system had for many years had been disguised by

artificially high growth rates, and that the recourse to short-term foreign borrowing only further aggravated the problems:

[R]apid growth, like high water, submerges rocks that can otherwise punch holes in the sturdiest boats … And when the water begin to recede, revealing the rocks below, the banks navigated the shoals by borrowing abroad and only ending up in whiter water (Eichengreen 1999:158)

Having identified the existence of government guarantees as the key distinguishing feature of the development strategy of Asian economies, and the key answer to his three "deeper questions" (see above), Eichengreen admits that "it takes two to tango" (Eichengreen 1999:159). "These Asian policies would not", he explains, "have had such powerful effects had they not coincided with global conditions encouraging US, European, and Japanese banks to lend" (Eichengreen 1999:159–160). "The consequences of Asian financial weaknesses could be contained", Eichengreen argues, "as longs as intermediaries … had limited access to funding" (Eichengreen 1999:160). But the relaxation of regulatory limits on their borrowing in the mid1990s combined with "structural and macroeconomic changes in the rest of the world" to allow Asian banks "to freely indulge their appetites for foreign funding" (ibid.). What Eichengreen refers to as "structural and macroeconomic changes in the rest of the world" is the process of "financial deregulation in Europe" which squeezed domestic margins for European investors, and "low interest rates and yields in US and Japan" (ibid.). These developments created an "incentive to borrow where interest rates were low and invest where they were high so long as the exchange rate was pegged", Eichengreen explains (ibid.). Because exchange rates were pegged there was "little perceived exchange rate risk to deter capital inflows", and with high capital mobility "the authorities in the capital-importing countries had little ability to restrain the growth of domestic credit" (Eichengreen 1999:161). Eichengreen explains that in the Asian economies high interest rates were needed as a "rationing mechanism to force the market to choose" among many attractive investment projects (ibid.). However, "the pegged exchange rate made it all but impossible to keep interest rates at a sufficient premium over foreign levels", and thus "excessive credit expansion and an unsustainable real estate boom were the inevitable results" (ibid.). Though pegging exchange rates vis-à-vis principal export markets had for long been a key element in the development strategies of Asian economies pursuing exportled economic growth, this was now, Eichengreen argues, "another legacy of Asia's development strategy that had outlived its usefulness" (Eichengreen 1999:162).

At the end of the day, therefore, we can only, Eichengreen contends, understand the Asian crisis as "a conjuncture of long-standing historical forces and short-term financial policies" (ibid.):

Ultimately, the explanation for the crisis lies in the region's history and economic development trajectory, which relied on bank-centred financial systems, the use of banks as instruments of industrial policy, and close connections between banks and politicians, all of which were designed to sustain high rates of investment and rapid economic growth. This was not a formula that could work forever (Eichengreen 1999:162).

"At another level", however, Eichengreen observes, "the explanation lies in financial errors committed in the mid-1990s" (ibid.). "Growth may have been slowing", he explains, "but the day of reckoning was delayed by the selective liberalization of capital accounts to facilitate short-term financial flows, aided and abetted by the low level of interest rates in the major money centres and by the migration of US and European investments banks to middle-income Asia" (ibid.). "These developments on the borrowing and lending sides", Eichengreen argues, "enabled the newly industrialized countries to borrow their way out of their difficulties for a time"—though in the end, "this only set them up for a harder fall" (ibid.).

"While these insights help one to understand the speculative attacks, they do not explain", Eichengreen stresses, "the full-blown economic and financial meltdown that followed"; "something more is needed to account for the exceptional severity and scope of the crisis" (ibid.). Comparing again with the Mexican peso crisis in 1994–95, Eichengreen notes that a key difference in the Asian crisis was that it was not the government but firms and banks that were exposed to foreign capital. Thus, whereas in the Mexican case, the depreciation of the peso "created financial problems first and foremost for the Mexican government", in Asia "the gravest problems were those created for the private sector" (Eichengreen 1999:163). "With so many banks and firms involved", Eichengreen argues, "the absence of an effective mechanism for coordinating debtor-creditor negotiations was a more serious problem than when there had been only the government on the debtor's side of the table" (ibid.). Moreover, Eichengreen stresses, "the foreign debts of Asian banks and firms were *unhedged*" (ibid.). Because exchange rates had been pegged for so long, borrowers "saw little reason to insure themselves" against depreciations "by purchasing relatively expensive currency futures and forwards" (ibid.). "Ironically", Eichengreen notes, "Asian governments' very success at pegging their exchange rates was one factor behind the severity of the crisis, for it lulled domestic banks and corporations into a false sense of security" (ibid.). Thus, in the Asian case the depreciation of currencies started what Eichengreen terms a "vicious circle":

Debt denominated in foreign currency became more expensive in domestic currency terms, leaving domestic residents poorer. Firms, facing a heavier burden invested less. Banks, facing a heavier burden, lent less. Meanwhile, more domestic output had to be devoted to servicing the same external debt. This meant freeing up a larger share of domestic

resources for debt-servicing purposes, which required using policy to restrict demand still further. But this only depressed output still more, in turn putting further downward pressure on the exchange rate and further elevating debt servicing costs in a vicious spiral (Eichengreen 1999:163)

In addition to this vicious circle, a self-fulfilling process was at play, Eichengreen argues. When the exchange rate began depreciating, "banks and firms that had previously left their foreign exposure unhedged, scrambled for cover … to protect themselves against the possibility of future exchange rate depreciation", thus "pushing the exchange rate down in a self-fulfilling prophecy" (Eichengreen 1999:164). Another important factor was, Eichengreeen argues, the absence in most Asian countries of "adequate bankruptcy and insolvency procedures and independent judiciaries" (ibid.). "The dangers posed by inadequate bankruptcy procedures may not be apparent in periods of rapid growth when few firms experience financial distress", he observes, but "will surface with a vengeance if and when growth slows" (Eichengreen 1999:165).

The final aspect in understanding the severity of the Asian crisis, to which Eichengreen draws attention, is the "the generalized revision of expectations"—"prompted by the devaluation of the baht and reinforced by the spread of financial upheavals to Indonesia and Malaysia" which, he argues, "alerted investors to the existence of *deeper problems*" (Eichengreen 1999:165–66). This is, Eichengreen notes, what Goldstein had termed the 'wake-up-call' hypothesis. While this term is "evocative", it does not "explain why this particular wake-up call was so loud and startling", Eichengreen argues, and thus, at the end of the day, it "simply begs the question" (Eichengreen 1999:166). To Eichengreen, the answer lies in "the bank-based nature of Asia's financial system" (ibid.). "The region had developed few financial markets", he argues, "on which information was impounded into the prices of exchange-traded financial assets" (ibid.). Instead, the system relied on "banks possessing relatively favourable access to information on their customer's financial position", and because there was "little independent information on the quality of loans, bad news served to discredit them as a group" (ibid.). "The difficulty of distinguishing good credit risks from bad ones" was further heightened, Eichengreen argues, by the "lack of transparency of bank balance sheets", which in turn reflected "the failure of supervisors to require banks to follow rigorous auditing and accounting practices" (166–167). "In this information-impacted environment", Eichengreen explains, "bank runs could lead to systemic banking crises and spill contagiously across countries" (Eichengreen 1999:167).

In the final section of his paper, Eichengreen identifies five lessons that his interpretation of the Asian crisis give occasion to. First, he argues, we should learn that "large current-account deficits are not benign" (ibid.). "Deficits have to be financed", he observes, and this places a country "at

the mercy of its creditors" (ibid.). "Those of us who live in California", he continues, "appreciate the advantages of earthquake insurance" (ibid.). "Policymakers need to … appreciate the importance of insuring themselves against financial tremors", he concludes, "by avoiding excessive deficits" (ibid.). Second, we should be aware that how a current account deficit is financed is crucial: "Dependence on short-term funding, and short-term funding denominated in foreign currency in particular, is risky business" (Eichengreen 1999:167–168). Third, we should recognize that "banks are a special source of vulnerability" (*ibid.*). In developing countries, Eichengreen contends, banks serve as "a source of financial intermediation services" (Eichengreen 1999:168). "The securitized markets that are the modern alternative", Eichengreen continues, "have more demanding information requirements and, historically, are later to develop" (ibid.). In the absence of this "modern alternative", developing countries regard banks as "too big and too important to fail" (ibid.). What we should learn, therefore, is, Eichengreen argues, to relate "bank capital requirements to the source of their funding as well as the riskiness of their loans" and, more generally, regulate "the flow of short-term foreign funding into the banking system" (ibid.). "Regrettably", Eichengreen observes, "this is precisely the opposite of what Asian governments, seeking to use the banks as instruments of industrial policy and conduits for the transfer of foreign funds, did in the years leading up to the crisis" (ibid.). Fourth, developing countries should, "with few exceptions", "move toward greater exchange rate flexibility", Eichengreen argues (ibid.). "A more flexible exchange rate", he explains, "gives banks and corporations an incentive to hedge their foreign exposure which better positions them to cope with financial turbulence if and when it occurs" (ibid.). Finally, Eichengreen stresses that "it will not always be possible to prevent or predict financial crises", and "the two options currently available for responding to crises —extending ever-bigger bailouts and standing aside and letting nature run its course—are equally unacceptable" (Eichengreen 1999:169). "This is why", Eichengreen concludes, "it is essential to create a third alternative" (ibid.).

4
What Happened to Asia?

Paul Krugman argues that the Asian crisis is not readily understood within the conceptual framework of "standard currency crises models" (Krugman 1998:1). A year or two before the Thai crisis, some economists (including Krugman himself) had "raised warning flags", but what they expected was a "conventional currency crisis followed by a modest downturn"—by no means the "much more drastic … collapses in domestic asset markets, widespread bank failures, bankruptcies on the part of many firms, and … severe real downturn" (ibid.). Nor had any of these observers expected, Krugman notes, that the crisis could spread from Thailand throughout and beyond East Asia. In Krugman's view, the key to understanding this failure to grasp the severity of what was coming was that Thailand's problems were conceived in terms of standard currency crises models. Only by understanding the ways in which the Thai crisis went far beyond a standard currency crisis may we begin to understand also, Krugman argues, the process and logic by which the crisis spread to first other East Asian countries, and then beyond the region, to Russia and Brazil.

Although "Asian economies did experience currency crises, and the usual channels of speculation were operative here as always", "the currency crises were only part of a broader financial crisis, which had very little to do with currencies or even monetary issues per se" (ibid.). Thus, "in order to make sense of what happened to Asia", Krugman contends, it "is necessary to adopt an approach quite different from that of traditional currency crisis theory" (ibid.). The alternative approach that Krugman suggests is one that focuses "on two issues normally neglected in currency crisis analysis" (ibid.): first, "the role of financial intermediaries", and "the moral hazard associated with such intermediaries when they are poorly regulated"; and, second, "the prices of real assets such as capital and land" (Krugman 1998:1–2).1

After these introductory remarks, Krugman outlines the five main sections of his paper. In the first of these, he offers a conceptual "framework for understanding the nature of the Asian crisis" (Krugman 1998:1). The next three sections then elaborate on the relationship between moral hazard and the three main elements of his explanatory framework:

overinvestment; over-pricing of assets; and disintermediation. These sections include a review of "standard analysis of the problem of moral hazard in financial intermediaries", showing "how it can lead to over-investment at the aggregate level"; an analysis of "how moral hazard can lead to overpricing of assets"; and how "a moral-hazard regime with overpriced assets can become vulnerable to financial crises" (Krugman 1998:2). Krugman admits that his "moral hazard/asset bubble" explanation of the Asian crisis, though "a strong contender for a leading role", is not "the full story of the Asian crisis" (Krugman 1998:3). Thus, in the final section of the paper, he gives "some qualifications to the story" (Krugman 1998:9).

THINKING ABOUT THE ASIAN CRISIS

"Conventional currency-crisis theory … focuses mainly", Krugman observes, "on the exchange rate—other asset prices are left in the background" (Krugman 1998:2). This holds for both first- and second- generation currency crisis models. In first- generation models, "a government with persistent money-financed budget deficits is assumed to use a limited stock of reserves to peg its exchange rate", a policy that will "ultimately be unsustainable" (ibid.). Thus, "the attempts of investors to anticipate the inevitable collapse" will "generate a speculative attack on the currency when reserves fall to some critical level" (ibid.). In second- generation models, a government may choose to abandon the defence of a pegged exchange rate if this is considered necessary for short-term macroeconomic reasons. In this conceptualization, "a speculative attack on a currency can develop either as a result of a predicted future deterioration in fundamentals, or purely through self-fulfilling prophecy" (ibid.). Krugman observes, however, that none of the factors that drive first- and second- generation crisis models "seems to have been present in any of the afflicted Asian economies" (ibid.). "On the eve of crisis", Krugman explains, "all of the governments were more or less in fiscal balance", they were not "engaged in irresponsible credit creation or runaway monetary expansion", and their "inflation rates, in particular, were quite low" (ibid.). With regard to the factors driving second- generation crises, none of the afflicted countries had "substantial unemployment when the crisis began" and thus there did not "seem to be the kind of incentive to abandon the fixed exchange rate to pursue a more expansionary monetary policy" (ibid.).

Instead, some features that are not included in standard currency crisis models seemed to be important in the course of events leading to the Asian crisis. "In all of the afflicted countries", Krugman observes, "there was a boom-bust cycle in the asset markets that preceded the currency crisis", and financial intermediaries seemed "to have been central players", by borrowing "short-term money, often in dollars, then [lending] that money to speculative investors, largely but not only in real estate" (Krugman 1998:

3). "What all of this suggests", Krugman argues, "is that the currency crisis is more a symptom than a cause":

[T]he Asian crisis is best seen not as a problem brought on by fiscal deficits, as in first-generation models, nor as one brought on by macroeconomic temptation, as in second-generation models, but as one brought on by financial excess and then financial collapse. Indeed, to a first approximation currencies and exchange rates may have had little to do with it: the Asian story is really about a bubble in and subsequent collapse of asset values in general, with the currency crisis more a symptom that a cause of this underlying real malady (Krugman 1998:3).

"So what would a true account of the Asian crisis look like?", Krugman asks. Key to the answer, he suggests, is the notion of moral hazard and the role of financial intermediaries. Financial intermediaries "were perceived as having an implicit government guarantee" and were "essentially unregulated", and therefore, Krugman argues, "subject to severe moral hazard problems" (ibid.). Consequently, these financial intermediaries engaged in "excessive lending", and this is what "created inflation—not of goods but of asset prices" (ibid.). A circular process was at play, Krugman argues: "proliferation of risky lending drove up the prices of risky assets which, in turn, made the financial condition of intermediaries seem sounder than it was" (ibid.). When, eventually, the bubble burst, "the mechanism of crisis" was the "same circular process in reverse: falling asset prices made the insolvency of intermediaries visible, forcing them to cease operations, leading to further asset deflation" (ibid.). It is this circularity, Krugman argues, that explains "both the remarkable severity of the crisis and the apparent vulnerability of the Asian crisis economies to self-fulfilling crisis—which in turn helps us understand the phenomenon of contagion between economies with few visible economic links" (ibid.).

MORAL HAZARD AND OVERINVESTMENT

"It has long been known that financial intermediaries whose liabilities are guaranteed by the government pose a serious problem of moral hazard", Krugman observes, referring to the savings and loans debacle in the US in the 1980s as "the classic example" (ibid.). The foreign investors that provided Asian financial intermediaries with financing (whether Thai finance companies or South Korean banks, or other), "believed that they would be protected from risk" (ibid.). A basic assumption in Krugman's account is the existence in Asian economies of "a class of financial intermediaries that were able to raise money at safe interest rates but lend that money at premium rates to finance speculative investments" (Krugman 1998:4). Owners of such

guaranteed intermediaries have a preference, Krugman argues, for "investments that could yield high returns even if there is also a strong possibility of heavy losses (ibid.)". Krugman then proceeds to explain the logic of moral hazard by means of "a simple numerical example" (ibid.) that compares two investments, one yielding a certain return and the other being risky, yielding either a $20 million gain or a $20 million loss (with a 50 pct chance of each of these two outcomes). The key objective of this example is to compare what decision the investor makes, depending on whether the decision is taken in the absence or presence of moral hazard. The crucial difference is that in the presence of moral hazard, the investor is assumed not to bear the costs if the investment fails—the government will step in and cover the loss.2 These two investment options are briefly summarized in schematic form below.

Krugman's point with this example is to illustrate why, in the presence of moral hazard problems, risky investments will be chosen, even when such investments yield a lower expected return than less risky investment options.

"This story about how moral hazard distorts investment is familiar", Krugman observes, but "it is perhaps a less familiar proposition that over-guaranteed and under-regulated intermediaries can lead to excessive investment by the economy as a whole (ibid.). Krugman proceeds to elaborate this point by means of a two-period model.4 The key point is that whereas economic models "normally think of investors as responding to expected values of the relevant variables", in these moral hazard models "the owners of intermediaries will instead focus on what we might call Pangloss values: the values that variables would take on if it turns out that we live in what is (from their point of view) the best of all possible worlds" (Krugman 1998:5). In this regime, unsurprisingly, investment will exceed what is profit-

Table 4.1 Investment Decisions in Moral Hazard Regime

	Absence of moral hazard	*Moral hazard*
Invested amount (I)	$100 million	$100 million
Return on investment—good outcome (50 pct chance)	$120 million	$120 million
Return on investment—bad outcome (50 pct chance)	$ 80 million	$ 80 million
Expected return (ER)	$ 100 million (0.5*120)+(0.5*80)= 100	$ 110 million (0.5*120)+0.5*(80 + 20)3 = 110
Profit (ER-I)	Zero	$ 10 billion
Profit—in comparison with the less risky investment	- $ 7 million (0–7)	+ $ 3 billion (10–7)

able, with detrimental effects: "[E]xcessive investment will lower expected welfare, because increased returns in the favourable state will not offset the increased losses in the unfavourable state" (Krugman 1998:5–6). Krugman notes that this is "the sort of distortion whose consequences can easily be made worse by globalization":

Suppose that this country did not have access to the world capital market—suppose, for example, that it had to rely on a fixed supply of domestic savings, unresponsive to the interest rate. Then the excessive investment demand generated by the intermediaries would not in fact lead to excessive investment—all that it would do is drive up the interest rate. Offering such an economy access to the world capital market might then ... actually make the economy worse off by allowing moral hazard in the financial sector to translate into real excess capital accumulation (Krugman 1998:6)

ASSET PRICES AND DISINTERMEDIATION

To this story of moral hazard and overinvestment, Krugman adds two new dimensions: asset prices and disintermediation. With regard to the former, Krugman argues that "Asian economies experienced a noticeable boombust cycle not only in investment but also or even especially in asset prices" (ibid.). This is precisely the result you would expect on the basis of his model. For with "financial intermediaries able to borrow at the world interest rate, because they are perceived as being guaranteed", the same analysis applies: "[I]ntermediaries will be willing to bid on the land, based not on expected value of future rent but on the Pangloss value", and thus, "all land will end up owned by intermediaries, and the price of land will be double what it would be in an undistorted economy" (ibid.).

In his final analytical exercise, Krugman considers "the possibility [of] ... some probability p that the government will credibly announce ... that henceforth creditors of the intermediaries are on their own" which could, for instance, reflect "the election of a reformist government that is no longer prepared to tolerate 'crony capitalism'" (Krugman 1998:7).

This analysis reinforces the conclusions of the previous analyses. In sum, Krugman's model "generates a story about self-fulfilling financial crises, in which plunging asset prices undermine banks, and the collapse of the banks in turn ratifies the drop in asset prices" (Krugman 1998:8). This model helps us understand, Krugman argues, not only how the Asian crisis could occur in the "absence of the usual sources of currency stress, whether in the form of fiscal deficits or macroeconomic difficulties", but also how the crisis could be so severe in the absence of "strong adverse shocks", and how it could spread "to countries that seemed to have few economic links with the initial victims (Krugman 1998:8–9). "The reason that traditional

measures of vulnerability did not signal a crisis" was, Krugman contends, "that the problem was off the government's balance sheet" (Krugman 1998:9). That is to say, "the underlying policy mistake was … not part of the government's visible liabilities until after the fact" (ibid.). It was the "boombust cycle created by financial excess" that "was the real driver of the whole process"—the currency crisis was "more a symptom than a cause (ibid.).

QUESTIONS AND QUALIFICATIONS

In the final section of his paper, Krugman mentionss five issues that are absent from his model, but which his "reality sense" compels him to discuss (ibid.). First, he admits that by assuming "that it is a purely rent-seeking device" that "serves no useful purpose", his model "may miss … important aspect[s]" (Krugman 1998:9). Second, he contends that "in practice", to some extent the Asian crisis "was associated with unwise investments … rather than with excessive investment per se "(ibid.). Third, Krugman observes, "the actual experience has been large changes in relative prices" which probably played "a crucial role in explaining why the financial crises produce such large declines in output (ibid.). Fourth, he admits the moral hazard implied by his model—i.e., that financial intermediaries can walk away from any loss—is a "very stark" one, and that an "obvious next step is to model moral hazard when the owners of intermediaries do have something to lose (ibid.). Fifth, "it is clearly wrong to blame all of the overinvestment and overvaluation of assets in Asia on domestic financial intermediaries" since, "after all, private individuals—and foreign institutional investors—did buy stocks and even real estate in all the economies now in crisis", which "suggests that other kinds of market failure, notably 'herding' by investors, still have some explanatory role to play" (Krugman 1998:10).

He does, however, conclude his paper by contending that the story provided by his model "is right in its essentials", and that therefore explaining the model in terms of "conventional currency-crisis models" is the "wrong track" (ibid.). "The Asian crisis", he concludes, "was mainly about bad banking and its consequences" (ibid.).

5

The East Asia Crisis

How IMF Policies Brought the World to the Verge of a Global Meltdown

In *Globalization and its discontents*, Joseph Stiglitz included a chapter on the Asian crisis. The subtitle of that chapter—'How IMF policies brought the world to the verge of a global meltdown'—indicates its approach. The chapter reads as a critical review of the role of the IMF, not only in exacerbating the crisis, but also in creating it in the first place. The three main sections of the chapter discuss, first, how the IMF's push for the rapid liberalization of financial and capital markets was the "single most important factor leading to the crisis" (Stiglitz 2002:99); second, how contractionary fiscal and monetary policies advocated by the IMF deepened the recession; and third, how the IMF's misguided approach to financial and corporate restructuring further exacerbated the crisis. These three main sections are then followed by a section that describes how the countries that did not follow IMF advice (Malaysia, China), or did so only partially (Korea) recovered much more quickly than those who did (Thailand, Indonesia), and a concluding section that outlines an alternative strategy to that of IMF, which—according to Stiglitz—would have faired better. In the following, the emphasis will be on the three main sections, explaining the onset of the crisis, and the two rounds of mistakes that, in Stiglitz' view, exacerbated it unnecessarily.

In support of his argument that rapid capital account liberalization was the "single most important cause of the crisis" (Stiglitz 2002:89), and as such a serious mistake, Stiglitz makes three key observations. First, he argues that the "combination of high savings rates, government investment in education, and state-directed industrial policy" served to make the region "an economic powerhouse", which for decades had produced "phenomenal" economic growth and "enormous" increases in standards of living "for tens of millions of people" (Stiglitz 2002:92). These impressive results, Stiglitz noted, were not achieved "in spite of the fact that they had not followed most of the dictates of the Washington consensus, but *because* they had not" (Stiglitz 2002:91, emphasis in original). In a situation where overall economic growth and savings rates had for decades been higher than anywhere else in the world, it made little sense, he contended, to argue that increased inflows of foreign capital

through the rapid liberalization of financial and capital markets were important for these economies (Stiglitz 2002:99).

Second, Stiglitz argues that the evidence indicates that "all too often capital account liberalization represents risk without a reward" (ibid.). Stiglitz stresses that this conclusion is derived "not just by carefully looking at what happened in the region, but by looking at what happened in the almost one hundred other economic crises of the last quarter century" (ibid.). "Even when countries have strong banks, a mature stock market, and other institutions that many of the Asian countries did not have, it can impose enormous risks", he argues (ibid.). In fact, there is little reason to believe, he argues, that *any* country "could have withstood the sudden change in investor sentiment" (ibid.). As part of his account of the risks involved in capital account liberalization, Stiglitz gives an example of the substantial financial interest an international investor has in currency speculation in this regime:

Assume a speculator goes to a Thai bank, borrows 24 billion baht, which, at the original exchange rate, can be converted into $1 billion. A week later the exchange rate falls; instead of there being 24 baht to the dollar, there are now 40 baht to the dollar. He takes $600 million, converting it back into baht, getting 24 million baht to repay the loan. The remaining $400 million is his profit—a tidy return for one week's work, and the investment of little of his own money (Stiglitz 2002:95).

Third, while the IMF held that the liberalization of financial and capital markets would be beneficial to these economies by increasing the *efficiency* of resource allocation (Stiglitz 2001:101) and their macroeconomic *stability* (Stiglitz 2002:100), this was seriously at odds with the evidence, Stiglitz argues. As an academic, he was "shocked":

In October 1997, at the very beginning of the crisis, the Fund was advocating the expansion of precisely those policies which underlay the increasing frequency of crises. As an academic, I was shocked that the IMF and the US Treasury would push this agenda with such force, in the face of a virtual absence of theory and evidence suggesting that it was in the economic interests of either the developing countries or global economic stability—and in the presence of evidence to the contrary (Stiglitz 2002:100).

Stiglitz finds it "hard to believe" that the IMF, and other advocates of rapid capital account liberalization, were not aware that capital flows are pro-cyclical, i.e. "that capital flows out of a country in a recession, precisely when the country needs it most, and flows in during a boom, exacerbating inflationary pressures" (Stiglitz 2002:100). However hard to credit, at the end of the day, it seemed that the IMF believed strongly in the benefits of free financial and capital markets:

If the market says, build office buildings, commercial construction must be the highest return activity. If the market says, as it effectively did after liberalization, build empty office buildings, then so be it; again, according the IMF logic, the market must know best (Stiglitz 2002:101, emphases in original).

When the crisis broke out, the response of the IMF was to provide huge amounts of money for the countries afflicted, in order for them to defend their currencies, and thus prevent devaluation and the inflationary pressures that would result from devaluation. The idea was that if markets could be convinced that "there was enough money in the coffers, there would be no point in attacking the currency, and thus 'confidence' would be restored" (Stiglitz 2002:95). In addition to helping the East Asian countries defend their currencies, this money "enabled the countries to provide dollars to the firms that had borrowed from Western bankers to repay their loans", and thus it was a "bailout to the international banks as much as it was a bailout to the country" (ibid.). In return for the money, the IMF required the countries to commit to a reform package, which was supposed to "rectify the problems that caused the crisis". "The ingredients" of such reform packages "typically include higher interest rates—in the case of East Asia much, much higher interest rates", Stiglitz explains, in addition to "cutbacks in government spending", "increases in taxes"—and "'structural reforms', that is, changes to the structure of the economy which, it is believed, lies behind the country's problems" (Stiglitz 2002:96).

To Stiglitz, it was curious that while the IMF were "loath to credit the region's governments with any of the successes of the previous quarter century, they were quick to blame the governments for the failings" (Stiglitz 2002:91). "How", he wondered, "if these countries' institutions were so rotten, had they done so well for so long?" (Stiglitz 2002:91). Not only had the East Asian countries had an "impressive record of growth", Stiglitz observes, but in addition they had had "fewer downturns over the previous three decades than any of the advanced industrial countries" (Stiglitz 2002:105). In fact, "there was more to praise in East Asia than to condemn", Stiglitz contends, and "if East Asia was vulnerable, it was a newly acquired vulnerability—largely the result of the capital and financial market liberalization for which the IMF was itself partly culpable" (ibid.). In Stiglitz' view the crisis was not caused by 'structural problems', and thus unsurprisingly, the IMF programs—"with all of their conditions and with all of their money"—failed:

They were supposed to arrest the fall in the exchange rates; but these continued to fall, with hardly a flicker of recognition by the markets that the IMF had 'come to the rescue'. In each case, embarrassed by the failure of its supposed medicine to work, the IMF charged the country with failing to take the necessary reforms seriously. In each case, it announced

to the world that there were fundamental problems that had to be addressed before a true recovery could take place (Stiglitz 2002:96–97).

By pointing to such "fundamental problems" the IMF not only denied their part of the responsibility in setting on the crisis, but by that very act further exacerbated it. For when the IMF argued that Asian economies were haunted by "fundamental problems" they undermined their own strategy of "restoring investor confidence"; making these assertions was like "crying fire in a crowded theatre" (Stiglitz 2002:97).

Having argued that rapid capital account liberalization as strongly pushed by the IMF was the most important cause of the crisis, and that the subsequent response of the IMF worsened the crisis rather than ameliorated it, Stiglitz moves on to analyze in more detail the elements of the IMF strategy. He divides this analysis between what he terms the first and the second 'round of mistakes'

THE FIRST ROUND OF MISTAKES

In its 'first round of mistakes' the IMF response to the crisis consisted of three overall policies. These were, in Stiglitz' phrasing, 'Hooverite-contractionary policies; 'beggar-thyself' policies; and 'strangling-an-economy-with-high-interest-rates' policies.

"Not for sixty years have respectable economists believed that an economy going into a recession should have a balanced budget", Stiglitz argues (Stiglitz 2002:106). Yet, this was what the IMF did. By emphasizing balanced budget measures, the IMF made the mistake of prescribing the same reforms it had requested when dealing with crises in Latin America, despite the fact that the East Asian crisis had little in common with those of Latin America. In Latin America the key problems were, Stiglitz explains, "profligate government spending and loose monetary policies that led to huge deficits and high inflation", whereas in East Asia "governments had surpluses and the economy enjoyed low inflation" (Stiglitz 2002:104). Thus, whereas in the "highly inflationary environment of Latin America", a decrease in excess demand was "what was needed", the opposite was the case in East Asia (ibid.): giving the "impending recession" the problem was "not excess demand but insufficient demand" (ibid.). "Dampening demand could only", Stiglitz notes, "make matters worse" (ibid.).

In addition to noting that contractionary fiscal policy—through the balanced budget requirement—was "exactly the opposite course" (Stiglitz 2002:105) of what was needed given the nature of the crisis, Stiglitz stresses that this policy principle had been rejected by the US Treasury as "bad economic policy" for the US when a balanced budget amendment to the US constitution had been debated. However, "despite the fact that expansionary fiscal policy was one of the few ways out of recession", and despite US rejection

of the balanced budget amendment, "the US Treasury and the IMF advocated the equivalent of a balanced budget amendment for Thailand, Korea and other East Asian countries" (Stiglitz 2002:106). This was not the only case of 'double standards' on the part of the IMF and the US Treasury with regard to key policy issues. Stiglitz notes that in the US plans to increase interest rates by "one quarter or one-half percentage point" caused serious worries over the potentialy adverse effects on the US economy, and "[y]et in East Asia, IMF bureaucrats … forced interest rate increases not ten but fifty times greater" (Stiglitz 2002:109). Add to this the fact that East Asian economies were far more vulnerable to interest rate increases than US or other Western economies, due to the high leverage of East Asian firms. "With high levels of indebtedness", Stiglitz observes, "imposing high interest rates, even for short periods of time, is like signing a death warrant for many of the firms—and for the economy" (Stiglitz 2002:104).

In defending their requirement to increase interest rates, the IMF argued that this would make it more attractive for capital to flow into these countries, and thus would help restore market confidence (Stiglitz 2002:110–111). In fact, however, the "excessive leverage" of East Asian firms and "weak financial institutions" had repeatedly been cited as key weaknesses, even by the IMF itself, and yet the IMF "pushed high interest rate policies that exacerbated those problems" (Stiglitz 2002:110). Higher interest rates "did not attract more capital into the country", but rather "made the recession worse and actually drove capital out of the country" (Stiglitz 2002:111).

The third and final mistake of the 'first round of mistakes, was what Stiglitz termed 'beggar-thyself policies'. In the 1930s, the countries hit by a downturn responded by trying to bolster their economies and shift "consumer demand to [their] own products" (Stiglitz 2002:107). The key policy measures in this strategy were the imposition of tariffs and competitive devaluations. As countries succeeded in this way in cutting back on imports, it inadvertently 'exported' the economic downturn to its neighbours. In relation to the Asian crisis, the IMF advised strongly against the imposition of tariffs and devaluations—but the strategy they devised instead had "an effect which was even worse than the beggar-thy-neighbour policies that had devastated countries around the world during the depression of the 1930s", Stiglitz argues (2002:107). The key element of the strategy devised by the IMF was for the countries to build a trade surplus. "With tariffs and devaluations ruled out, there were but two ways to build a trade surplus", Stiglitz observes:

One was to increase exports, but this is not easy, particularly when the economies of your major trading partners are weak and your own financial markets are in disarray, so exporters cannot obtain finance to expand. The other was to reduce imports—by cutting incomes; that is, inducing a major recession. Unfortunately for the countries, and the world, this was the only option left (Stiglitz 2002:108).

The latter is what happened. The combination of "contractionary fiscal and monetary policies" and "misguided financial policies" exacerbated the economic downturn and reduced incomes. This, in turn, reduced imports and led to huge trade surpluses, "giving the countries the resources to pay back foreign creditors" (ibid.). If the overall objective was to pay back foreign creditors, the strategy devised by the IMF was a success, Stiglitz notes, but by any other measure it was a failure, due to the severe costs in terms of firm bankruptcies, increasing unemployment and poverty—"hence the name of these policies—"beggar-thyself" (ibid.). The overall effect of the IMF's initial response to the crisis Stiglitz depicts as follows:

The high interest rates increased the number of firms in distress, and thereby increased the number of banks facing nonperforming loans. This weakened banks further. The increased distress in the corporate and financial sectors exacerbated the downturn that the contractionary policies were inducing through the reduction in aggregate demand. The IMF had engineered a simultaneous contraction in aggregate demand and supply (Stiglitz 2002:110–111).

It seemed, Stiglitz noted, that, in "focusing on protecting investors, [the IMF] had forgotten about those in the countries it was supposed to be helping"; that "in focusing on financial variables, like exchange rates, it had almost forgotten about the real side of the economy"—it seemed, in short, that the IMF "had lost sight of its original mission" (Stiglitz 2002:109).

THE SECOND ROUND OF MISTAKES—BUMBLING RESTRUCTURING

"As the crisis worsened", Stiglitz observed, "the need for 'restructuring' became the new mantra" (Stiglitz 2002:113). The IMF was no more successful in this area than in the former one—in fact, the restructuring policies pursued by the IMF "helped push the sinking economies down further" (ibid.). The IMF advocated the restructuring of banks as well as corporations. With regard to banks, the strategy they devised was to separate "the really sick banks, which should be closed immediately, from the healthy banks" and a third group of banks, that were "sick but reparable" (Stiglitz 2002:116). The key criterion in evaluating banks was their ratio of capital to outstanding loans—the capital adequacy ratio. "The IMF insisted", Stiglitz observed, "that banks either shut down or *quickly* meet [the] capital adequacy ratio" (Stiglitz 2002:116). Once again, the policy advocated was one that further exacerbated the economic downturn—and, once again, it was a policy that the US had cleverly avoided when experiencing its savings and loans debacle in the early 1980s, where "most of the weak banks were

taken over by or merged into other banks" (Stiglitz 2002:115). Though it does make sense, when only one bank has a problem, to insist that it meets capital adequacy standards, Stiglitz argues that this policy "can be disastrous" when "many, or most, banks are in trouble" (Stiglitz 2002:116). When facing an economic downturn, raising new capital is hard for banks, and thus the only option available is to "reduce outstanding loans":

But as each bank calls in its loans, more and more firms are put into distress. Without adequate working capital, they are forced to cut back on their production, cutting into the demand for products other firms. The downward spiral is exacerbated. And with more firms in distress, the capital adequacy ratio of banks can even be worsened. The attempt to improve the financial positions of the banks backfired (Stiglitz 2002:116).

In short, the IMF overlooked a critical lesson; "the importance of keeping credit flowing" (Stiglitz 2002:116). On this issue of bank restructuring, South Korea ignored the advice of the IMF, recapitalizing "its two largest banks rather than closing them down"—which is an important factor in understanding, Stiglitz contends, "why Korea recovered relatively quickly" (Stiglitz 2002:117). With regard to the restructuring of firms, Stiglitz criticizes the IMF for confusing financial restructuring with real restructuring. The IMF approach to corporate restructuring was that "companies that owed money should be closed or taken over by their creditors" (Stiglitz 2002:113). This strategy "was no more successful than its strategy for restructuring banks" (Stiglitz 2002:118):

It confused financial restructuring—entailing straightening out who really owns the firm, the discharge of debt or its conversion to equity—with real restructuring, the nuts-and-bolts decision: what the firm should produce, how it should produce its output, and how it should be organized (Stiglitz 2002:118).

When many firms are in financial distress it is of paramount importance to the economy, Stiglitz argued, that the government does "whatever it can to facilitate a quick resolution" (ibid.). However, the IMF insisted that governments should not "take an active role in financial restructuring but push for real restructuring, selling assets … and bringing in outside (typically foreign) management" (ibid.). Stiglitz notes that although IMF rhetoric "continually focused on the weaknesses as underlying the East Asia crisis", it "failed to understand how financial markets work and their impact on the rest of the economy" and that it did not "adequately take into account the corporate and financial distress to which its so-called stabilization policies, including the high interest rates, contributed so strongly (Stiglitz 2002:115). As was the case with regard to bank restructuring, the IMF treated the distress that corporations experienced as bearing witness that they were

fundamentally 'unhealthy', and thus had to be closed down or sold off, rather than as the result of temporary, if severe, financial difficulties, that could be dealt with by means of financial restructuring.

CONCLUDING SECTIONS

"The question of how to best manage a recovery is difficult", Stiglitz admits, "and the answer clearly depends on the cause of the problem". However, "for many downturns", he continues, "the best prescription is the standard Keynesian one: expansionary fiscal and monetary policy".

The problems in East Asia were more complicated, because, part of the problem was weaknesses in finance—weak banks and firms with excess leverage. But a deepening recession makes these problems worse. Pain is not a virtue in its own right; pain by itself does not help the economy; and the pain caused by IMF policies, deepening recession, made recovery more difficult (Stiglitz 2002:121, emphasis in original).

The basic strategy that Stiglitz advocates consists in maintaining the economy "at as close to full employment as possible" by pursuing an "expansionary … monetary and fiscal policy, the exact mix of which would depend on the country in question" (Stiglitz 2002:130). Stiglitz agreed with the IMF on the importance of financial restructuring—that is, addressing the problem of weak banks, but "would have approached it totally differently, with a primary objective of maintaining the flow of finance, and a stand-still on existing debt-repayment" (Stiglitz 2002:130). Such a debt restructuring worked well for Korea, he notes. With regard to corporate restructuring, Stiglitz advocates "the implementation of special bankruptcy provisions aimed at the quick resolution of distress" (Stiglitz 2002:130), including a strong role played by the government towards this end. Such government intervention could have helped in "establishing clear ownership of firms, enabling them to re-enter credit markets [and] take full advantage of the opportunities for export that resulted from their lower exchange rate" (Stiglitz 2002:131). This would have had the further advantage of eliminating the "incentive for asset stripping", providing them "with strong incentives to engage in any real restructuring that was required—and the new owners and managers would have been in a far better position to guide this restructuring than international or domestic bureaucrats" (Stiglitz 2002:131).

6

The Asian Debt and Development Crisis of 1997–? Causes and Consequences

Robert Wade begins his account of "the history of the [Asian] crisis" by explaining the background to the "capital push into Asia" (Wade 1998a: 1538).1 The starting point was, Wade argues, the Plaza Accord of 1985, which "caused a rise in the value of the yen against the US dollar" (ibid.). In response, "Japanese companies sought a new cheaper manufacturing base in a US dollar zone", and for this purpose, "Southeast Asia was the obvious choice"—in addition to being close to Japan and having currencies pegged to the US dollar, these countries could offer "cheap and well-educated workers" (ibid.). These factors, combined with "very cheap credit in Japan" and "strong Japanese government encouragement", resulted in a "Japanese-led investment and export boom in Southeast Asia" (ibid.). At the time, not only Japan but also European countries were trying "to stimulate domestic consumer demand and economic growth by means of expansionary monetary policies" (ibid.). These policies were, however, of limited effectiveness and thus the result was "excess liquidity in the world system at large" (Wade 1998a: 1539). This excess liquidity "spilled over into financial asset markets worldwide", Wade explains, with much of it ending up "in the hands of financial institutions in the United States, Japan and Europe", which "invested in the US stock market … [and] heavily in Asia" (ibid.). These factors combined to create a massive increase of capital flows into Southeast Asian countries. From 1994 to 1996, capital flows to South Korea, Indonesia, Malaysia, Thailand and the Philippines rose from $47 to $93 billion, with private commercial banking accounting for $32 billion of the increase (ibid.). "The flow of borrowed money had a self-reinforcing effect on confidence, investment and economic growth", Wade argues, and thus, he contends, "there was less and less compulsion on the part of lenders, borrowers or governments to improve financial supervision or control bank asset quality" (ibid.). These capital flows were, however, "premised on the assumption that the exchange rate would hold"—which, ultimately, it didn't (ibid.).

CAPITAL LIBERALIZATION

It had been a "reasonable assumption", Wade argues, that the pegged exchange rates of the Asian countries2 would hold, for while their "domestic

inflation was somewhat higher than that in Japan and the United States" so was their productivity growth (ibid.). However, the countries had "undergone radical financial deregulation over the 1990s, including near-removal of restrictions on the inflow and outflow of mobile capital", and this deregulation "happened with little attention to the new kinds of regulation that would be required and with only a thin base of financial skills" (ibid.). "Banks and finance companies still operate in much of East and Southeast Asia as family businesses", Wade explains, "with management structures unable to cope with the complexity of present-day finance" (ibid.). In the new situation of "deregulated financial systems", Wade observes, it became possible for "inexperienced private domestic banks and firms to take out large, dollar-denominated loans from foreign lenders and on-lend with generous spreads" (ibid.). The potential to make high profits for "those with access to much cheaper foreign credit" was, Wade argues, a "chief reason" why firms and banks, both national and international, joined the IMF and the World Bank in pressuring governments "to undertake financial deregulation" (ibid.). Many of the governments "bought the monetarist view that inflation control should be the overriding priority of macroeconomic policy and that the exchange rate should be an "anchor" for inflation control" (Wade 1998a: 1540). The result was, Wade argues, a "significant overvaluation" of currencies, which hurt exports, made imports cheaper—and thus, overall, increased the current account deficits of the countries pursuing these policies (ibid.).

HIGH SAVINGS AND HIGH DEBT

"[W]ell before the huge inflow of foreign funds and continuing through it", Wade observes, "Asian households saved" (ibid.). "Gross domestic savings are typically one-third of GDP or more … giving East and Southeast Asia the world's biggest pool of savings" (ibid.). For instance, whereas gross domestic savings in 1995 were 36 percent of GDP in Korea and Thailand and 42 percent in China, they amounted to only 15 percent in the US and UK (ibid.). This pattern is at odds with the conventional wisdom, Wade notes, which regards "high-income countries as capital-abundant and low-income countries as capital-short" (ibid.). Because of the high level of household savings, "East and Southeast Asia is a lower-income region where capital is in a sense more 'abundant' than in higher-income regions of North America and Europe", Wade notes (ibid.). Household savings in Asia are "for the most part deposited in banks rather than invested in equities", which means that banks in Asia have the role of intermediating "a huge inflow of savings" (ibid.). With households being net savers, with little of the savings invested abroad and with government not being "a major borrower (in contrast to most of the G-7 countries)", Wade observes, "the borrowers must be firms and other investors" (ibid.). This is why, in these Asian economies, "the system is biased toward high ratios of debt to equity

in the corporate sector"—it's simply "the other end of their high savings" (ibid.). Firms that have a high level of debt to equity "are vulnerable to shocks that disturb" the flow of capital, Wade explains, for whereas equity requires "a *share* of profits", "debt requires a *fixed* level of repayment" (ibid., emphasis in original). Therefore, "the higher the debt-to-equity ratio the more likely" it is that a "depressive shock will cause illiquidity, default and bankruptcy" (ibid.). As a consequence, another part of the Asian system is that banks and firms "cooperate to buffer systemic shocks", and that governments support this cooperation (ibid.). This need for government support, in turn, "gives the government a powerful instrument for influencing the behaviour of both firms and banks", Wade explains (ibid.). Thus, the Asian model of 'alliance capitalism'—often "derogatorily called 'crony capitalism'" and "understood in *political* terms, such as corruption and the survival strategies of rulers"—does in fact have, Wade argues, an "*economic* rationale" (ibid., emphasis in original).

"Countries of the region vary", Wade observes, in "how the government uses its influence over banks and firms", from "the developmental states of Japan (1935–80), South Korea and Taiwan, where the state coordinated, directed, and collaborated with firms entering major world industries", to "Thailand and Indonesia, which have made no more than sporadic efforts at public sector directional thrust or public-private collaboration in sectoral development" (ibid.). But "for all the variation in the role of the state", what remains is, Wade argues, a situtation in which "relatively deep debt structures, with their vulnerability to external shocks, are common to the region" (ibid.).

PRECONDITIONS FOR THE CRISIS

What were the preconditions of the crisis, then? Wade provides a list of four key preconditions (Wade 1998a: 1540–41):

• Very high rates of domestic saving, intermediated from households to firms via banks, creating a deep structure of domestic debt.

• Fixed exchange rate regimes, with currencies pegged to the US dollar,3 which created the perception of little risk in moving funds from one market to another.

• Liberalization of capital markets in the early to mid-1990s and deregulation of domestic financial systems at about the same time, without a compensating system of regulatory control.

• Vast international inflows of financial assets, coming from excess liquidity in Japan and Europe being channelled through financial institutions scouring Asia for higher returns and lending at even lower nominal rates than domestic borrowers could borrow from domestic sources, creating a deep structure of foreign debt.

Having set out what he perceives as the background of the crisis and identified the key preconditions for it, Wade moves on to describe in more detail the *course* of the crisis; from international exchange rate developments, to Thailand's devaluation and further depreciation against the dollar, to the contagion from South East Asia into East Asia. The following will provide a somewhat condensed version of Wade's account of the events.

THE COURSE OF THE CRISIS

"The movement towards crisis began", Wade argues, with "inflationary pressure" (Wade 1998a: 1541). "The inflow of financial capital and foreign direct investment to Southeast Asia in the 1990s, combined with the fixed exchange rate regime", "forced an increase in domestic money supply", Wade explains, because under the fixed rate system the central bank had "to buy the foreign currency and issue domestic money in exchange" (ibid.). This increase in domestic money supply, in turn, "fuelled inflation at around 6%", while "inflation in Japan and the United States had become much less" (ibid.). At the same time, the Japanese and Chinese currencies depreciated significantly against the US dollar. With their currencies pegged to the US dollar, this constituted a "double blow" for the South East Asian countries, "squeezing them from above and from below" (ibid.). In sum, the inflationary pressure and the appreciation of their currencies against the Japanese and Chinese currencies put the Southeast Asian countries in a difficult situation. With a "squeeze on exports" and a "cheapening of imports", soon "all four Southeast Asian economies ran current account deficits of between 4 and 8% of GDP, Thailand's being the biggest of all" (ibid.). In a situation of capital abundancy (high savings plus foreign capital inflows) and with "reduced prospects for export-oriented manufacturing", investors in Southeast Asia turned to real estate:

Property speculation flourished, and went on flourishing as foreign currency continued to pour in and the domestic money supply continued to expand. As people expected inflation to continue, property investment continued to appear the best hedge. For several years in the first half of the 1990s property prices in Bangkok rose at more than 40% a year (Wade 1998a: 1541).

"Thailand's private sector-generated property bubble burst in 1995, and the stock market crashed in mid-1996" (ibid.). "When the property market crash came", Wade explains, "it ripped through the whole financial sector and on into the foreign exchange market as foreign investors saw that domestic borrowers were less able to meet the now much more expensive debt service charges on their short-term foreign loans" (ibid.).

As economic growth and export growth "slowed sharply", "the prospect of a baht devaluation" made companies in Thailand, both foreign and domestic, try "to sell their baht for dollars" (ibid.). "There were runs on the baht in mid-1996 and again in early 1997", and while "the Thai central bank tried to buy up baht" to defend the exchange rate, eventually it "gave up as reserves fell to dangerously low levels" (ibid.). In early May 1997, rumours spread that the Japanese would increase their interest rate, and this, combined with "worries … circulating about Thailand's currency", to raise "fears among commercial bankers, investment bankers, and others about the safety of big investment positions throughout the region that were predicated on currency stability" (ibid.). Once again, investors sold holdings in Thai baht, and in early July 1997 "the Thai baht was floated and sank" (ibid.).

In August 1997, "the IMF stepped in with a support package and 'conditionality' measures that included the freezing of many finance companies" (Wade 1998a: 1541–42). "This was the start", Wade argues, paraphrasing Jeffrey Sachs, of the IMF "screaming fire in the theatre": "The freezing of finance companies sent uninsured depositors into a panic" (Wade 1998a: 1542). Whereas previously international investors and international rating agencies "had focused on *macro*economic factors such as budget deficits, debt/GDP ratios, and export growth", after the shock of the Thai devaluation, they "suddenly began to reevaluate risk and focused on … *micro*economic risks such as the volume of dollar debt maturing in the next 12 months, the debt/equity ratios of the corporate sector, and the currency denomination of foreign liabilities" (ibid., emphasis in original). From this new risk perspective, Wade argues, "*all* the Southeast Asian currencies suddenly looked vulnerable, since all the economies had a significant overhang of short-term dollar debt whose repayment looked problematic if exchange rates were to collapse" (ibid., emphasis in original). In combination with the IMF's insistence that Thailand should undertake comprehensive "structural and institutional reforms", which "signalled to international investors that the whole economy was in a much deeper mess than they had assumed" (ibid.), this refocusing of risk stimulated a selling pressure on currencies throughout the region. As Malaysia and Indonesia soon followed Thailand in letting their currencies float, investors and local companies were confirmed "in thinking that a competitive devaluation in Southeast Asia was underway, the rational response to which was to sell as much local currency as possible—thereby fulfilling the prophecy" (ibid.).

In mid-October Taiwan devalued its currency, and though the devaluation was small (about 12%), "it came as a shock" because Taiwan was "famous for its towering foreign exchange reserves" (ibid.). "That Taiwan could devalue", Wade explains, "led the owners of mobile capital to fear that Hong Kong might do the same, and Korea too" (ibid.). Thus, Taiwan came to be "a fire bridge from Southeast to East Asia" (ibid.).

By this time, around October and November 1997, the whole region was awash with panic. Investors began to pay attention to the term structure of Korea's foreign debt. They estimated short-term debt at $110 billion, more than three times Korea's official foreign exchange reserves. Rumours circulated that President Kim ..., not wanting to finish his term embroiled in crisis, might be inflating the true level of the exchange reserves and concealing some of the debt. Investors scrambled for the exit, accelerating the fall of the won (Wade 1998a: 1543).

"Since Korea competes with Taiwan, Hong Kong, and southern China in many industries", Wade observes, investors "saw risks of a further round of competitive, crisis-driven devaluations of the Hong Kong and Taiwan dollars" (ibid.). A "net inflow of private capital of $93 billion in 1996" to Southeast Asia and Korea became a "net outflow of an estimated $12 billion in 1997, a swing in the net supply of private capital of $105 billion in just one year" (ibid.). "This is 11% of the pre-crisis GDP of the five economies, a staggering change", Wade observes (ibid.).

THE IMF'S KOREA STRATEGY

In December 1997, the IMF "organized $57 billion from official sources to lend to Korea so that its private companies could repay US, Japanese and European banks as the short-term debt came due" (Wade 1998a: 1543). "If the Fund's earlier interventions in Thailand and Indonesia amounted to screaming fire in the theatre", Wade argues, "then its intervention in Korea amounted to screaming even louder" (ibid.). While the IMF had insisted on "far-reaching institutional reforms" in Thailand, in Korea the IMF "demanded nothing less than an overhaul of the Korean economy, beginning with the financial system and continuing into corporate governance, labour markets, and the trade regime; as well as a contractionary macroeconomic policy of higher taxes, cuts in government spending, and much higher real interest rates" (ibid.). The IMF "said it would provide the credit only as Korea altered these central features of its economy", and thus the "signal of fundamental unsoundness was even louder than earlier for Thailand and Indonesia" (ibid.). The main components of the IMF restructuring programme for Korea were the following: first, troubled financial institutions were to be closed down or recapitalized; second, foreign financial institutions were to be able freely to buy up domestic ones; third, banks were to follow Western ("Basle") prudential standards; fourth, international (read "Western") accounting standards should be followed; fifth, the government was required not to intervene in the lending decisions of commercial banks, to eliminate all government-directed lending and abandon any measures to assist individual corporations to avoid bankruptcy, including subsidized credit and tax privileges; sixth, Korea's capital

account should be further opened, to enable even freer inflow and outflow of capital, and all restrictions on foreign borrowings by corporations were to be eliminated; seventh, the trade regime should be further liberalized, to remove trade-related subsidies and restrictive import licensing; and finally, labour market institutions and legislation should be reformed 'to facilitate redeployment of labour' (Wade 1998a: 1543–44).

Not only did these requirements "go far beyond" what was "necessary to restore Korea's access to capital markets"; the package failed to bring a halt to the deterioration of Korea's foreign exchange reserves (Wade 1998a: 1544).

THE DOWNWARD SPIRAL

Soon, a "huge contractionary wave propagating itself through the region" resulted (Wade 1998a: 1544). International banks "slashed credit lines to all borrowers", Wade explains, including export-oriented firms that would otherwise have benefited "from currency depreciation" (ibid.). "Even the big Korean *chaebol*, with worldwide brand names" soon found it "difficult to get even *trade* credit" to "cover the import of inputs into export production" (ibid.). Further, "the much higher real interest rates and cuts in domestic demand required by the Fund" were "tipping many profitable but high debt/equity firms into bankruptcy" (ibid.). Moreover, "meeting Western standards for the adequacy of banks' capital entails a rapid fall in banks' debt/equity ratios", Wade explains, and consequently "a sharp cut in their lending, causing more company bankruptcies" (ibid.). In the face of massive company bankruptcies, the corporate sectors of the region were "being offered at fire-sale prices", and only outsiders had "the capital to buy them up or to recapitalize existing banks" (ibid.). Thus, Wade contends, "we may be in the early stages of a massive transfer from domestic to foreign ownership", which will not just entail a "transfer of control and profits", but also "affect the basic dynamic" of the Asian economies (ibid.).

Wade is not impressed by the role of the IMF in the course of the crisis. It seemed "particularly unwise", he argues, for the IMF to insist "that companies receive even more freedom than before to borrow on international capital markets on their own account, without government coordination, when it was their uncoordinated borrowing that set up the crisis in the first place" (ibid.). "This will make the country more, not less, vulnerable to capital flight", he notes. The attempt by the IMF to "dismantle the high debt system" was problematic not only because this system had clear "developmental advantages", but also because the attempt to create a "Western-type financial system" introduced a new "source of instability", resulting from the fact that the Asian system of "household deposit savings" is not easily integrated "with a financial structure based on Western norms of prudent debt/equity ratios" (ibid.).

TURNING POINTS

"Any coherent account of the crisis runs the danger of making it look inevitable", Wade argues. "In fact, things could have been different", he continues, and then provides a list of seven factors that could have halted the accelerating panic (Wade 1998a: 1545). First, he argues, "had Japan addressed its banking problems earlier … through a debt reconstruction program … Japanese banks would not have had to slash their refinancing to [Asian] borrowers in the autumn of 1997" (ibid.). Second, "had the Japanese government pledged $10 billion to the IMF package for Thailand in August 1997, rather than $4 billion", he contends, confidence might "have been restored" (ibid.). Third, "had the US congress … been less isolationist, less opposed to any government largesse abroad", Wade contends, it might not have "put a restriction on the use of public resources for such purposes as the Thai package", and it might not have "objected to increasing the IMF's resources" for such packages (ibid.). Fourth, "had developing countries liberalized their financial systems more slowly", thus "resisting Western pressure for rapid liberalization", then "the domestic lending excesses and vulnerability to outflows of hot money would have been curbed", he notes. Fifth, "had developing country political leaders been prepared", he argues, to "check wild real estate investment and speculation in junk bonds, the vulnerabilities would also have been less" (ibid.). Sixth, "had there had been 'sand in the wheels' of the international financial system (such as a tax on international currency transactions), the build-up to crisis" may had been slowed, he argues. Finally, had the IMF focused "less on mobilizing a bail out fund and more on organizing debt rescheduling negotiations between the debtors", thus sticking with "its mandate of helping countries to cope with temporary foreign exchange shortages and regaining access to international capital markets" then, he argues, "its prescriptions might have looked less like screaming fire in the theatre" (ibid.).

CAPITAL OPENING AND THE WALL STREET-TREASURY-IMF COMPLEX

"Perhaps the single most irresponsible action in the whole crisis", Wade contends, "was capital account liberalization without a framework of regulation" (ibid.). By this action, Wade argues, economies that were "built for patient capital" were exposed to "short-term financial pressures", which "allowed the private sector to sidestep domestic monetary restrictions via foreign borrowings", which in turn helped "cause currency overvaluation" (ibid.). "The blame is shared between national governments and international organizations", Wade contends, but "it has to fall disproportionately on the IMF, that for several years now has been pushing hard for capital account opening" (ibid.). "Why has the Fund

been pushing capital account opening ... in countries that are awash with domestic savings", Wade asks, and why did it go "so far beyond its traditional concern with balance-of-payments adjustments ... , seeking to impose on Thailand, Indonesia and Korea institutional free-market reforms"—even though such reforms were not "necessary to restart the flow of funds?" (ibid.). And "why", he asks, did the IMF do "so little to organize debt *rescheduling* negotiations, preferring to seek additional bail-out funds from G-7 governments and then give them out *in return for structural and institutional reforms?*" (ibid., emphasis in original).

The "deeper answer involves", Wade argues, "the interests of the owners and managers of international capital" (ibid.). Wade cites Nobel Laureate James Tobin for the contention that Asian countries were the "victims" of a "flawed international exchange rate system that, under U.S. leadership, *gives the mobility of capital priority over all other considerations*" (Tobin, cited in Wade 1998a: 1546, emphasis in original). Wade quotes another prominent economist, Jagdish Bhagwati, professor of economics at Columbia University, known for his strong support of free *trade*, for arguing that the reason why the IMF was seeking to open financial markets was that Wall Street had "become a very powerful influence in terms of seeking markets everywhere":

Morgan Stanley and all these gigantic firms want to be able to get into other markets and essentially see capital account convertibility as what will enable them to operate everywhere. Just like in the old days there was this "military-industrial complex", nowadays there is a "Wall Street-Treasury complex" because Secretaries of State like Rubin come from Wall Street ... So today, Wall Street views are very dominant in terms of the kind of world you want to see. They want the ability to take capital in and out freely. It also ties in to the IMF's own desires, which is to act as a lender of last resort. They see themselves as the apex body which will manage this whole system. So the IMF finally gets a role for itself, which is underpinned by maintaining complete freedom on the capital account (Bhagwati, cited in Wade 1998a: 1546).

Wade further cites Bhagwati for the assertion that "many countries have grown well without capital account convertibility, including China today and Japan and Western Europe earlier", and that, in Bhagwati's judgment, "it is a lot of ideological humbug to say that without free portfolio capital mobility, somehow the world cannot function and growth rates will collapse" (ibid.).

Wade develops these observations further, asserting that "US and UK financial firms ... can gain hugely ... in an institutional context of arms-length transactions, stock markets, open capital accounts and new financial instruments", and that their "respective Treasuries are deeply

responsive to their needs and Jesuistic in their commitment to the neoclassical 'Washington Consensus'" (ibid.). He further notes that the US Congress has "passed a bill saying that no US funds may be made available to the IMF" until it is certified that all G-7 governments agree in public that any borrower countries will be required to liberalize trade and investment and to eliminate "government directed lending on non-commercial terms" and "provision of market distorting subsidies to favoured industries, enterprises, parties or institutions" (ibid.). Further, Wade argues, this "extended complex" has led to a "process of amending the IMF's articles of agreement to require member governments to remove capital controls and adopt full capital account convertibility" (ibid., emphasis in original). The agenda of financial liberalization has been further pursued by the IMF, Wade argues, in the context of the 1996–97 WTO agreement "on liberalizing financial services" (ibid.). Although "many developing country governments, including … several Asian ones, opposed the WTOs efforts to liberalize financial services", the agreement was ultimately signed in December 1997, in the midst of the Asian crisis (ibid.). By signing the agreement, "more than 70 countries" committed themselves, Wade explains, "to open banking, insurance and securities markets to foreign firms" (ibid.). At the time, Thailand and Malaysia "saw no choice", Wade contends; "either they signed or their receipt of IMF bail-out funds would be complicated" (ibid.). "Meanwhile", Wade observes, the OECD had been "pushing ahead with the negotiation of the Multilateral Agreement on Investment, that liberalizes all direct foreign investment restrictions, requiring signatory governments to grant equal treatment to foreign as to domestic companies", an agreement that would in effect "preclude many of the policies of the developmental state" (ibid.). There was, in other words, a concerted effort on behalf of these international institutions, Wade argues:

These events—the revision of the IMF's articles of agreement, the WTO's financial services agreement, and the OECD's Multilateral Agreement on Investment—are the expression of a Big Push from international organizations, backed by governments and corporations in the rich countries, to institute a worldwide regime of capital mobility that allows easy entry and exit from any particular place (Wade 1998a: 1546–47).

Wade observes that to the extent that these agreements are "ratified and enforced", they will "help secure the predominance of the Anglo-American system" (Wade 1998a: 1547). "That system", he argues, based as it is "on maximizing returns through the optimal allocation of the existing stock of capital and savings", is "suited to maintaining stability" in high-income countries, whereas the Asian system which focuses "on the accumulation of capital and deliberate creation of Schumpeterian rents through the acquisition of new technology", is "suited to [stimulate] fast growth"

(ibid.). “As long as the Asian system operates on the basis of long-term relationships and patient capital”, Wade argues, “Anglo-American capital is at a disadvantage in these markets”—and this is why the ‘extended complex’ felt that “the Asian system must be changed” (ibid.). For “what is the point”, Wade asks, “of being the core, the hegemon, if the periphery does not do what you want?” (ibid.).

“There is always a fine line to be trod”, Wade observes, “between an interest-based theory and a conspiracy theory” (ibid.). “It is difficult to know”, Wade notes, “to what extent and at what point some events in the Asian crisis were deliberately encouraged by those who stood to gain from the sudden loss of resources by Asian governments and from the opportunities to gain control of Asian companies at knock-down prices”.

Whatever their degree of intentionality and their methods of concerting strategy, there is no doubt that Western and Japanese corporations are big winners from the Asia crisis. Their euphoria is nicely caught in the remark by the head of a UK-based investment bank, ‘If something was worth $lbn yesterday, and now it’s only worth $550m, it’s quite exciting’ (Wade 1998a: 1547).

THE FUTURE

In the final section of his article, Wade reflects on the implications of the crisis for the future with regard to East-West relations and the international financial regime in particular. Before proceeding to the latter of these, I shall briefly indicate the nature of Wade’s reflections on the former.

“The crisis will leave a legacy of resentment towards the West”, Wade argues, and quotes then Malaysian prime minister, Mahathir Mohamad, for stressing that Malaysians “must be willing to make sacrifices in defending the country’s currency or risk being ‘recolonized’ by foreign powers:

The fall in our currency’s value has made us poorer, exposing us to the possibility of being controlled by foreign powers. If this happens, we will lose the freedom to run our country’s economy and with it our political freedom also. In short, we will be re-colonized indirectly … We cannot give up and surrender. We must be willing to face challenges, willing to sacrifice in defending our freedom and our honour (Mahathir, cited in Wade 1998a: 1548).

Wade further cites Henry Kissinger, former US Secretary of State, for the warning that even Asian friends “whom I respect for their moderate views, argue that Asia is confronting an American campaign to stifle Asian competition” (Kissinger, cited in Wade 1998a: 1548).

The Asian crisis not only given a new centrality to the IMF, but had also resulted in its "coming under renewed scrutiny" (ibid.). One predominantly line of questioning lies, Wade argues, in whether IMF bailout programmes result in a moral hazard problem, encouraging "lenders and borrowers to be careless, believing that they will be bailed out with little loss" (ibid.). In Wade's view, this is "almost certainly not" the case—"although the opponents of the IMF have managed to convince many US congressmen that the Mexican bail out in 1995 helped to create the conditions for the Asian crisis" (ibid.). These critics assume, Wade argues, "that the prospect of IMF support was an important reason for largescale lending to Asia", whereas, "more likely", it was "the perception of Asia as a growth machine [that] attracted the funds" (Wade 1998a: 1549–1550).

Instead, Wade argues, the crisis "should provoke a Bretton Woods II, a fundamental debate about the character of the international financial regime in the post-Cold War world", focusing on the following set of questions (Wade 1998a: 1550):

- Should we make a sharp distinction between free trade and free capital movements, seeking to encourage the former while constraining the latter?
- Are international financial markets "efficient," can they fail, can speculation be destabilizing?
- Has the growth of derivative markets and other forms of leverage created the preconditions for aggressive intermediaries, such as hedge funds, to disrupt the financial markets of smaller countries?
- Does the growing securitization of credit in response to the emergence of pension funds and mutual funds require the development of new forms of financial supervision comparable to those which have long existed for banks?
- How can developing countries obtain the benefits of international lending—in terms of investing more than they save—while limiting their exposure to the costs of unstable flows?

"At the forefront" of these discussions should be, Wade argues, "the absence of empirical evidence that capital account convertibility is good for developing countries", and "the abundance of historical evidence that free international capital markets are prone to excesses that result in high social costs" (ibid.).

Wade is aware, of course, that measures to limit capital mobility will meet considerable resistance from what he termed the (extended) Wall Street-Treasury-IMF complex:

Vast profit opportunities, including those of the foreign exchange markets and the derivatives markets, would shrink, [and] hundreds of thousands of employees would be laid off. Moreover, the US government would lose one of the great assets of hegemonic status: the

ability to create enough credit to sustain domestic expansion and project military force abroad at the same time, without raising taxes or interest rates (Wade 1998a: 1550).

"This paper has presented the crisis not as a symptom of the weakness of 'Asian state capitalism'", Wade states towards the end of his paper, "but as the result, on one level, of a collective action problem, in which each lender tries not to refinance for fear that others will not also refinance" (ibid.). "At a deeper level", however, "the crisis is a symptom of the weakness of a regime of international credit creation with insufficient limits and rules, in which such crises are endemic", he argues—referring to similar events in Latin America in the 1980s, in Mexico in 1994, in the US in 1980s (ibid.). "In each case", he explains, "excessive debt" was created, and "the government then [squeezed] the "real" economy … in order to repay the creditors" (ibid.). "We must now learn the lesson", Wade argues: "the solution has to involve regulation of international credit creation and of short-term capital movements", that is, "a new regime of international finance" (ibid.). In support of this contention Wade cites Martin Wolf, columnist for the *Financial Times*, "one of the three main organs of world capitalist views":

"[I] is impossible to pretend that the traditional case for capital market liberalization remains unscathed. Either far greater stability than at present is injected into the international monetary system as a whole or the unavoidably fragile emerging countries must protect themselves from the virus of short-term lending … After the crisis, the question can no longer be whether these flows should be regulated in some way. It can only be how." (Wolff, cited in Wade 1998a: 1550)

7

Two to Tango?

INTRODUCTION

The objective of this chapter is first and foremost to problematize the debate on the Asian crisis. The debate proceeded *as if* the appropriate policy response to the Asian crisis could be identified by 'getting the causation right', by identifying the 'main' cause. But the causation of the Asian crisis was inescapably dual, in the sense that there could be no 'excessive borrowing' on the part of Asian economies, without 'excessive lending' on the part of international (Western, Japanese) financial institutions. Hence, whether an author identifies 'crony capitalism' in Asia or the misguided policies of the IMF as the 'ultimate' cause, this is analytically invalid. Attribution of blame and policy responsibility can only be normative, based on moral judgment. Unfortunately, the belief that an 'ultimate' cause exists which may be identified precludes serious and sober analyses of the pros and cons of different policy strategies. Instead, key issues are conflated and the political, moral and normative issues obfuscated. Eventually, all this played a key role in making the IFA initiative appear a 'necessary' response to the financial crises of the 1990s in general, and to the Asian crisis in particular.

Before proceeding to this problematization of the debate on the Asian crisis, an analysis of the four narratives set out in the preceding chapters is proposed (section 1), based on the theoretical framework outlined in Chapter 2. This leads to a brief comparison of the narratives, highlighting a few of their main differences, as well as identifying the four main lines of problematization that constitute the debate (section 2). With these analyses providing the general background, the final section of the chapter problematizes the debate on the Asian crisis, focusing particularly on the relationship between the 'mainstream' narratives and the policy response of 'the international community' (section 3).

GOVERNMENTALITY ANALYSIS OF THE FOUR NARRATIVES

This section summarises each of the four narratives, using the categories developed in Chapter 2 for a governmentality analysis of them: causality, epistemology, morality and policy.1 One of these dimensions, epistemology,

is used to organize a comparison of the narratives after the summaries. A brief recapitulation of definitions (cf. Chapter 2) is warranted:

- Causality: accounts of cause and effect
- Morality: attribution of innocence and blame; assignment of responsibility
- Epistemology: conceptions of key actors and objects
- Policy: allocation of tasks and challenges; governmental technologies; values and ideals

BARRY EICHENGREEN'S NARRATIVE

Causality

Eichengreen notes that East Asian economies, "since the early 1980s", had experienced "high economic growth", "fuelled by high rates of savings and investment", "sound macroeconomic policies" and "outstanding export growth". By 1996, however, some "disquieting signs" were beginning to show: current account deficits had increased; export growth rates were slowing; equity prices were falling and exposure to foreign capital had become high. These were all signs indicating the "three sources of vulnerability" that the East Asian economies suffered from, Eichengreen argues: macroeconomic imbalances, financial sector weaknesses and short-term maturity of debt. The financial systems of the afflicted countries were "bank-led", and in such bank-led financial systems, Eichengreen contends, banks are considered "too big and too important to fail". This meant that banks "enjoyed government guarantees that promised to bail them out of any and all difficulties". Moreover, the financial systems in the afflicted countries were characterised by inadequate supervision and regulation. This allowed them to "rely excessively on high-cost foreign funding" and "saddle themselves with non-performing loans", Eichengreen explains. The accumulation of "large stocks of short-term debt denominated in foreign currency that had to be rolled over regularly" constituted a "stock problem", Eichengreen argued, in addition to the "flow problem" of needing to continuously "attract capital inflows to finance their current account deficits". Thus, although East Asian economies had enjoyed high growth for a long period, there were nevertheless macroeconomic "difficulties" associated with the Asian development strategy. Access to international capital helped disguise these difficulties for a while, but at the end of the day this "only set them up for a harder fall". The Asian development strategy was "a formula that could not work forever"; "the days when East Asian governments could 'pick winners' ... allowing them to minimize the role of the market mechanism [were] long past". "Ultimately", Eichengreen argues, the explanation for the crisis lay in the Asian development strategy and

trajectory, "which relied on bank-centred financial systems, the use of banks as instruments of industrial policy, and close connections between banks and politicians"—in brief, "crony capitalism".

Morality

Asian governments were guilty of "weakness" in two main respects. First, they committed the crucial blunder of failing to upgrade financial supervision and regulation. Second, they failed to "take bold measures'" when the crisis hit. In the case of Thailand, for instance, an initiative to raise revenues for the purpose of recapitalizing the banking system by increasing gasoline taxes was reversed "in response to public pressures". Generally, Asian economies suffered from 'vulnerabilities' that required their governments to pursue "painful policies". Had such policies been implemented, Eichengreen argues, Asian economies might well have "escaped the zone of vulnerability", before a "shock to confidence occurred". In this weak regulatory regime, Asian financial intermediaries were allowed to "rely excessively on foreign funding" and "over-commit to the property market and industry". Asian financial intermediaries were half victims of their weak governments, half victims of their own excesses, in other words. These 'excesses' bore witness, in turn, of the 'immaturity' of Asian financial intermediaries vis-à-vis modern, global finance, Eichengreen argues. The role of international investors, on the other hand, was merely one of responding to market signals. International investors were increasingly concerned, Eichengreen contends, with the sustainability of growth in the Asian economies and thus eventually responded to a series of shocks to their 'confidence' by withdrawing capital from these economies.

Policy

Eichengreen articulates "five lessons" that follows from his "interpretation of the crisis". The first two of these consist in the contention that policymakers must "appreciate the importance of insuring themselves against financial tremors by avoiding "excessive [current-account] deficits"—particularly, deficits financed in the form of short-term borrowing "denominated in foreign currency". A further lesson of the Asian crisis is, Eichengreen argues, that in developing countries "banks are a special source of vulnerability", and thus must be carefully regulated and supervised, and certainly *not* be used as "instruments of industrial policy and conduits for the transfer of foreign funds". Moreover, developing countries should "move toward more flexible exchange rates", because this would give banks and corporations an "incentive to hedge their foreign exposure" and thereby improve their ability to "cope with financial turbulence if and when it occurs".

PAUL KRUGMAN'S NARRATIVE

Causality

Krugman stresses the absence of serious macroeconomic difficulties. Unemployment was low, inflation rates were low, government budgets were in balance, etc. Krugman does mention, briefly, that current account deficits were high in Thailand, but does not accord this a central role in explaining the crisis. To Krugman, the "real driver" of the Asian crisis was the "boombust cycle" in asset prices. Asian economies were characterised by the presence of government guarantees to financial intermediaries, implicitly promising to bail them out if their investments failed. Government guarantees, in combination with under-regulation, encouraged over-lending by domestic financial intermediaries, Krugman argues. In the absence of access to international capital markets, this "excessive investment demand" would not have translated into *actual* excessive investment, he stresses, but would merely have driven up the interest rate. In Krugman's account, thus, it was a combination of three factors that created "financial excess" and eventually "financial collapse": (i) moral hazard as a consequence of government guarantees, (ii) under-regulation of financial intermediaries, and (iii) capital account liberalization. These three factors proved to be a lethal combination. Asian economies engaged in massive foreign borrowing which led to excessive domestic investment, creating an asset bubble which, eventually, made the entire financial system collapse, throwing the economies into "severe real downturn".

Morality

To Krugman, it all boils down to the "implicit government guarantee" in the context of an "essentially unregulated" financial market. Asian governments hence were culpable of "over-guaranteeing and under-regulating financial and corporate sectors". This resulted in "severe moral hazard problems", which in turn led to "excessive risky lending'" and "overpricing of assets". Asian financial and corporate sectors were victims of flawed government policies, in other words. The same goes for international investors; expecting that Asian financial intermediaries would be bailed out, they were equally prone to moral hazard problems. Again, international investors are responsive and rational, given the circumstances, and by and large innocent.

Policy

Krugman differs from the other three authors by concluding his paper not by drawing lessons, but touching upon some of the aspects that the model he proposes does not account for. Most importantly, he notes that there are

"other kinds of market failure, notably 'herding' by investors", that have "some explanatory role to play", although these are not part of his model. Nevertheless, the main lesson that Krugman's narrative deliver is that a financial system which is "over-guaranteed" and "under-regulated" is prone to a new type of financial crisis that can occur even when the "macroeconomic fundamentals" are good. Asian governments should, by implication, abandon implicit government guarantees and upgrade financial regulation.

JOSEPH STIGLITZ'S NARRATIVE

Causality

Asian economies had been extremely successful for three decades, both in terms of growth and stability and in raising the living standards of "millions of people". In contrast to Eichengreen and Krugman, Stiglitz stresses that in addition to their exceptional economic growth these economies suffered "fewer downturns over the three previous decades than any other advanced industrial country". "No other set of countries had managed", he notes, "to save at such [high] rates" and to invest the funds so well. Whereas Eichengreen and Krugman perceive capital account liberalization as a 'messenger', exposing the fundamental weaknesses of Asian financial systems, Stiglitz sees it as "the single most important cause of the crisis"—and as completely unnecessary, as the East Asian economies were doing extremely well and had no need for "additional capital". Stiglitz's explanation for the Asian crisis reads almost as a direct reply to Eichengreen: "if East Asia was vulnerable, it was a newly acquired vulnerability—largely the result of capital and financial market liberalization". To Stiglitz, the IMF's policy of pushing for capital account liberalization was a huge mistake. There was ample evidence, Stiglitz argues, that such policies were precisely what underlied the "increasing frequency of crises". Adding fuel to the flames, the IMF's policy response exacerbated the financial crisis and its destructive impact on Asian banks, companies and households, Stiglitz continues. First, a recession was created by pursuing a set of contractionary policies (balanced budgets, high interest rates, trade surpluses through income reduction), which was the exact opposite of what was needed. Second, by confusing real restructuring with financial restructuring, the IMF failed to realize the importance of 'keeping credit flowing', so crucial to recovery from crisis.

Morality

Stiglitz stresses the role of IMF, both in creating the crisis and in subsequently aggravating it. First, the IMF insisted on rapid capital account liberalization despite both theoretical and empirical "evidence" of its detrimental effects, and secondly, it prescribed a set of policies that were

contractionary, when what was needed was in fact the opposite, Stiglitz argues. In addition to the role of the IMF, Stiglitz touches briefly on the incentives involved for international investors. Stiglitz explains the gain made by an international investor speculating in a devaluation of the baht. Imagine, says Stiglitz, that an investor "goes to a Thai bank, borrows 24 billion baht", converts it "into $1 billion", and then converts $600 million back "a week later", after the Thai exchange rate has fallen. He will then be able to repay the 24 billion baht he borrowed and keep the remaining $400 million as his profit—"a tidy return for one week's work". There is hardly any mentioning in Stiglitz's account of the role of Asian governments, or the role of Asian financial intermediaries—which were the focus for Krugman and Eichengreen. Only indirectly does he comment on the Asian side of the equation, contending that "even when countries have strong banks, a mature stock market, and other institutions that many of the Asian countries did not have", capital account liberalization can "impose enormous risks". Stiglitz agrees, it seems, that Asian economies were, in some senses, not 'strong', not 'mature'—but argues that this had little to do with either the onset or the aggravation of the Asian crisis. In Stiglitz's view, capital account liberalization "all too often represents risk without reward", and he finds little reason to believe that "*any* country could have withstood the sudden change in investor sentiment". In sum, capital account liberalization, pushed by the IMF, induced the crisis, which only became as severe as it did, however, because the IMF imposed contractionary rather than expansionary policies.

Policy

To Stiglitz, the main lesson to be learnt is that when a crisis threatens, it is of paramount importance that expansionary policies are pursued—not contractionary policies, for these will only aggravate the situation; in fact, such policies may be the key factor in bringing about a crisis that might otherwise have been avoided. The IMF must reverse its rigid insistence on contractionary policies, Stiglitz stresses. A further lesson is, he argues, that when a crisis threatens it is of paramount importance that policies assure that credit keeps flowing—and thus, both the IMF and national governments must focus on quick debt rescheduling, ensuring the survival of "profitable but distressed banks and firms".

ROBERT WADE'S NARRATIVE

Causality

To understand the Asian crisis, one must first understand the Asian model of capitalism, Wade argues. In Asia, household savings are "for the most part deposited in banks rather than invested in equities", which means that

banks in Asia have the role of intermediating "a huge inflow of savings", he explains. With households being net savers, with little of the savings invested abroad, and with government not being "a major borrower (in contrast to most of the G-7 countries)", borrowers "must be firms and other investors", Wade observes. This is why one finds "high ratios of debt to equity in the corporate sector" in Asian economies. Firms that have a high level of debt to equity "are vulnerable to shocks that disturb" the flow of capital, Wade explains, for whereas equity requires "a *share* of profits", "debt requires a *fixed* level of repayment". Therefore, "the higher the debt-to-equity ratio" the more likely it is that a "depressive shock will cause illiquidity, default and bankruptcy". This is why another part of the Asian system is that banks and firms "cooperate to buffer systemic shocks" and that governments support this cooperation. This need for government support, in turn, "gives the government a powerful instrument for influencing the behaviour of both firms and banks", Wade explains. The 'high-debt model'—with its focus on accumulation and high rates of investment, mediated through banks and predicated upon "long-term relationships" between business, credit and the state—is geared towards generating rapid economic growth. Wade calls this model "alliance capitalism", rejecting the term "crony capitalism". The Asian model of 'alliance capitalism'—often understood negatively, "in *political* terms"—does in fact have an important *economic* rationale, Wade stresses. This understanding of the Asian model of capitalism leads to the following interpretation of the Asian crisis. The developmental strategy of East Asian economies was predicated on high savings by households which translated into high debt-to-equity ratios in the corporate sector, a model which had clear, developmental advantages. With capital account liberalization and the absence of a framework to regulate foreign borrowing, highdebt practices of the banks and firms in the East Asian economies were extended to foreign capital. This not only contributed to the overvaluation of the currencies of these economies, but made them extremely vulnerable to foreign capital flows. Thus, when the crisis came it was to a large extent beyond the ability of the East Asian "alliance capitalism" to cope with.

Morality

To Wade the "single most irresponsible action in the whole crisis was capital account liberalization without a framework of regulation", because this exposed East Asian economies "built for patient capital" to "short-term financial pressure". This was problematic, Wade argues, not only because it was key in bringing on the crisis in the first place, but also because it introduced a whole new type of vulnerability in these economies, stemming from the fact that the Asian system of high household savings was not easily integrated "with a financial structure based on Western norms of prudent debt/equity ratios". Wade hence shares with Stiglitz a critical perspective on the role of the IMF, although for Wade, the role of the IMF is seen in the broader context of a 'Wall Street-US Treasury- IMF complex'. From this perspective, the IMF's

advocacy of capital account liberalization is a result of the influence of Wall Street interests on the policies of the US Treasury. Like Stiglitz, Wade touches on the incentives involved for international investors, noting the financial gains to be made from buying Asian companies at "knock-down prices". To illustrate, Wade cites the head of UK-based investment bank for his excitement about being able to buy something that "was worth $1 billion yesterday" for only "$50 million" the day after. Wade shares with the other authors the contention that the corporate and financial sectors of the afflicted Asian economies were, in some senses, 'immature'. Thus, he stresses that bank and finance companies "still operate ... as family businesses with management structures unable to cope with the complexity of present-day finance", and that capital account liberalization made it possible for these "inexperienced" financial intermediaries to "take out large, dollar-denominated loans" in response to the prospect of high profits based on cheap foreign credit. Wade's primary criticism of Asian governments is that they bought "the monetarist view that inflation control should be the overriding priority ... and that the exchange rate should be an 'anchor' for inflation control".

Policy

Wade differs from Eichengreen and Krugman in arguing that, in his perspective, the Asian crisis was by no means a "symptom of the weaknesses of 'Asian state capitalism'". Instead, Wade sees the crisis as a "symptom of the weakness of a regime of international credit creation with insufficient limits and rules, in which such crises are endemic". Thus, to Wade, the lesson that "we must now learn" is that "the solution has to involve regulation of international credit creation and of short-term capital movements"; in brief, it has to involve the construction of "a new regime of international finance" (ibid.).

COMPARISON OF THE NARRATIVES

Differences among the four authors are substantial, in other words. Krugman characterizes the East Asian economies by means of a moral hazard model, arguing that the crisis was mainly about bad banking. Eichengreen describes what he sees as the three sources of vulnerability in Asian economies, and argues that the Asian model of 'picking winners' was bound to fail sooner or later. Stiglitz argues that there was 'more to praise than to condemn' in the Asian model of capitalism, and that the collapse of the afflicted economies had little to do with the Asian model and everything to do with capital account liberalization and misguided IMF policies. Finally, Wade explains the logic of the Asian high-debt model, emphasizing the developmental advantages of "alliance capitalism". Given that each narrative has already been summarized in significant detail (Chapter 3 to 7), I present the comparative analysis of key *conceptions* in schematic form:

Table 7.1 Key Conceptions in the Four Narratives

	Eichengreen	*Krugman*	*Stiglitz*	*Wade*
Conception of Asian model of capitalism	'Crony capitalism'—unsustainable in the long run	Subject to severe 'moral hazard problems'—prone to new type of financial crisis	'Economic powerhouse'—unprecedented economic growth and stability	'Alliance capitalism': substantial 'developmental advantages'
Conception of Asian governments	Weak: 'crucial blunders' and unwilling 'to take bold measures'	'Over-guaranteeing' and 'under-regulating' their financial markets	'Misled' by the IMF to pursue a series of wrong policies	Huge variation in the role of the state in the region
Conception of Asian banks and other financial intermediaries	Rely excessively on foreign funding, and saddle themselves with non-performing loans	Make overly risky investments, believing that if investments fail they will incur no loss (cf. bail-out)	Absence of 'mature stock markets' etc.—but highly *stable* financial systems	Play key role in 'alliance capitalism', but 'inexperienced' vis-à-vis global finance

Two key differences need to be highlighted at this point. First, neither in Eichengreen's nor in Krugman's account is the role of the IMF problematized. Eichengreen does briefly mention the IMF, but only in referring to its pre-crisis attempts to 'warn' the Asian economies. If the role of the IMF is limited in Krugman and Eichengreen's accounts, the opposite is the case in the accounts given by Joseph Stiglitz and Robert Wade. Stiglitz, in particular, stresses the role of the IMF, both in bringing on the crisis and in subsequently aggravating it. Second, by stressing the financial interests of international investors in the Asian crisis, Stiglitz and Wade attribute a role to these actors that is fundamentally different from the merely 'responsive' and 'concerned' role alluded to by Eichengreen and Krugman.

Four Lines of Problematization

A revision of the typology developed towards the end of Chapter 2 may now be proposed. Just as problematizations of internal causes came in two species—Asian real economy causes versus Asian financial system causes—so do problematizations of external causes. One the one hand, there is the line of problematization already included in the typology, focusing on 'international excess liquidity'. On the other hand, there is a line of problematization that focuses on the role of international economic governance and crisis policies. Thus, in this sense, the selected narratives have indeed succeeded in both illustrating and 'stretching' the typology developed in Chapter 2;

instead of a trichotomy, we now have a typology consisting of four main lines of problematization, which may now be briefly explicated2.

First, a line of problematization focusing on *Asian real economy* causes sees excessive investment and the misallocation of funds as the result of non-market ('crony') relations between business, credit and the state. In this perspective, the Asian model of 'crony capitalism' was bound to fail sooner or later, because a system based on government guarantees and state-directed credit could not be sustainable in the long run. Secondly, the line of problematization focusing on *Asian financial system* causes argues that the economies involved failed to accompany liberalization of their capital accounts with the necessary up-grading of domestic financial regulation and supervision. Liberalising capital accounts without upgrading the institutional framework in the financial sector made it possible for financial intermediaries to accumulate non-performing loans. Had the proper institutional framework been in place, these economies would not have ended up with such high exposure to short-term foreign capital. The Asian crisis was, in other words, not a wholesale failure of the Asian model of capitalism, but a result of inadequate financial regulation and supervision to accompany the process of capital account liberalization. Thirdly, the line of problematization focusing on *international excess liquidity* contends that financial crises are endogenous to liberalized, internationally integrated financial markets. Financial crises occur frequently in different parts of the world as excess liquidity moves in and out of economies. In a situation with excess liquidity, flows of international capital will enter into economies where returns are high and will be withdrawn again as (expected) returns decrease. Such shifting capital flows are bound to create financial crises in the countries subjected to them. Finally, the line of problematization focusing on the role of *capital account liberalization and contractionary crisis* policy asserts that capital account liberalization as pushed by the IMF was the single most important factor in bringing on the crisis, which was then further aggravated by the pursuit of contractionary monetary and fiscal policies—the opposite of what is needed when a crisis threatens. In this account, there might have been no Asian crisis had it not been for the conventional wisdom about economic policy promoted *inter alia* by the IMF.

Each of these four lines of problematization are associated with a particular policy prescription. For the line of problematization focusing on *Asian real economy* causes, the implied policy prescription is to abandon government guarantees and state-directed allocation of resources, as these are the factors underlying over-borrowing and misallocation of funds in the first place. In the line of problematization that focused on *Asian financial system* causes, the implied policy prescription is to engage in a thorough upgrading of financial regulation and supervision, as the absence of such a regulatory framework is considered to be what made possible the excessive borrowing that caused the crisis. For the line of problematization that focused on *international excess liquidity*, the implied policy prescription

is to control, limit or regulate international excess liquidity and short-term capital mobility, as it is the sudden shifts in international capital flows that are seen to have caused the crisis. Finally, for the line of problematization that focuses on the role of *capital account liberalization and contractionary crisis policy*, the implied policy prescription is to reverse IMF conditionality and policy advice in favour of expansionary rather than contractionary policies, as well as suggesting temporary use of capital controls.

'IT TAKES TWO TO TANGO' …

Regardless of perspective, at least one thing is beyond dispute. There could have been no Asian crisis without both borrowing and lending; whenever someone borrows abroad, someone abroad is lending. All four authors acknowledge this duality in the causation of the crisis: Asian economies could not have build up high levels of foreign debt without foreign lending. Given that causation in this sense is dual, the attribution of blame for a situation of 'excessive exposure' cannot be 'objective' as opposed to normative. William McDonough, fomer President of the Federal Reserve Bank of New York, acknowledged this when commenting on the spectacular crash of the Argentinean economy in 2001. "It's like a nephew who becomes dependent on a very rich, doting uncle", he said. "Suddenly the uncle dies and leaves the money to someone else, or decides he doesn't love the nephew anymore and cuts him off. You can ask, who's responsible—the uncle or the kid?" (McDonough, cited in Blustein 2005:6). The metaphor of uncle and nephew is patronizing, of course, but the main point remains valid nonetheless: attribution of blame for 'excessive exposure' to foreign capital is not and cannot be anything but normative, a moral judgment. But in narratives on the Asian crisis there was a tendency to obfuscate moral judgments by arguing that one side of the *causation* was somehow 'more the cause' than the other, regardless of widespread recognition of the fundamental duality of the causation.3

Krugman therefore presented a model showing "how moral hazard can lead to over-investment at the aggregate level" (Krugman 1999:316). Discussing "how reasonable a picture this is of the Asian crisis", Krugman recognised that "it is clearly wrong to blame all of the over-investment and overvaluation of assets in Asia on domestic financial intermediaries" (Krugman 1999:316). "After all", he contended, "private individuals, and foreign institutional investors, did buy stocks and even real estate in all the economies now in crisis" (Krugman 1999:326). In the concluding remarks, however, Krugman argues that the Asian crisis was somehow "mainly" a crisis of "bad banking" in Asian countries (Krugman 1999:326).

Eichengreen deployed a similar rhetorical strategy. "It takes two to tango", he stressed: "[T]hese Asian policies would not have had such powerful effects had they not coincided with global conditions encouraging the US, European and Japanese banks to lend" (Eichengreen 1999:159–160).

In his concluding remarks on the causes of the crisis, the dual emphasis is collapsed, however. "*Ultimately*", Eichengreen contends, "the explanation for the crisis lies in the region's history and economic development trajectory", asserting that the Asian model of capitalism was "not a formula that could work forever" (Eichengreen 1999:162). Though there were two sides to the crisis, 'ultimately' the problem was that the Asian model was unsustainable in the long run. The duality of the causation is first recognised, then denied. The recognition of the duality of the causation is, in both Eichengreen's and Krugman's account, little but cosmetic, in other words. If this was a matter confined in its consequences to economics departments and popular economics magazines, perhaps one needn't worry too much about it. But the one-sidedness that characterise the narratives of Krugman and Eichengreen came to prevail in official policy responses as well.

STRUCTURAL REFORM PROGRAMMES

The IMF's policy responses "have been totally one-sided", the editors of the *Cambridge Journal of Economics* special issue on the Asian crisis noted (Chang et al., 1998:652). Only Asian economies, they explained, "have had to accept adjustment and the structural reforms which are supposed to make them less crisis prone", whereas international financial operators "have received help without being required to make the institutional and regulatory reforms which would make it more likely that in the future they would assess and price risks properly and allocate financial resources more efficiently" (ibid.). The policy response of the international community focused on one side of the equation, and did so at full weight. The IMF orchestrated a number of large-scale, official financing packages, including a $17 billion package for Thailand, a $36 billion package for Indonesia and a $58 billion package for South Korea (Kenen 2001:8). As mentioned in the introduction, the Thai government pledged to address the 'fundamental causes' of the crisis in return for a large financing package. This meant that structural reform programmes included efforts to 'dismantle state-sponsored monopolies and cartels', 'privatization of state enterprises', 'improvement of disclosure requirements', 'transparency', etc.4 These "exceptionally comprehensive" reform programmes were necessary, the IMF argued, to get to the "heart of the weaknesses in financial systems and in governance" in Asian economies (IMF 1999a: 18). In case these structural reforms proved insufficient, the IMF obtained commitments from the crisis countries to adopt "*any additional measures* that may be necessary" (Thai Central Bank and Finance Ministry 1997, emphasis added). These far-reaching pledges were made in the context of a 'Letter of Intent'. Although a Letter of Intent is in principle a unilateral declaration, it is in fact the outcome of a negotiation with the IMF, and should progress on the various performance criteria stated in the Letter of Intent turn out to be disappointing, the IMF

may suspend the financing package (Kenen 2001:9). Commitments made were binding, in other words, and the costs of not sticking with commitments made likely to be substantial. There could, in brief, be little doubt that the structural reform programmes launched by the IMF strived to dismantle a form of capitalism considered improper, with a determination to adopt whatever measure necessary to achieve this goal. The IMF, acting on behalf of the international community, was determined to replace the Asian model of 'crony capitalism' with a model of 'proper' capitalism; a model of capitalism based 'transparency' and 'competition'.

CONTROVERSY

The IMF's structural reform programmes were controversial for a number of reasons. One widespread criticism was that they exacerbated the crisis. Some even argued that if it hadn't been for the IMF's misguided response to the Thai crisis, it would never have spread to become an *Asian* crisis. The Meltzer report, a study commissioned by the US Congress to examine the future and efficacy of international financial institutions in the wake of the Asian crisis, further found that structural reform programmes were both "intrusive and ineffective".5 Other observers argued that structural reforms were to large extent irrelevant, in the sense of having "no bearing whatsoever" on the urgent problems of the countries afflicted by the crisis:

Why should Indonesia be made to eliminate food subsidies, reduce its tariffs, and abolish domestic monopolies, such as those dealing in garlic and cloves? Why should Korea be forced to agree that foreigners be allowed to acquire domestic financial institutions? Why must it eliminate 'directed lending' by Korean banks and move swiftly to strengthen corporate governance? (Kenen 2001:9–10).

In addition to being criticised for being intrusive, ineffective and irrelevant, some argued that structural reforms were 'destructive'. From this perspective, international 'meddling' with the internal, economic affairs of Asian countries threatened to dismantle a model of capitalism that had been exceptionally successful in the preceding three decades. Asserting that the Asian crisis was the result of incompatibility between open, volatile international capital markets on the one hand, and 'Asian models' of capitalism on the other, Manfred Bienefeld declared that "the fact that it is those models that are now being deconstructed is nothing short of a tragedy" (Bienefeld 1999). A key factor in the economic development of the East Asian economies was, Bienefeld argued, that these economies were characterised by stable financial systems that were cost-effective from the perspective of the sectors of the economy for which it provided financing. This, to Bienefeld, had a clear competitive advantage over financial systems

Table 7.2 East Asian Economic Growth Compared

	East Asia and Pacific	*US*	*World*
1965–1980	7,3	2,7	4,1
1980–1989	7,9	3,0	3,1
1990–1996	9,4	2,5	1,8

Source: World Bank and IMF data, reproduced from Singh 1999:12.

in Western economies that were characterised by high profits at the expense of stability and growth in other sectors of the economy. Ajit Singh launched a similar criticism, stressing the high and stable economic growth that East Asian economies had enjoyed for more than three decades.

The economic development of the Asian economies over the preceding three decades was exceptional not only in terms of its high annual GDP growth rates, but also in being to a high degree shared, thus resulting in unprecedented reductions of poverty. On this subject, Joseph Stiglitz remarked in a *Wall Street Journal* interview in 1998, that,

In 1975, 6 out of 10 Asians lived on less than $1 a day. Korea, Thailand and Malaysia have eliminated poverty and Indonesia is within striking distance of that goal. The USA and other Western countries, which have also seen solid growth over the last 20 years but with little reduction of their poverty rates, could well learn from the East Asian experience (Stiglitz, cited from Singh 1999:12–13).

The IMF made minor concessions in response to criticism,6 but fiercely defended its insistence on comprehensive structural reforms. It would simply have been wrong, the IMF argued, to ‘clean up’ insolvent banks in East Asian countries without addressing the ‘fundamental’ flaws of their financial systems. Comprehensive structural reforms were essential for these economies to recover from the crisis, the IMF insisted.

CONFLATION OF KEY ISSUES

By attributing blame and policy responsibility solely to the Asian side of the equation and absolving foreign investors completely, three issues were conflated:

- observing that an economic agent is unable to service its debt
- judging that borrowers, not lenders, are to blame and should be held responsible for a debt deflation crisis
- concluding that the indebted economy is fundamentally flawed, and thus in need of ‘structural reform’

The first part of this conflation—sliding from the observation that an economic agent is unable to service his debt, to blaming borrowers and absolving lenders, as if this was somehow 'natural'—will be discussed in more detail in Chapter 17, so I leave it for now.

But even *if* the normative stand of one-sidedly blaming borrowers is assumed, this does not warrant the conclusion that the indebted economy is fundamentally flawed and in need of structural reform. Attributing responsibility is one thing; condemning a model of capitalism quite another. One can, of course, always discuss the relative merits of competing models of capitalism. But to argue that the debt deflation crisis 'proved' that the Asian model of capitalism was fundamentally flawed is nonsense. This slide, from blaming borrowers to condemning the Asian model of capitalism,7 is closely related to what Chang and colleagues termed a "revival of Orientalism", by which "all manner of fantasies and prejudices [were] projected onto Asia, with no real concern for their veracity" (Chang et al. 1998:649–651).8 In any case, it is noteworthy that when the crisis spread beyond East Asia and started affecting the US and German economies as well, "no one talked about *weak* institutions and *poor* governments as the cause of recessions" (Stiglitz 2002:120, emphasis added). "Now", Stiglitz notes, commentators and policy-makers "seemed to have remembered that such fluctuations have always been part of market economies" (ibid.).

Add to this that even if one adopts the normative stance of holding foreign withdrawal of capital free of responsibility, this does not explain why governments were warned not to launch capital controls, nor why efforts to increase the relative incentives for longer term commitments of capital flows, as opposed to short-term capital, were discouraged. The East Asian countries involved were required to assume their responsibilities for policy reform in and through structural reform—and structural reform only—as if structural reforms were somehow the 'necessary' response.

'ULTIMATE' CAUSATION

If one builds a narrative that recognizes dual causation, and yet arrives at one-sided attribution of blame and policy responsibility, there are only two options. Either one makes that moralizing explicit—or one ventures into obfuscation and illogicality. Though there is certainly attribution of blame in the four narratives on the Asian crisis, this is rarely made explicit *as* moral judgment. How is it that narratives which first recognise and then collapse dual causatio, may nevertheless appear coherent? How is that severe conflation may pass unnoticed? Two factors may contribute to explaining this: 'ultimate causation' and 'internal consistency'.

Narratives tend to give particular weight to one line of problematization. It is the 'internal consistency' between a dominant mode of problematization and the associated policy prescription that renders a narrative persuasive.

This choice of focus, of privileging one line of problematization and one type of policy response, does not occur 'out of the blue', of course. It needs to take place in a manner that is persuasive to its readers. In this regard, reference to 'ultimate causation' is essential.

The notion that an 'ultimate' cause exists which may be identified is what assists in obfuscating conflation and moralizing. Without a general collapsing of dual causation in the debate—based on references to 'ultimate' cause—it wouldn't have been possible to convince so many that structural reforms were simply the 'necessary' response. Only by attributing the Asian crisis one-sidedly to the 'weaknesses' of Asian economies could Asian capitalism be framed as an 'improper' form of capitalism, as a pathological condition in urgent need of cure. Without the notion that an 'ultimate' cause exists that may be identified, it is difficult to see how interlocutors could have seen the policy recommendation issue as a 'positive' rather than a normative issue. When narratives proceed as if the policy issue could and should be settled by 'getting the causation right'—identifying the right 'main' cause—sober analyses of the pros and cons of different policy strategies are the exception rather than the rule.9 Without widespread belief in 'ultimate' causation, the debate on policy responses would have had to proceed in terms of a comparative analyses of competing policy strategies instead. The belief in 'ultimate causation' thus not only obfuscates normative judgment in academic narratives, it also precludes serious analysis and discussion of competing policy strategies, and conditions a policy response by 'the international community' that conflates the key issues.

CONCLUDING REMARKS

The IFA initiative was often legitimized politically as a 'necessary' response to the financial crises of the 1990s in general, and to the Asian crisis in particular. The analysis has demonstrated that such claims to necessity were invalid. The debate was generally characterized by a collapsing of dual causation and the official policy response by a conflation of the key issues. Hence, a comparative analysis and discussion of the main competing policy strategies never took place. These points are important to stress and to bear in mind. At the end of the day, shared explanatory practices such as the collaping of dual causation and the conflation of key issues may be seen as a *sine qua non* of the construal of the Asian crisis as 'improper', and hence for the emergence of the global disciplinary regime of the IFA also.

One of the major outcomes of the debate on the Asian crisis was a complete reversal of popular conceptions on the comparative merits of different models of capitalism, reversing the perceived hierarchy of Asian versus Anglo-American models of capitalism. This renewed belief in the 'liberal market economy' was not only deeply ingrained in the structural reform

programmes negotiated by the IMF with the afflicted East Asian economies, it also—as we shall see in Part 2—became the underlying logic of international efforts to strengthen 'the international financial architecture' (IFA). In and through the IFA initiative, many of the elements of the structural reform programmes were *codified* in the form of standards of 'best practice' and *universalized* in the sense that they were seen as permanently applicable to economies throughout the world and at all times, whether afflicted by a financial crisis or not. The fact that the debate on the Asian crisis paved the way for the birth of a norm for a 'proper' economy, and for the subsequent launching of a global disciplinary regime illustrates all too well the broader societal effects of the explanatory practices of supposedly non-normative economists.

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8
Strengthening the International Financial Architecture (IFA)

INTRODUCTION

In a speech given at the Brookings Institution in April 1998, Robert Rubin, then Secretary of the US Treasury, stressed the need to strengthen the 'architecture' of the international financial system. Rubin's speech has been identified as the first (official) use of the term 'international financial architecture' (Kenen 2001). The emergence of this new nomenclature signalled a new way of thinking about international finance and its regulation, addressing a perceived need for reforms that "aimed at preventing future crises and resolving more effectively the crises that do occur" (Kenen 2001:1). In the aftermath of the East Asian crisis, both political and academic discourse increasingly subscribed to the notion that there was a need for regulatory reforms with regard to international finance, and that such reforms would entail a work of *construction*—as opposed to the emphasis on *deregulation* in the preceding decade.1 The term 'architecture' was widely adopted in the debate, but often without explicit definition. In the academic debate, use of the term said little about the policies proposed in the name of reforming, or 'strengthening', it. In the political arena, however, the architecture metaphor was soon invested with substantial regulatory content. The IFA marked the emergence of a new approach to the regulation of international finance by emphasising the upgrading of financial regulation and the supervision of individual countries and individual financial institutions.2

The IMF (2000a) explains that the IFA initiative has concentrated on five major areas: transparency; developing and assessing internationally accepted standards; financial sector strengthening; involving the private sector; and modifying IMF financial facilities. These five dimensions of the IFA were closely intertwined. The Financial Sector Assessment Programme (FSAP) may be seen as the quintessential expression of this new regulatory approach in international finance.

First, an overview is given of the FSAP (section 1). This is followed by a depiction of its two main components, standards and codes (section 2), and financial stability analysis (section 3). Before a few concluding remarks, the Coordinated Compiliation Exercise is discussed briefly (section 4).

THE FINANCIAL SECTOR ASSESSMENT PROGRAM (FSAP)

When the Financial Sector Assessment Program (FSAP) was first launched in May 1999, it was a pilot project run jointly by the World Bank and IMF. The FSAP reflected an emerging consensus in the 'international community' that new policies, tools and methodologies were needed to foster financial stability and development. "Financial instability can significantly harm growth and cause major disruptions, as was seen in the financial crises of the 1980s and 1990s", the IMF explained (IMF 2005a: 2). However,

Effective surveillance of national financial systems, along with a harmonization and convergence of key components of financial policies, will help minimize those types of risks and will promote orderly development of financial systems (IMF 2005a: 1)

The contention was that if countries were to reap the benefits of access to international capital without 'excessive risk' of contagious international financial instability, they would have to strengthen their financial systems. The FSAP pilot thus intended, on one hand, to reduce the likelihood and severity of financial sector crises and contagion and, on the other hand, to help foster economic growth. For both of these overall objectives, the notion of 'financial system soundness' was key, since it was expected to increase financial stability while at the same time contributing to economic growth. The FSAP would identify the "strengths, vulnerabilities, and risks" of national financial systems and, ultimately, "help design appropriate policy responses" (IMF 2005a: 325). To achieve these goals, countries would need to *monitor* the soundeness of their financial systems, *assess* the effectiveness of their monetary and financial policies, and to *adopt* standards and codes of 'best practice', the new consensus asserted. In face of these challenges, there was a strong need for guidance, hence the launching of the FSAP and the development of an FSAP Handbook.

The FSAP Handbook presented both a "general analytical framework" and a number of "specific techniques and methodologies for assessing the overall stability and development needs of financial systems in individual countries and for designing policy responses" (IMF 2005a: 3). "A key purpose" of the Handbook was, the IMF explained, to "help country authorities conduct their own assessments of the soundness, structure, and development needs of [their] financial system" (IMF 2005a: 2). Overall, the Financial Sector Assessment Program may be said to consist of two main components: assessment of compliance with standards, and assessment of the stability of the financial system. These two main components then inform a third: assessment of the financial sector's reform and development needs (Hilbers 2001:2). In the following, these two main components of the FSAP are briefly depicted.

STANDARDS AND CODES

In October 1998, the G7 countries tasked Dr Hans Tietmeyer, President of Deutsche Bundesbank, with preparing a report on how a Financial Stability Forum (FSF) could be set up to "promote stability in the international financial system" (FSF 2007a).2 Tietmeyer's report, presented in February 1999, was endorsed by the G7 countries, and the FSF was convened in April 1999. A key task for the FSF was to identify "economic and financial standards that are internationally accepted as important for sound, stable and well functioning financial systems" (FSF 2007b), and to devise a strategy for promoting the implementation of the standards (FSF 2000), mobilising the resources and efforts of the IMF, the Bank of International Settlements and the World Bank. Developing such standards and promoting their global adoption became a "prominent component" of efforts to "strengthen the international financial architecture". A wide range of public and private institutions—including "all major standard setting bodies" (IMF 2005a: 329)—contributed to the development of standards and codes of good practice: Standards were developed in twelve areas, which fell into three main categories: policy transparency, financial sector integrity, and market integrity. *Policy transparency* involved standards for transparency in data dissemination, fiscal policy, and monetary and financial policy. In

Table 8.1 Actors in the Standard-Setting Process

Intergovernmental groupings	G7; G8; G10; G20; G24; G77; APEC; Commonwealth
International regulatory and supervisory groupings	Basle Committee on Banking Supervision (BCBS); Committee on the Global Financial System (CGFS); Committee on Payment and Settlement Systems (CPSS); Financial Action Task Force (FATF); International Association of Insurance Supervisors (IAIS); International Organization of Supreme Audit Institutions (INTOSAI); International Organization of Securities Commissions (IOSCO)
International agencies and institutions	Bank for International Settlements (BIS); International Monetary Fund (IMF); Organization for Economic Co-operation and Development (OECD); Regional Development Banks (IADB; AfDB); United Nations Agencies; The World Bank
Professional Associations	International Accounting Standards Board (IASB); International Federation of Accountants (IFAC); International Federation of Insolvency Professionals (INSOL)
Consultative fora	Financial Stability Forum (FSF); G30

Source: Emmenegger (2006) and (IMF 2005a).

Table 8.2 Overview of Standards of 'Best Practice'

Policy transparency	*Financial sector integrity*	*Market integrity*
Data dissemination (IMF) Fiscal policy transparency (IMF)	Banking supervision (Basle Committee) Securities (IOSCO)	Accounting (IASC) Auditing (IFAC) Corporate governance (WB; OECD)
Transparency in monetary and financial policy (IMF)	Insurance (IAIS) Payments systems (CPSS) Anti-money laundering	Insolvency and creditor rights (UNCITRAL; IMF; WB)

the area of *financial sector integrity*, standards were developed for banking supervision, securities, insurance, payments systems, and anti-money laundering. And finally, with respect to *market integrity*, standards were developed for corporate governance, accounting, auditing and insolvency, and creditor rights (IMF 2008).3 For each standard, responsibility was assigned to one or more institutions and standard-setting bodies (cf. parentheses in Table 8.2). Responsibility for coordinating these efforts was assigned to the IMF and the World Bank. The IMF coordinated efforts in the first two main areas of standardization (policy transparency and financial sector integrity), and the World Bank in the third (market integrity).

Compliance with standards of 'best practice' was expected to benefit countries in five main ways. First, if a country complied with these standards, it would strengthen its economic institutions, and with them its financial system in particular as well as its economy more generally. Second, by complying with standards, countries would be able to borrow foreign capital at lower interest rates because financial markets would then consider these 'less risky' and reward them in terms of a lower cost of capital. Third, there would be the significant benefit of reducing the impact of an external crisis because compliance with standards could ensure continued access to foreign capital in situations where this would have been difficult in the absence of compliance. Fourth, as a consequence of the lower cost of foreign capital, achieved by compliance with standards, the solvency of governments would be higher—and thus compliance could in some cases even help *prevent* a financial crisis (IMF, 2003a: 26). In sum, these factors would all contribute to increasing the stability of the domestic financial system. At the international level, compliance to standards would increase transparency and thus result in "better informed lending and investment decisions" and—by thus allowing for "more effective market discipline"—would result in "greater financial stability" at the international level" (IMF 1999b:2; 2006b: 2). In more general terms, adherence to international standards and codes was expected to ensure "that economies function *properly* at the national level", which was seen

as "a key prerequisite for a well-functioning international system" (IMF 2000b: 3, emphasis added).

The system of standards was accompanied by a system of surveillance. "We commit ourselves to ensure", the G7 countries declared, "that private sector institutions in our countries comply with these principles, standards and codes of best practice" (G7 1998:8–9). And "we call upon all countries which participate in global capital markets", the declaration continued, "to commit to comply with these internationally agreed codes and standards" (ibid.). Further, the G7 countries called upon the IMF "to monitor … the implementation of these codes and standards as part of its regular surveillance under Article IV", as well as to "publish in a timely and systematic way the results of its surveillance of the degree to which each of its member countries meets internationally recognised codes and standards of transparency and disclosure in the form of a Transparency Report" (ibid.).

In addition to the coordination mentioned above, the IMF and the World Bank have played a role in the standards initiative in five main ways: contributing to the development of standards; encouraging the adoption and implementation of standards by member countries; offering technical assistance for implementation; assessing compliance with standards; and producing and publishing 'Reports on the Observance of Standards and Codes' (ROSCs). ROSCs—the operational name of what was initially termed 'transparency reports'—communicated the results of assessment missions to member countries. ROSCs summarized "the extent to which countries observe certain internationally recognized standards and codes", the FSAP Handbook explains (2005a: 337). Standards relating to financial integrity and policy transparency are usually prepared within the framework of the FSAP. In these cases, assessments of compliance are reported to authorities in the form of so-called 'detailed assessment reports', summaries of which are "included as part of the FSSAs that are presented to the IMF Board in the context of Fund surveillance" (ibid.). This procedure is seen as important because it situates assessments of compliance with standards in the "broader context of risks and vulnerabilities that affect the financial system", and thus makes it possible to assess the link between standards compliance and overall financial risks. "Gaps in compliance with standards also provide an input into identifying development needs and desired structural reforms", the IMF stresses, "to strengthen institutions, markets, and infrastructure" (2005a: 338). This is a key reason, the IMF explains, that "standards assessments are an integral part of the FSAP" (ibid.).

With regard to standards for market integrity, these "are typically assessed on a stand-alone basis" by the World Bank (2005a: 339). Only "when appropriate", are one or more of these market integrity standards assessments conducted in the context of an FSAP (ibid.). FSAPs will, however, draw upon any such stand-alone assessments of market integrity standards that might be available. In so doing, the focus of FSAPs here will be on "financial sector aspects of corporate governance, accounting and

auditing, and insolvency regime, as part of the assessment of preconditions for effective supervision" (ibid.). In general, ROSCs and FSAP are seen to "have reinforced each other to achieve the shared objectives" (ibid.)

FINANCIAL STABILITY ANALYSIS

FSAPs are intended to provide a "comprehensive health check-up" of a country's financial sector, in the words of Manuel Conthe, Vice President of the World Bank's Financial Sector (IMF 2001). FSAPs constitute a "diagnostic work", crucial in helping national authorities build and develop "risk management capacity" (IMF 2001). In and through such diagnostic work, FSAPs were intended to identify the financial sector reform and development needs of countries, and detect warning signs of potential financial crises.

The FSAP defines financial system stability in a broad sense. Financial stability refers both to preventing financial institutions from failing "in large numbers" and to avoiding "serious disruptions to the intermediation functions of the financial system", be they payments, savings facilities, credit allocation, or risk mitigation and liquidity services (IMF 2005a: 35). On the basis of this dual definition, financial stability is perceived as a continuum "on which financial systems can be operating inside a stable corridor, near the boundary with instability, or outside the stable corridor" (ibid.). A key purpose of financial stability analysis is to assess the position of financial systems on this continuum, and in the process identify potential threats to financial system stability, as well as devise policy recommendations for enhancing stability and reducing vulnerability on the basis of these analyses. 'Exposures', 'buffers', and 'linkages' are key concepts for these assessments and analyses. Each of these concepts reflect the fact that financial systems, in the current age of global financial integration, are perceived as precarious entities which call for delicate and sophisticated regulatory governance. The vision of the FSAP thus is to continuously assess the soundness and vulnerability of financial systems, encompassing a range of economic, regulatory, and institutional issues pertaining to financial stability. Of particular interest is whether a given financial system exhibits vulnerabilities that could, in various ways, undermine financial stability—whether by triggering a liquidity or solvency crisis, by amplifying a macroeconomic shock, or simply by impeding policy responses to such shocks (ibid.).

The assessments and analyses undertaken during FSAPs were and are ultimately concerned with policy prescriptions. Depending on the assessment made, policy prescriptions would either suggest further crisis prevention (when the financial system is stable), remedial action (when it is approaching instability) or crisis resolution initiatives (when instability prevails). The FSAP Handbook depicts 'macroprudential surveillance' and 'financial

market surveillance' as the key methodologies deployed in financial stability analysis; in the following both of these are explained further.4

EARLY WARNING SYSTEMS

A key presumption of the FSAP is that surveillance of financial markets provides information crucial in assessing the risk that some shock—or combination of shocks—will hit and potentially threaten the stability of the financial sector. The cornerstone of such surveillance is so-called 'early warning system' (EWS) models. EWS models are by their nature *forward-looking*. On the basis of different types of indicators they strive to assess the likelihood that an 'extreme shock' will hit the financial system. Needless to say, EWS models "do not have perfect forecasting accuracy", but do offer a "systematic method to predict crises" (IMF 2005a: 36).5 Drawing on a vast literature on the factors that cause financial crises, EWS models endeavour to combine a number of indicators into a single measure of the risk of a crisis, while seeking to minimize both 'false alarms' and 'missed crises'.

In endeavouring to predict financial crises, the EWS literature distinguishes between three main types of crises. First, '*currency crisis*' refers to a sudden and sizable depreciation of the exchange rate and significant loss of reserves; second, '*debt crisis*' refers to large- scale default or restructuring of external debt; and third, '*banking crisis*' refers to rundowns of bank deposits and consequent widespread failures of financial institutions (IMF 2005a: 38).6 Empirical studies suggest that currency crises occur more frequently than debt crises and banking crises—and that when the latter two types of crisis occur, it is often along with, or shortly after, a currency crisis. Banking crises are often more protracted than the other types of crisis, and thus potentially particularly damaging to an economy. At the same time, however, banking crises are seen as the least predictable of the three.

Given its dire consequences, three approaches to forecasting banking crises are deployed: a macroeconomic approach, the balance-sheet approach and the market indicators approach. Each of these subscribe to different notions of what causes a banking crisis. The macroeconomic approach assumes that banking crises are caused by macroeconomic policies and thus strives to predict them using macroeconomic variables. The balancesheet approach, on the other hand, regards banking crises as the result of 'poor banking practices' which may therefore be predicted on the basis of bank balance-sheet data. Finally, the market indicators approach is based on the assumption that there is more to the 'health' of a bank than what shows on its balance-sheet. The market indicators approach draws on data on equity and debt prices—which are in themselves forward-looking and available at high frequency—to arrive at more adequate assessments of a bank's situation.

Although EWS models exist in many forms and as a whole may be said to be quite comprehensive, the FSAP Handbook stresses that they should be seen as just "one of a number of inputs into the IMF's surveillance process" (IMF 2005a: 37).

FINANCIAL SOUNDNESS INDICATORS

Whereas EWS models focus on vulnerabilities in the *external* position, macroprudential analysis focuses on vulnerabilities in *domestic* financial systems arising from macroeconomic shocks. One might say that EWS models assess the likelihood and severity of a shock, but leave the analysis of the likely domestic impact of such a shock to macroprudential analysis. EWS models and macroeconomic analysis complement and reinforce one another, in other words. The FSAP Handbook stresses that macroprudential surveillance assesses the soundness of the financial sector as a whole, as compared to microprudential surveillance, which assesses the soundness of individual financial institutions. Macroprudential surveillance reflects, the Handbook argues, a need to "identify risks to the stability of *the system as a whole*, resulting from the collective effect of the activities of many institutions" (IMF 2005a: 38, emphasis added). A combination of quantitative and qualitative data is used for macroprudential surveillance. Monitoring so-called 'financial soundness indicators' (FSIs) and conducting 'stress tests' are the key quantitative methodologies used in assessing how conditions in non-financial sectors translates into financial sector vulnerabilities. These quantitative methodologies are complemented with data on the "quality of the legal, judicial, and regulatory framework", as well as on "governance practices in the financial sector and its supervision" (ibid.). This qualitative dimension of macroprudential surveillance often takes the form of assessments of 'standards and codes of best practice'; the Handbook explains.
Two types of indicators are deployed in macroprudential analysis: financial soundness indicators and macroeconomic indicators.7 Whereas the macroeconomic indicators to a large extent are 'the usual suspects' (exchange rate volatility, interest rates, current account deficits, etc.), financial soundness indicators represent a "new body of economic statistics" (IMF 2005a: 22). Financial soundness indicators include thirty-three indicators covering a range of aspects from capital adequacy and asset quality, to profitability and market risk sensitivity. FSIs are grouped into a core set and an encouraged set. The 'core set' covers only the banking sector, reflecting the fact that banking sector FSIs are considered "essential for surveillance in virtually every financial system" (ibid.). More specifically, the 'core set' included indicators on regulatory capital to risk-weighted assets, nonperforming loans to total gross loans, interest margin to gross income, and liquid assets to short-term liabilities, etc (See Table 8.3).

Table 8.3 The Core Set of Financial Soundness Indicators (FSIs)

Indicator	*Description*
Regulatory capital to risk-weighted assets	Broad measure of capital, incl. items giving less protection against losses (subordinated debt, tax credits and unrealized capital gains)
Regulatory Tier 1 capital to riskweighted assets	Highest quality capital such as shareholder equity and retained earnings, relative to risk-weighted assets
Nonperforming loans net of provisions to capital	Indicates the potential size of additional provisions that may be needed relative to capital
Nonperforming loans to total gross loans	Indicates the credit quality of banks' loans
Sectoral distribution of loans to total loans	Identifies exposure concentrations to particular sectors
Return on assets and return on equity	Assesses the scope for earnings to offset losses relative to capital or loan and asset portfolio
Interest margin to gross income	Indicates the importance of net interest income and scope to absorb losses
Noninterest expenses to gross income	Indicates the extent to which high noninterest expenses weakens earnings
Liquid assets to total assets and to short-term liabilities	Assesses the vulnerability of the sector to loss of access to market sources of funding or a run on deposits
Net open position in foreign exchange to capital	Measures foreign currency mismatch

Source: IMF 2005a: 23.

The 'encouraged set', on the other hand, covers FSIs for key non-financial sectors, reflecting the fact that balance-sheet weaknesses in those sectors are a "source of credit risk for banks and, thus, help detect banking sector vulnerabilities at an earlier stage" (ibid.). The 'encouraged set' includes indicators for 'other financial corporations', 'non-financial corporations', 'households' and 'real estate markets'.

The core set of FSIs are perceived as relevant to all countries, whereas the encouraged set may be relevant "in many, but not all, countries" (ibid.). A key advantage of this two-tiered approach to FSI compilation is, the IMF argues, that it helps avoid a "one-size-fits-all approach" (IMF 2001:23). Thus, the choice of FSIs should be made on the basis of the character of a country's financial system. Countries should be careful not to settle for the 'core set' of FSIs, however. "Although the core set provides an

initial prioritization", the IMF explains, "the choice should not be limited to this set", but complemented with a range of encouraged FSIs, selected on the basis of the specific characteristics of the country's financial system, the importance of non-financial institutions, etc. (IMF 2005a: 39). More specifically, analysis of the structure, ownership and degree of concentration of the financial system will indicate "the relative importance of different types of financial institutions" (banks, securities companies, insurance companies, pension funds), as well as the relative importance of private, public and foreign ownership (ibid.). Such characterization of a country's financial system will help authorities make an initial identification of "structural issues and developmental needs" and help set priorities for the selection and analysis of FSIs, the IMF notes (ibid.).

Data on these indicators are collected for individual institutions, and these institution-level data are then aggregated to become material for macroprudential analysis. In aggregated form, FSIs are a key feature of efforts to "monitor the financial system's vulnerability to shocks" and its "capacity to absorb the resulting losses" (IMF 2005a: 39). The IMF notes that since FSIs themselves are "either backward-looking or contemporaneous indicators of financial soundness", one should complement these with "various market-based indicators, which are forward-looking indicators of soundness and are available with higher frequency" (IMF 2005a: 23–24).

STRESS-TESTING

In terms of the 'alerting' objective, a crucial technology in the FSAP is 'stress-testing'. These were intended to be the *forward-looking* component of macro-prudential analysis (IMF, 2000:2). Stress tests endeavour to assess the vulnerability of financial systems to "exceptional but plausible events" (IMF 2005a: 39). This is done, basically, by "providing an estimate of how the value of each financial institution's portfolio will change when there are large changes to some of its risk factors (such as asset prices)" (ibid.).

Stress-testing along these lines is considered crucial for authorities in enhancing their ability to identify and diagnose financial sector vulnerabilities (Hilbers 2001:3). Orginally, stress tests were developed for use at the portfolio level to enable an understanding of changes in the value of a portfolio in consequence of larger changes in some of its risk factors. Over the years, such tests have become increasingly used as a generalized risk management tool by financial institutions, culminating in attempts to undertake the stress-testing of entire financial systems. Such "system-focused stress testing is best seen as a multi-step process", the IMF explains, "that involves examining the key vulnerabilities in the system and providing a rough estimate of sensitivity of balance sheets to a variety of shocks (IMF 2005a: 46). Steps in this process include: (a) identifying the major risks

and exposures in the system and formulating questions about those risks and exposures, (b) defining the coverage and identifying the data that are required and available, (c) calibrating the scenarios or shocks to be applied to the data, (d) selecting and implementing the methodology, and (e) interpreting the results (ibid.).

In and through such 'system-focused' stress-testing, FSAPs endeavour to "marry a forward-looking macro-perspective with an assessment of the sensitivity of a collection of institutions to major changes in the economic and financial environment" (ibid.). Such stress-testing is particularly useful, the IMF argues, because it provides "a quantitative measure of the vulnerability of the financial system to different shocks" (IMF 2005a: 47). This measure may then be used along with other FSAP assessments to "draw conclusions about the overall stability of a financial system" (ibid.).

Stress-testing models what happens at the levels of individual financial institutions and subgroups of institutions when a certain shock occurs, in terms of both the aggregate effect and the distribution of that effect among institutions. Such stress-testing assesses, in other words, the impact of different types of macroeconomic shocks on the profitability and solvency of financial institutions. Stress tests differentiate between six main types of risk: interest rate risk, exchange rate risk, credit risk, liquidity risk, equity and/or real estate price risk and commodity price risk. Stress-testing usually involves one or more of these types of risk, as well as one or more of the following types of analysis: *sensitivity analysis*, which seeks to identify the vulnerabilities of the financial system to changes in individual financial variables (such as interest rates, exchange rates, and equity prices); *scenario analysis*, which endeavours to assess the resilience of the financial system to scenarios that entail simultaneous changes in a number of macroeconomic variables; and *contagion analysis*, which aims to assess the impact of a shock transmitting from an individual financial institution to the rest of the financial system.

THE COORDINATED COMPILATION EXERCISE (CCE)

Following internal reviews of the FSAP and of the FSI initiative, the IMF soon asserted that "comprehensive FSAP assessments and reassessments" could only "take place once in 8 to 9 years" and that hence use of "additional tools" would be necessary in order to "monitor the financial sector on a more continuous basis" (IMF 2005a: 342). In 2004, the IMF's launched what it termed the *Coordinated Compilation Exercise on Financial Soundness Indicators* (CCE). The overall objective of the CCE was to promote the compilation of FSIs on a regular basis. Along with market-based indicators, regularly compiled FSIs were to serve as key inputs in a mode of financial sector surveillance that would be more regular and continuous than the FSAP itself. Targeting supervisors and statisticians in 62 member countries,

the CCE pursued a dual objective. First, it aimed to develop the capacity of member countries to compile FSIs considered "important to the surveillance of their financial systems", and second, to disseminate the data compiled in order to "increase transparency and strengthen market discipline" (IMF 2007a). At the outset, the CCE was a pilot project, and thus initially collection of data was not carried out continuously, but at a given point in time (end-2005). The database and dissemination system created by the IMF for the CCE exercise was constructed, however, so that it would allow for the storing and dissemination of data collected on a regular basis, was a continuation of the CCE later to be decided upon. In November 2007, the Executive Board of the IMF in fact endorsed a proposal to make the CCE a permanent programme and to create a "centralized public FSI database" that will be "available to member countries, international institutions, and markets" (IMF 2007b).

Since the inception of the CCE, a Compilation Guide has been developed and technical assistance provided to the 62 member countries enlisted in the initiative. The CCE initiative matured in January 2007, when the IMF publicized the first set of financial soundness indicators on its website, after three years of preparation and data compilation (IMF 2007a). Whereas data provided through ROSCs and FSAPs were mainly qualitative, the CCE endeavours to make quantified data on the financial soundness of economies available to financial markets. The CCE published data on twelve FSIs, corresponding to the 'core set' mentioned earlier, as well as on a number of FSIs belonging to the 'encouraged set' (see example of FSI sheet below, for UK). The advantage of the CCE initiative is that by publisizing a small set of indicators on its website, the IMF presents the financial soundness of economies to financial markets in the simplest and most easily accessible way possible.

CONCLUDING REMARKS

The IFA initiative marked an increased focus on reforms aimed at crisis prevention, as opposed to reforms concerned with crisis resolution. One aspect of this can be seen in the shift from focusing on loan conditionality to focusing on standards and codes. This shift reflected the recognition that conditionality was not the right vehicle for the financial sector reform agenda. Loan conditionality was more and more seen as an inadequate strategy, amounting to "locking the barn door after the horse is stolen" (Kenen 2001:109). Conditionality does not last long enough to ensure the required financial sector reforms, for such reforms take many years to accomplish. Standards, on the other hand, were not tied to a particular loan, and hence not to a limited period of time either. On the contrary, ROSCs and FSAPs were inscribed in a logic of *continuous reassessment* of compliance with standards.

The FSAP was designed to help authorities as well as markets, understand and assess better the strengths and weaknesses of financial systems. The FSAP marked a significant shift in terms of the types of data that were perceived as relevant to assessing the viability of economies. Both markets and authorities had previously focused their attention on a relatively small set of macroeconomic variables, and on a set of economic policy issues that were seen as particularly important for the growth and development prospects of a country. The FSAP did not discard these modes of representing economies to financial market participants and authorities. The 'usual suspects'—current account deficits, inflation, interest rates, etc.—were still there. But these were now to be complemented by new types of data, including compliance data and financial soundness indicators. Such data would be critical, said the IMF, "in producing reliable assessments of the strengths and vulnerabilities of financial systems" and in "enhancing disclosure of key financial information to markets" (IMF 2000:1).

In more general terms, the FSAP operationalised two crisis- prevention strategies, each with its own time horizon, which have been the two main pillars of the IFA, at least until recently. On one hand, various modes of financial stability analysis served the overall objective of constituting an early warning system, endeavouring to detect signs of weakness and vulnerability as early as possible. The promotion of compliance with standards, on the other hand, operated with an altogether different time horizon. Adopting standards is a demanding process in both time and resources, and its effectiveness in terms of crisis prevention is likely to occur only in a longer term perspective.

Today, the IFA initiative is in trouble. In this respect, there is substantial symbolic significance to the fact that the IMF's IFA website is no longer being updated. For the last couple of years there has been considerable concern over the future of the FSAP, which finds itself "at a critical cross-roads", according to the IEO in its comprehensive evaluation (IEO 2006a: 6). There is a danger, the IEO argued, that "achievements made" in the initial phases would "erode" if the FSAP was not subjected to "significant modifications" (IEO 2006:6). There are no signs, however, that the FSAP has indeed been subject to any such major reforms. On IMF's FSAP website one finds no entries for 'policy papers' nor for 'other related FSAP material' dated later than 2005, except the IEO evaluation from 2006. Instead, it seems that the international community, spearheaded by the IMF, is now betting on increased and intensified publication of financial soundness indicators as the way forward, as witnessed by the CCE initiative. This, however, is a dangerous strategy, as later chapters will discuss.

9

Michel Foucault's Analysis of Disciplinary Power

INTRODUCTION

Michel Foucault wrote his work on the generalization of disciplinary power in the eighteenth century not as an investigation into some distant past, long overdue, but as a 'history of the present'. Foucault endeavoured to write about our present through the lenses of the past—rather than the other way around. Noting the concurrent emergence of freedom and the generalization of disciplinary power, Foucault embarked on a study of the governmental technologies that simultaneously condition and constrain that freedom. Indeed, one could say that Foucault's work entailed an "endless critique of technologies of freedom in the name of freedom itself" (Osborne 2003:12). Foucault did not suggest that disciplinary power was an invention of the eighteenth century.1 The point Foucault tried to make was rather that in the course of the eighteenth century a *recasting* and a *generalisation* of disciplinary power took place:

Many disciplinary methods had long been in existence—in monasteries, armies, workshops … Taken one by one, most of these [disciplinary] techniques have a long history behind them. But what was new, in the eighteenth century, was that, by being combined and generalized, they attained a level at which the formation of knowledge and the increase of power regularly reinforce one another in a circular process (Foucault 1991b: 137, 224).

As indeed every system of power, disciplinary power is concerned with "the ordering of human multiplicities", Foucault notes (Foucault 1991b: 218). Disciplinary power differentiates itself, however, by endeavouring to exert power on the basis of a particular 'tactics'. This tactics of disciplinary power is characterised by three key guiding principles. First, there is the principle of obtaining the exercise of power "at the lowest possible cost", whether economically—in terms of the expenditure it involves—or politically, in terms of the resistance is arouses; for these purposes, disciplinary power is characterised by its "discretion" and by efforts to attain its

"relative invisibility" (Foucault 1991b: 218). Secondly, there is the principle of bringing the effects of disciplinary power "to their maximum intensity" and of extending these effects "as far as possible, without either failure or interval" (ibid.). And finally, he mentions the principle of linking this "growth of power" to the "output of the apparatuses" within which it is exercised, be they educational, military, industrial or medical (ibid.).

This "triple objective" of disciplinary power corresponds, Foucault argues, "to a well-known historical conjuncture", by which two societal transformations intertwined (ibid.). The eighteenth century was characterised by so large a population growth that a fundamental "change of quantitative scale in the groups to be supervised or manipulated" resulted. This same period was characterised also by a tremendous growth in the production apparatus, which was "becoming more and more extended and complex" as well as "more costly" (ibid.). The "development of the disciplinary methods" reflected, Foucault argues, the "need to adjust [the] correlation" of these two societal transformations (ibid.). In Foucault's view, these two processes, the accumulation of men and the accumulation of capital, simply "cannot be separated" (Foucault 1991b: 221). "It would not have been possible", Foucault explains, "to solve the problem of the accumulation of men without the growth of an apparatus of production capable of both sustaining them and using them" (ibid.) And conversely, it was "the techniques that made the cumulative multiplicity of men useful" which made the acceleration of "the accumulation of capital" possible (ibid.). The rise of disciplinary power introduces power mechanisms that belong to an entirely "different economy" (Foucault 1991b: 219). Whereas previously mechanisms of power had proceeded "by deduction", they were now "integrated into the productive efficiency of the apparatuses from *within*, into the growth of this efficiency and into the use of what it produces" (ibid., emphasis added). "For the old principle of 'levying-violence'", Foucault explains, disciplinary power substitutes the principle of "'mildness-production-profit'" (ibid.).

In the following, we take a closer look at Foucault's analysis of the rise of disciplinary power. This analysis is most elaborate in *Discipline and Punish* (Foucault 1991b). Thus, the following three main sections correspond to Foucault's original division of his analysis in that book. First, a section on 'docile bodies' describes how the human body enters "a machinery of power that explains it, breaks it down and rearranges it" and in the process produces docile bodies, that is, bodies that "may be subjected, used, transformed and improved (Foucault 1991b: 136–38). Second, a chapter on 'the means of correct training' argues that the success of disciplinary power "derives from the use of simple instruments; hierarchical observation, normalizing judgment and their combination in a procedure that is specific to it, the examination" (Foucault 1991b: 170). Third, a chapter on 'panopticism' argues that disciplinary power is predicated on a "constant division between the normal and the abnormal", and the existence of a "whole set

of techniques and institutions for measuring, supervising and correcting the abnormal"; and that Bentham's Panopticon was "the architectural figure of this composition" (Foucault 1991b: 199–200).

DOCILE BODIES

"Many disciplinary methods had long been in existence—in monasteries, armies, workshops", Foucault stresses, but "in the course of the seventeenth and eighteenth centuries the disciplines became general formulas of domination" (Foucault 1991b: 137). The disciplines were different from all earlier forms of discipline, Foucault notes. The disciplines differed from *slavery* by not being "based on a relation of appropriation of bodies", but being able to "dispense with this costly and violent relation" and yet obtain "effects of utility at least as great" (ibid.). Similarly, the effects of the disciplines were not predicated on a "constant, total, massive, non-analytical, unlimited relation of domination"—as in the case of the relation of *'service'* between a master and his 'caprice' (ibid.). In contrast to these earlier methods of discipline, modern disciplinary power is predicated upon the birth of an 'art of the human body', Foucault argues:

The historical moment of the disciplines was the moment when an art of the human body was born, which was directed not only at the growth of its skills, nor at the intensification of its subjection, but at the formation of a relation that in the mechanism itself makes it more obedient as it becomes more useful, and conversely (Foucault 1991b: 137–38).

Since then, the body has been an *exercised* body; a body "manipulated, shaped, trained"; a body which "obeys, responds, becomes skilful and increases its forces" (Foucault 1991b: 136).2 Foucault explains that this "discovery" of the body as a governmental object "was written simultaneously" in two dimensions, or registers; the "anatomo-metaphysical register" and the "technico-political register" (ibid.). Whereas the technico-political register was "constituted by a whole set of regulations and by empirical and calculated methods relating to the army, the school and the hospital, for controlling or correcting the operations of the body", the anatomo-physical register derived from the work of physicians and philosophers (starting with Descartes):

These two registers are quite distinct, since it was a question, on the one hand, of submission and use and, on the other, of functioning and explanation: there was a useful body and an intelligible body. And yet there are points of overlap from one to the other ... [A]t the centre ... reigns the notion of 'docility', which joins the analysable body to the manipulable body (Foucault 1991b: 136).

"It was certainly not the first time", Foucault argues, that "the body had become the object of such imperious and pressing investments" (ibid.). On the contrary, "in every society, the body was in the grip of very strict powers, which imposed on it constraints, prohibitions or obligations" (ibid.). There was, however, a number of ways in which this disciplinary power was new.

First, there was the *scale of control*: no longer was it a matter of "treating the body, en masse, 'wholesale', as if it were an indissociable unity", but rather of "working it 'retail'"(Foucault 1991b: 137). Second, there was the *object of control*: no longer was it "the signifying elements of behaviour or the language of the body" that was the object of control, but rather "the economy, the efficiency of movements, their internal organization"; for which "the only truly important ceremony is that of exercise" (ibid.). Third, there was *the modality*: instead of supervising the *result* of an activity, now it was the *processes* of the activity that were subject to control, through "uninterrupted, constant coercion", "exercised according to a codification that partitions as closely as possible time, space, movement" (ibid., emphasis added).

"These methods", Foucault argues, "made possible the meticulous control of the operations of the body", "assured the constant subjection of its forces" and "imposed on them a relation of docility-utility" (ibid.). To denote these methods, Foucault suggests the term 'disciplines' (ibid.). What was being formed at the time "was a policy of coercions", Foucault explains, through which the human body entered "a machinery of power that explores it, breaks it down, and rearranges it" (Foucault 1991b: 138). With the disciplines, a new 'mechanics of power' had been born, which produced "subjected and practised bodies, 'docile' bodies" (ibid.).

Discipline both increased and decreased the forces of the body: it *increased* the forces of the body "in economic terms of utility", and diminished them "in political terms of obedience" (ibid.). In Foucault's analysis, these two aspects are not only intimately related, but in fact *constitutive* of what modern disciplinary power is:

If economic exploitation separates the force and the product of labour, let us say that disciplinary coercion establishes in the body the constricting link between an increased aptitude and an increased domination (Foucault 1991b: 138).

Schools, barracks, the hospital and the workshop were the key institutions in which meticulous regulation, inspection and supervision "of the smallest fragment of life and of the body" were organized (Foucault 1991b: 140). It was on the basis of processes of "meticulous observation of detail" and of a "whole corpus of methods and knowledge" with regard to the "control and use of men", Foucault contends, that "the man of modern humanism was born" (Foucault 1991b: 141).

THE ART OF DISTRIBUTIONS

Discipline "individualizes bodies" by distributing and circulating them "in a network of relations" (Foucault 1991b: 146). "In discipline", Foucault explains, the "elements are interchangeable, since each is defined by the place it occupies in a series, and by the gap that separates it from the others" (Foucault 1991b: 145). The unit of disciplinary methods is, in other words, "not the territory (unit of domination), nor the place (unit of residence), but the rank: the place one occupies in a classification" (ibid.). "In the eighteenth century", Foucault observes, "'rank' begins to define the great form of distribution of individuals in the educational order":

[R]ows or ranks of pupils in the class, corridors, courtyards; rank attributed to each pupil at the end of each task and each examination; the rank he obtains from week to week, month to month, year to year; an alignment of age groups, one after another; a succession of subjects taught and questions treated, according to an order of increasing difficulty (Foucault 1991b: 146–47).

In this "ensemble of compulsory alignments", Foucault continues, each pupil, "according to his age, his performance, his behaviour", occupies sometimes one rank, sometimes another" (ibid.). The pupil "moves constantly", in other words, over a "series of compartments", some of which are "'ideal' compartments, marking a hierarchy of knowledge or ability", others expressing "the distribution of values or merits in material terms in the space of the college or classroom" (Foucault 1991b: 147). "The organization of a serial space was one of the great technical mutations of elementary education", Foucault argues. The "traditional system", in which a pupil worked "for a few minutes with the master, while the rest of the heterogeneous group remained idle and unattended", was superseded. "By assigning individual places", Foucault explains, the serially organized class made possible the "supervision of each individual and the simultaneous work of all" (ibid.). It made the educational space function not only as "a learning machine", but also as a "machine for supervising, hierarchizing, rewarding", Foucault stresses (ibid.).

"In organizing 'cells', 'places' and 'ranks', the disciplines create complex spaces that are at once architectural, functional and hierarchical", Foucault observes (Foucault 1991b: 148): These spaces "guarantee the obedience of individuals" and "a better economy of time and gesture" (ibid.). "The first of the great operations of discipline is", Foucault argues, "the constitution of '*tableaux vivants*', which transform the confused, useless, or dangerous multitudes into ordered multiplicities" (Foucault 1991b: 148). Foucault observes how "the drawing up of 'tables' was one of the great problems of the scientific, political and economic technology of the eighteenth century" (ibid.), and mentions two key examples of efforts towards this end. First, the

construction of "rational classifications of living beings" took place in the context of "botanical and zoological gardens" (ibid.). Second, in a similar vein, an "economic table" was built, which by observing, supervising, and regularizing "the circulation of commodities and money", could serve "as the principle of the increase of wealth" (ibid.). It was, in other words, not only in the disciplining of bodies that analysis and classification were key. Issues of control and order were inextricably intertwined with issues of classification. Across a wide range of domains the operation of discipline was made up of "twin operations" (ibid.): on the one hand, intelligibility and analysis, and, on the other hand, distribution and supervision. Two registers, in other words, one *anatomo-metaphysical*, concerned with functioning and explanation, the other *technico-political*, concerned with submission and use.

In the eighteenth century, the table was both a technique of power and a procedure of knowledge. It was a question of organizing the multiple, of providing oneself with an instrument to cover it and to master it; it was a question of imposing upon it an 'order' (Foucault 1991b: 148).

"Whereas natural taxonomy is situated on the axis that links character and category", Foucault argues, "disciplinary tactics is situated on the axis that links the singular and the multiple", and thus renders possible, simultaneously, the "characterization of the individual as individual and the ordering of a given multiplicity" (Foucault 1991b: 149).

THE CONTROL OF ACTIVITY

Just as there were principles and techniques for the distribution of individuals in space, the disciplines involved principles and techniques for the control of *activity*. Through principles and techniques for controlling the activities of bodies "a new object was being formed": the mechanical body was superseded by the natural body, Foucault argues (Foucault 1991b: 155). The natural body was, Foucault explains, "the bearer of forces and the seat of duration", "susceptible to specified operations, which have their order, their stages, their internal conditions, their constituent elements" (ibid.). This "natural body" is a "body of exercise" rather than a body of "rational mechanics"; it is a body in which "a number of natural requirements and functional constraints are beginning to emerge" (ibid.). It is a body, in other words, that opposes and resists "excessively artificial movements", Foucault explains, quoting Guibert, a contributor to these new forms of knowledge about the 'natural body':

On entering most of our training schools, one sees all those unfortunate soldiers in constricting and forced attitudes, one sees all their muscles contracted, the circulation of their blood interrupted ... If we studied the

intention of nature and the construction of the human body, we would find the position and the bearing that nature clearly prescribes for the soldier…. Since the hip-bone, which the ordinance indicates as the point against which the butt end should rest, is not situated the same in all men, the rifle must be placed more to the right for some, and more to the left for others (Guibert 1772, cited in Foucault 1991b: 155).

Whereas "procedures of disciplinary distribution" were essentially "techniques of classification and tabulation"—articulating the dual problem of individualization and multiplicity-ordering—the disciplinary controls of activity belonged to a "whole series of researches … into the natural machinery of bodies" (Foucault 1991b: 156), discovering in bodies "specific processes": "behaviour and its organized requirements gradually replaced the simple physics of movement" (ibid.). With this 'natural body' showing "the conditions of functioning proper to an organism", disciplinary power "had as its correlative an individuality" that was "not only analytical and 'cellular', but also natural and 'organic'", Foucault notes (ibid.).

THE COMPOSITION OF FORCES

Whether in the context of the army or of factories, the "new demand" to which discipline had to respond was that of constructing a "machine whose effect will be maximized by the concerted articulation of the elementary parts of which it is composed" (Foucault 1991b: 163). This demand for a *composition of forces*, in the form of efficient 'machines', was expressed in three main ways, Foucault argues. First, whereas previously it was the "bravery" and "strength" of the body that were the "principal variables" defining it, now instead it is "the place it occupies, the interval it covers, the regularity, the good order according to which it operates its movements" that defines it (Foucault 1991b: 164). Second, each of the "chronological series that discipline must combine to form a composite time" are key elements of a machinery (ibid.): the time of each of these series "must be adjusted to the time of the others in such a way that the maximum quantity of forces may be extracted from each and combined with the optimum result" (Foucault 1991b: 165). Third, for this "carefully measured combination of forces" to succeed, a "precise system of command" is required (Foucault 1991b: 166). This system of command must be predicated not only on precision but also on "brevity and clarity"; an order "must trigger off the required behaviour" without a need "to be explained or formulated" (ibid.). The relation between "the master of discipline" and the person "subjected to it" is, in other words, a relation "of signalization":

It is not a question of understanding the injunction but of perceiving the signal and reacting to it immediately, according to a more or less artificial, prearranged code. Place the bodies in a little world of signals to

each of which is attached a single, obligatory response: it is a technique of training, of *dressage* (Foucault 1991b: 166, emphasis added).

In the context of the school, Foucault argues, this relation of signalization should induce a "good pupil" that "hears the noise of the signal" to imagine that he is "hearing the voice of the teacher or rather the voice of God himself calling him by his name" (ibid.). "The pupil will have to have learnt the code of the signals", Foucault explains, and to "respond automatically to them" (ibid.).

Whereas historians of ideas "usually attribute the dream of a perfect society to the philosophers and jurists of the eighteenth century", Foucault stress that there was also "a military dream of society":

Its fundamental reference was not to the state of nature, but to the meticulously subordinated cogs of a machine, not to the primal social contract, but to permanent coercions, not to fundamental rights, but to indefinitely progressive forms of training, not to the general will but to automatic docility … While jurists or philosophers were seeking in the pact a primal model for the construction or reconstruction of the social body, the soldiers and with them the technicians of discipline were elaborating procedures for the individual and collective coercion of bodies (Foucault 1991b: 169).

THE MEANS OF CORRECT TRAINING

Foucault stresses the close link between discipline and training. At the beginning of the seventeenth century, Foucault notes, 'strict discipline' was referred to as "an art of correct training" (Foucault 1991b: 170). Rather than "bending all its subjects into a single uniform mass", disciplinary power "separates, analyses, differentiates … to the point of necessary and sufficient single units", and trains and transforms "confused, useless multitudes of bodies and forces into a multiplicity of individual elements" (ibid.). "Discipline 'makes' individuals", in other words; "it is the specific technique of a power that regards individuals both as objects and as instruments of its exercise", Foucault argues (ibid.). Three "simple instruments" are essential for the success of this disciplinary power, Foucault argues: "hierarchical observation, normalizing judgement and their combination in a procedure that is specific to it, the examination" (ibid.).

HIERARCHICAL OBSERVATION

"The exercise of discipline presupposes", Foucault argues, "a mechanism that coerces by means of observation" and, conversely, "observes by means

of coercion" (Foucault 1991b: 170–71). "Slowly", Foucault explains, the classical age saw "the construction of those 'observatories' of human multiplicity for which the history of the sciences has so little good to say" (Foucault 1991b: 171). Whether in the form of working-class housing estates, hospitals, asylums, prisons, or schools, these 'observatories' had as their "ideal model" or "underlying principle" the military camp, Foucault argues (ibid.), a "diagram of power" that acted by means of "general visibility" and a "spatial 'nesting' of hierarchized surveillance" (ibid.). "In the perfect camp", Foucault explains, "all power would be exercised solely through exact observation", and thus "the geometry of the paths, the number and distribution of the tents, the orientation of their entrances, the disposition of files and ranks were exactly defined", in order to construct a "network of gazes that supervised one another" (ibid.).

The military camp, Foucault argues, "was to the rather shameful *art of surveillance* what the dark room was to the great science of optics" (Foucault 1991b: 172, emphasis added). Disciplinary power was predicated upon observation, or surveillance, and this in turn gave rise to a new architectural problematic, Foucault explains. The challenge was to develop an architecture that was not simply concerned with being seen, or with observing its external space, but with rendering visible "those who are inside it" (ibid.). This new architecture should operate, Foucault explains, to "transform individuals, to act on those it shelters", "to provide a hold on their conduct", "to make it possible to know them, to alter them" (ibid.):

The old simple schema of confinement and enclosures—thick walls, a heavy gate that prevents entering or leaving—began to be replaced by the *calculation of openings*, of filled and empty spaces, *passages and transparencies* (Foucault 1991b: 172, emphasis added).

Referring to the construction of a French military school, Foucault notes how the building was conceived as simultaneously a "mechanism for training" and an "apparatus for observation" (ibid.). Rooms were "distributed along a corridor like a series of small cells", with officer's quarters situated at "regular intervals", and a window placed "on the corridor wall of each room" to allow for surveillance. For similar disciplinary reasons, the inspectors' table in the dining-room was "slightly raised … so that they may see all the tables of the pupils", and latrines were "installed with half-doors, so that the supervisor on duty could see the head and legs of the pupils, and also with side-walls sufficiently high that those inside cannot see each other" (Foucault 1991b: 173).

One should not see in this a set of unimportant "petty mechanisms", Foucault stresses, but a "scrupulous concern with surveillance (ibid.). "These mechanisms can only be seen as unimportant", Foucault argues, "if one forgets the role of this instrumentation, minor but flawless, in the progressive objectification and the ever more subtle partitioning of individual behaviour"

(ibid.). Disciplinary institutions formed around men an apparatus of observation and training, which "functioned like a microscope of conduct" by means of "fine, analytical divisions" (ibid.). "The perfect disciplinary apparatus", Foucault argues, would "make it possible for a single gaze to see everything constantly", and its "central point" would be "both the source of light illuminating everything, and a locus of convergence for everything that must be known; *a perfect eye that turned*" (ibid., emphasis added).

"The hierarchized surveillance of the disciplines" should not be seen, Foucault stresses, as "a thing" but as "a piece of a machinery" (Foucault 1991b: 177). Although the "pyramidal organization" of hierarchized surveillance "gives it a 'head', it is the apparatus *as a whole* that produces 'power' and distributes individuals in this permanent and continuous field" (ibid., emphasis added):

This enables the disciplinary power to be both absolutely indiscreet, since it is everywhere and always alert, since by its very principle it leaves no zone of shade and constantly supervises the very individuals who are entrusted with the task of supervising; and absolutely discreet, for it functions permanently and largely in silence (Foucault 1991b: 177).

NORMALIZING JUDGMENT

"At the heart of all disciplinary systems", Foucault argues, "functions a small penal mechanism" (ibid.) "The disciplines established an 'infrapenality'", he explains, which "partitioned an area that the laws had left empty" (Foucault 1991b: 178). There were, Foucault argues, a number of "micro-penalties" at work in a range of disciplinary institutions, from the school to the army. A micro-penality of *time*, "addressing lateness, absences, and interruptions of tasks"; a micro-penality of *activity*, "addressing inattention, negligence, and lack of zeal"; a micro-penality of *behaviour*, "addressing impoliteness and disobedience"; a micro-penality of *speech*, "addressing idle chatter, and insolence", a micro-penality of the *body*, "addressing 'incorrect' attitudes, irregular gestures, and lack of cleanliness", and, finally, a micro-penality of *sexuality*, "addressing impurity and indecency" (ibid.). To these micro-penalties corresponded, Foucault observes, a series of punishments, ranging from "light physical punishment to minor deprivations and petty humiliations" (ibid.)—all of which served the purpose of "making the slightest departures from correct behaviour subject to punishment" (ibid.). What is specific to this disciplinary penality, Foucault stresses, is that it punishes "non-observance" (ibid.). It is "that which does not measure up to the rule" that is punished (ibid.). Thus, with disciplinary penality, it is the "whole indefinite domain of the non-conforming" that is rendered punishable (Foucault 1991b: 178–79). In natural extension thereof, disciplinary punishment is essentially

"corrective", being concerned, that is, with "reducing gaps" and thus favouring punishments in the form of exercise—"intensified, multiplied forms of training" (Foucault 1991b: 179). But this system of micro-penalities and corrective punishments is, Foucault stresses, "only one element of a double system", a system where gratification and reward are the flip side of micro-penalty and punishment, and where rewards should be "more frequent than penalties" (Foucault 1991b: 180).

"This mechanism with two elements", Foucault explains, makes possible "the definition of behaviour and performance on the basis of the two opposed values of good and evil" (ibid.). Thus, "instead of the simple division of the prohibition, as practised in penal justice, we have a distribution between a positive pole and a negative pole; all behaviour falls in the field between good and bad marks, good and bad points" (ibid.):

[I]t is possible to quantify this field and work out an arithmetical economy based on it. A penal accountancy, constantly brought up to date, makes it possible to obtain the punitive balance-sheet of each individual … Through this micro-economy of a perpetual penality operates a differentiation that is not one of acts, but of individuals themselves … By assessing with precision, discipline judges individuals 'in truth'; the penality that it implements is integrated into the cycle of knowledge of individuals (Foucault 1991b: 180–81).

In the context of schools, this hierarchizing penality had "a double effect", Foucault explains (Foucault 1991b: 182). On the one hand, it "distributed pupils according to their aptitudes", "conduct", and "the use that could be made of them when they left the school", and on the other hand, "it exercised over them *a constant pressure to conform to the same model*, so that they might all be subjected to 'subordination, docility, attention in studies and exercises, and to the correct practice of duties and all the parts of discipline' (ibid., emphasis added). In short, Foucault notes, there was constant pressure "so that they might all be like one another" (ibid.).

This "art of punishing", which is so central in the regime of disciplinary power, "is aimed neither at expiation, nor … at repression", Foucault stresses. Rather it brings into play five "distinct operations": comparison, differentiation, hierarchization, homogenization and exclusion (ibid.). Together, these five operations of the art of punishing constitute what Foucault refers to as 'normalizing judgement'. Individuals are differentiated from one another either in relation to "a minimal threshold", "an average to be respected" or "an optimum towards which one must move" (Foucault 1991b: 183). In all three cases, the art of punishing measures and hierarchizes "the abilities, the level, the 'nature' of individuals" (ibid.). In and through this measuring and hierarchization is defined "the constraint of a conformity that must be achieved" as well as the "external frontier of the abnormal" (ibid.).

The regime of disciplinary power is *opposed* "term by term" to a "judicial penality", Foucault argues (ibid.). First, the "essential function" of judicial penality "is to refer not to … observable phenomena, but to a corpus of laws and texts that must be remembered" (ibid.). Second, judicial penality operates "not by *differentiating* individuals, but by specifying acts according to a number of general categories; not by *hierarchizing*, but quite simply by bringing into play the binary opposition of the permitted and the forbidden; not by *homogenizing*, but by operating the division, acquired once and for all, of condemnation" (ibid.). The disciplinary mechanisms brought into play a "penality of the norm", Foucault argues (ibid.). "Drawing upon a whole series of very ancient procedures", Foucault continues, the disciplines created "a new functioning of punishment", establishing "the power of the Norm". "Is this the new law of modern society?" Foucault asks (Foucault 1991b: 184). "Let us say rather", he continues, that "since the eighteenth century, it has joined other powers"—including law—"imposing new delimitations upon them" (ibid.). While in a sense, "the power of normalization imposes homogeneity", it does so by means of an individualization that makes it possible "to measure gaps, to determine levels, to fix specialties and to render the differences useful by fitting them one to another" (ibid.). "It is easy to understand", Foucault argues, "how the power of the norm functions within a system of formal equality" (ibid.): "Within a homogeneity", the norm introduces—"as a useful imperative and as a result of measurement"—"all the shading of individual differences" (ibid.).

EXAMINATION

The third of the 'simple instruments' of disciplinary power combines the two first; the examination consists of a combination of "the techniques of an *observing hierarchy* and those of a *normalizing judgment*" (Foucault 1991b: 184, emphasis added). The examination "establishes over individuals a visibility", Foucault explains, "through which one differentiates them and judges them" (ibid.). "In all the mechanisms of discipline", Foucault observes, "the examination is highly ritualized", combining "the ceremony of power", "the form of the experiment" and "the establishment of truth" (ibid.). "The superimposition of the *power relations* and *knowledge relations*"—so characteristic of disciplinary power—"assumes in the examination all its visible brilliance", Foucault notes (ibid., emphasis added).

By means of the examination, Foucault argues, disciplinary power holds individuals in "a mechanism of objectification"—and thus, with disciplinary power, "we are entering the age of the infinite examination" (ibid.). "The examination leaves behind it", Foucault notes, "a whole meticulous archive" (Foucault 1991b: 189). The examination "places individuals in a field of surveillance", "situates them in a network of writing", and "engages them in

a whole mass of documents that capture and fix them", Foucault explains (ibid.). Thus, the procedures of examination were accompanied "by a system of intense registration and of documentary accumulation" (ibid.), which "opened up two correlative possibilities" (Foucault 1991b: 190):

- The constitution of the individual as a describable, analysable object, "in order to maintain him in his individual features, in his particular evolution, in his own aptitudes or abilities, under the gaze of a permanent corpus of knowledge"
- The constitution of a comparative system "that made possible the measurement of overall phenomena, the description of groups, the characterization of collective facts, the calculation of the gaps between individuals, their distribution in a given 'population'"

By combining hierarchical surveillance and normalizing judgement, the examination "assures the great disciplinary functions", including "distribution and classification", "maximum extraction of forces and time", and "optimum combination of aptitudes" (ibid.).

"The disciplines mark the moment", Foucault argues, when "the reversal of the political axis of individualization takes place" (ibid.). In societies such as the feudal regime, one is marked as an individual in proportion to the power or privilege one possesses, Foucault notes. In the disciplinary regime, on the other hand, "individualization is descending": it is not those with power and privilege but "those on whom power is *exercised*" that are subject to individualization (Foucault 1991b: 193, emphasis added). In a disciplinary regime, Foucault explains, power "becomes more anonymous and more functional" and "is exercised by surveillance rather than by ceremonies", "by comparative measures that have the 'norm' as reference", "by 'gaps' rather than by deeds" (ibid.). Foucault argues that with the rise of disciplinary mechanisms a transition took place, by which "the normal took over from the ancestral" and "measurement from status" (ibid.). This transition substituted, in brief, "for the individuality of the memorable man that of the calculable man"—and this is the moment, Foucault argues, "when the sciences of man became possible and a new political anatomy of the body was implemented" (ibid.).

PANOPTICISM

Foucault saw in the measures taken at the end of the seventeenth century, when the plague appeared in a town, "a compact model of the disciplinary mechanism" (Foucault 1991b: 195). The plague was "met by order", Foucault stresses, and by the power of discipline, "which is one of analysis" (Foucault 1991b: 197). Foucault cites at length an orderly specifying of the measures a town should take if the plague appeared; here is a condensed version:

[T]he town [is divided] into distinct quarters, each governed by an intendant. Each street is placed under the authority of a syndic, who keeps it under surveillance; if he leaves the street, he will be condemned to death ... Every day, the intendant visits the quarter in his charge ... [and the syndic] goes into the street for which he is responsible, stops before each house: gets all inhabitants to appear at the windows ... ; informs himself as to the state of each and every one of them; ... Everything that may be observed during the course of the visits —deaths, illnesses, complaints, irregularities—is noted down and transmitted to the intendants and magistrates ... Five or six days after the beginning of the quarantine, the process of purifying the houses one by one is begun. All the inhabitants are made to leave ... perfume is poured around the room; after carefully sealing the windows, doors and even the keyholes with wax, the perfume is set alight ... Four hours later, the residents are allowed to re-enter their homes (Foucault 1991b: 195–197).

A town where the plague has appeared "is a segmented, immobile, frozen space", Foucault notes, with each individual "fixed in his place": "if he moves, he does so at the risk of his life" (ibid.). "Everyone is locked up in his cage", "answering to his name and showing himself when asked" (Foucault 1991b: 196). Foucault stresses, in other words, the comprehensive system of surveillance evoked to meet the plague: "the slightest movements are supervised", "all events are recorded", "each individual is constantly located, examined and distributed among the living beings, the sick and the dead" (Foucault 1991b: 197). The other end of the system of surveillance is a "system of permanent registration: reports from the syndics to the intendants, from the intendants to the magistrates or mayor" (Foucault 1991b: 196). In brief, the "medical and political correlative" of the plague was *discipline*. Behind the disciplinary mechanisms of "our own time", Foucault contends, "can be read the haunting memory of ... the plague" (Foucault 1991b: 198):

The constant division between the normal and the abnormal, to which every individual is subjected, brings us back to our own time, by applying the binary branding and exile of the leper to quite different objects; the existence of a whole set of techniques and institutions for measuring, supervising and correcting the abnormal brings into play the disciplinary mechanisms to which the fear of the plague gave rise. All the mechanisms of power which, even today, are disposed around the abnormal individual, to brand him and to alter him, are composed of those two forms from which they distantly derive (Foucault 1991b: 199–200).

"Generally speaking", Foucault argues, "all the authorities exercising individual control function according to a double mode" (Foucault 1991b:

199): On the one hand, there is a "binary division and branding", defining individuals as mad or sane, dangerous or harmless, normal or abnormal (ibid.). On the other hand, there is "coercive assignment" and "differential distribution", defining who an individual is, "where he must be; how he is to be characterized; how he is to be recognized; how a constant surveillance is to be exercised over him" (ibid.).

"If it is true that the leper gave rise to rituals of exclusion", Foucault elaborates, "then the plague gave rise to disciplinary projects" (Foucault 1991b: 198). "Rather than the massive, binary division between one set of people and another", the plague "called for multiple separations, individualizing distributions, an organization in depth of surveillance and control, an intensification and a ramification of power" (ibid.). The leper was met with "separation"; the plague with "segmentations"; the former was "marked", the latter "analysed and distributed" (ibid.). "Just as the image of the leper, cut off from all human contact, underlies projects of *exclusion*", so does the image of the plague, in all its *confusion and disorder*", underlie all disciplinary projects (Foucault 1991b: 199, emphasis added). Note, continues Foucault, that the "exile of the leper and the arrest of the plague do not bring with them the same political dream"; "the first is that of a pure community, the second that of a disciplined society" (ibid.).

THE PANOPTICON

Jeremy Benthams' *Panopticon* was 'the architectural figure' of the disciplines, Foucault argues. Originally, the architecture was developed for the purpose of creating prison houses which were effective in surveying and disciplining the inmates and yet economical in terms of the resources needed to achieve this. "We know the principle on which it was based"; Foucault notes:

[A]t the periphery, an annular building; at the centre, a tower; this tower is pierced with wide windows that open onto the inner side of the ring; the peripheric building is divided into cells, each of which extends the whole width of the building; they have two windows, one on the inside, corresponding to the windows of the tower; the other, on the outside, allows the light to cross the cell from one end to the other. All that is needed, then, is to place a supervisor in a central tower and to shut up in each cell a madman, a patient, a condemned man, observe from the tower, a worker or a schoolboy. By the effect of backlighting, one can observe from the tower, standing out precisely against the light, the small captive shadows in the cells of the periphery. They are like so many cages, so many small theatres, in which each actor is alone, perfectly individualized and constantly visible (Foucault 1991b: 200).

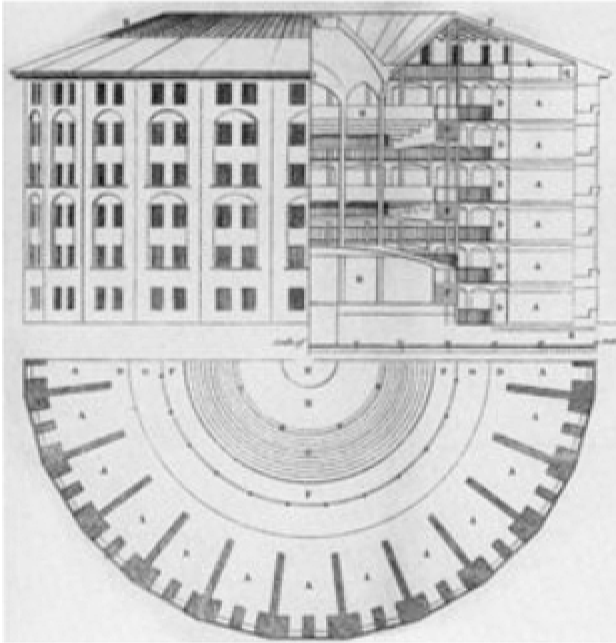

Figure 9.1 Bentham's Panopticon

The strength of the Panopticon was that the power it exercised over the inmates was at the same time *visible* and *unverifiable*. While the inmate would "constantly have before his eyes the tall outline of the central tower" from which he was "spied upon", the architecture was such that the inmate would never be able to verify whether the inspector was actually in the central tower or not. He had therefore to behave *as if* surveillance was perpetual and total. The panopticon was, in other words, "a machine for dissociating the see/being seen dyad: in the peripheric ring, one is totally seen, without ever seeing; in the central tower, one sees everything without ever being seen" (Foucault 1991b: 201–202).

Hence the major effect of the Panopticon: to induce in the inmate a state of conscious and permanent visibility that assures the automatic functioning of power. So to arrange things that the surveillance is permanent in its effects, even if it is discontinuous in its action; that the perfection of power should tend to render its actual exercise unnecessary; that this architectural apparatus should be a machine for creating and sustaining a power relation independent of the person who exercises it; in short, that the inmates should be caught up in a power situation of which they are themselves the bearers (Foucault 1991b: 201).

The plague-stricken town and the Panopticon mark "the transformations of the disciplinary programme"—"at a distance of a century and a half", Foucault argues. Whereas disciplinary power in the case of the "plaguestricken town" was "exceptional" in nature, in the case of the Panopticon it was *generalized*; it was "a way of defining power relations in terms of the everyday life of men" (Foucault 1991b: 205). The Panopticon was by no means an architecture intended only for prisons. Jeremy Bentham set out to show how one could make disciplinary institutions based on the architecture of the Panopticon "function in a diffused, multiple, polyvalent way throughout the whole social body" (Foucault 1991b: 208–209):

Morals reformed—health preserved—industry invigorated instruction diffused—public burthens lightened—Economy seated, as it were, upon a rock—the gordian knot of the Poor-Laws are not cut, but untied—all by a simple idea in Architecture! (Bentham, cited in Foucault 1991b: 207).

This passage cited by Foucault is from Bentham's Preface to the Panopticon. It is worth citing Bentham's foreword at length; it continues as follows:

To say all in one word, it will be found applicable, I think, without exception, to all establishments whatsoever, in which, within a space not too large to be covered or commanded by buildings, a number of persons are meant to be kept under inspection. No matter how different, or even opposite the purpose: whether it be that of punishing the incorrigible, guarding the insane, reforming the vicious, confining the suspected, employing the idle, maintaining the helpless, curing the sick, instructing the willing in any branch of industry, or training the rising race in the path of education: in a word, whether it be applied to the purposes of perpetual prisons in the room of death, or prisons for confinement before trial, or penitentiary-houses, or houses of correction, or work-houses, or manufactories, or mad-houses, or hospitals, or schools (Bentham 1787:2–4).

Bentham saw the Panopticon as "polyvalent in its applications", Foucault notes: not only does it promise to reform prisoners, it also proposes to serve to "treat patients, to instruct schoolchildren, to confine the insane, to supervise workers, to put beggars and idlers to work" (Foucault 1991b: 205). The Panopticon is—says Foucault, paraphrasing Bentham—applicable "to all establishments whatsoever, in which … a number of persons are meant to be kept under inspection". (Foucault 1991b: 205–6). It simply is, Foucault cites Bentham as having said, "a great and new instrument of government", the excellence of which consists in "the great strength it is capable of giving to *any* institution it may be thought proper to apply it to" (Bentham, cited in Foucault 1991b: 206).3

The strength of the Panopticon as a means to "perfect the exercise of power" derives from three sources, in Foucault's analysis. First, it reduces "the number of those who exercise it, while increasing the number of those on whom it is exercised" (ibid.). Second, it exerts a "constant pressure", "even before the offences, mistakes or crimes have been committed" (ibid.). Third, "it never intervenes", but is instead exercised "spontaneously and without noise" (ibid.). Whereas traditionally, power was that which was seen, shown and manifested, disciplinary power is "exercised through its *invisibility*", Foucault stresses (Foucault 1991b: 187, emphasis added). "In discipline", it is not power itself but "the subjects who have to be seen" (ibid.). Thus, disciplinary power "imposes on those whom it subjects a principle of compulsory visibility", which "assures the hold of the power that is exercised over them" (ibid.). "It is the fact of being constantly seen, of being able always to be seen", Foucault stresses, which "maintains the disciplined individual in his subjection":

The scarcely sustainable visibility of the monarch is turned into the unavoidable visibility of the subjects. And it is this inversion of visibility in the functioning of the disciplines that was to assure the exercise of power even in its lowest manifestations (Foucault 1991b: 189).

With the Panoption, it was "not necessary to use force to constrain the convict to good behaviour", Foucault observes, nor "the madman to calm, the worker to work, the schoolboy to application, the patient to the observation of the regulations" (Foucault 1991b: 202). Bentham himself was surprised, Foucault notes, that panoptic institutions 'could be so light': "there were no more bars, no more chains, no more heavy locks; all that was needed was that the separations should be clear and the openings well arranged" (Foucault 1991b: 202).

One might say, Foucault remarks, that the "constraining force" of power had "passed over to the other side"—to the side "of its surface of application" (ibid.). "He who is subjected to a field of visibility, and who knows it", Foucault explains, "assumes responsibility for the constraints of power" and thus "makes them play spontaneously upon himself" (ibid.): "He inscribes in himself the power relation in which he simultaneously plays both roles; he becomes the principle of his own subjection" (Foucault 1991b: 202–3). As the person who is subjected to power in this manner becomes the principle of his own subjection, "the external power may throw off its physical weight"—and the more it does so, "the more constant, profound are its effects" (Foucault 1991b: 203). Bentham described the Panopticon as a 'technical programme', but although, in appearance, it may seem "merely the solution of a technical problem", the fact remains, Foucault stresses, that "a whole type of society" emerges through it. "At the level of an elementary and easily transferable mechanism", the Panopticon "programmes the basic functioning", Foucault

asserts, “of a society penetrated through and through with disciplinary mechanisms” (Foucault 1991b: 209).

CONCLUDING REMARKS

“There are two images … of discipline”, Foucault argues, and it is the movement from one to the other that marks the rise of what he terms “the disciplinary society” (Foucault 1991b: 209, emphasis added). The first image of discipline is that of the “enclosed institution, established on the edges of society”, which is “turned inwards towards negative functions: arresting evil, breaking communications, suspending time” (ibid.). The other image is that of ‘Panopticism’, “a functional mechanism that must improve the exercise of power by making it lighter, more rapid, more effective, a design of subtle coercion” (ibid.). The movement from one to the other is a movement from a “schema of *exceptional* discipline to one of *generalized* surveillance” (ibid., emphasis added). This shift from exceptional to generalized surveillance is based on “the gradual extension of the mechanisms of discipline”, in the course of the seventeenth and eighteenth centuries, “throughout the whole social body” (ibid.).

This “extension of the disciplinary institutions” was, however, “only the most visible aspect”, Foucault argues, “of various, more profound processes (Foucault 1991b: 210). Part and parcel of the rise of the disciplinary society was what Foucault terms the “functional inversion of the disciplines” (ibid.). Whereas previously disciplinary power had been negative in the sense of being expected to “fix” or “neutralize dangers” or avoid “inconveniences”, it came to play instead “a positive role”, seeking to “increase the possible utility of individuals” (ibid.). As the disciplines came to function more and more as “techniques for making useful individuals”, they moved from “a marginal position on the confines of society” to the “most central and most productive sectors of society” (industry, education, military), and became attached to “some of the great essential functions: factory production, the transmission of knowledge, the diffusion of aptitudes and skills, the war-machine” (Foucault 1991b: 211).

“The extension of the disciplinary methods” was inscribed, Foucault notes, “in a broad historical process”, encompassing the development of a range of agronomical, industrial, and economic technologies (Foucault 1991b: 224). Foucault stresses, however, that, “compared with the mining industries, the emerging chemical industries or methods of national accountancy, compared with the blast furnaces or the steam engine, panopticism has received little attention” (ibid.). Though panopticism has often been regarded as little more than a “bizarre … utopia”, it is in fact “the abstract formula of a very real technology”, Foucault argues, namely, “that of individuals” (Foucault 1991b: 225). “The ideal point of penality today”, Foucault asserts, would thus be an “indefinite discipline”:

An interrogation without end, an investigation that would be extended without limit to a meticulous and ever more analytical observation, a judgement that would at the same time be the constitution of a file that was never closed, … a procedure that would be at the same time the permanent measure of a gap in relation to an inaccessible norm and the asymptotic movement that strives to meet in infinity (Foucault 1991b: 227).

"The practice of placing individuals under 'observation' is a natural extension", Foucault remarks, "of a justice imbued with disciplinary methods and examination procedures" (ibid.). Is it surprising, then, Foucault asks, "that the cellular prison, with its regular chronologies, forced labour, its authorities of surveillance and registration, its experts in normality, who continue and multiply the functions of the judge, should have become the modern instrument of penality?" (Foucault 1991b: 227–28). And is it surprising, he asks, "that prisons resemble factories, schools, barracks, hospitals"—"which all resemble prisons?" (ibid.).

10
Disciplining Economies

INTRODUCTION

This chapter presents the IFA as a system of disciplinary power, drawing upon the work of Michel Foucault (cf. Chapter 9). This analytical framework is well-suited for depicting the way in which the IFA was thought to contribute to the stability and resilience of the international financial system, as well as for problematizing the underlying assumptions in subsequent chapters. In this chapter, the focus is on analysing the IFA as a *system* of disciplinary power. Although never explicitly articulated as such, there can be little doubt that the IFA, both in its intentions and in its design, was a system of disciplinary power, to be imposed on economies worldwide. Needless to say, a system of disciplinary power targeting economies will be different from systems of disciplinary power targeting individuals. Above and beyond such inevitable differences, there are strong parallels, however.

The envisaged contribution of the IFA to the stability and resilience of the international financial system is intimately related to a recasting of 'market discipline'. Without the comprehensive supranational bureaucracy of the IFA, financial markets would not be able to assess risk properly and make well-informed investment decisions, the architects of the IFA now contended. Only on the basis of these new forms of data on compliance with standards and with financial soundness would market discipline be effective.

This chapter first depicts the rethinking and recasting of market discipline that took place in and through the IFA initiative (section 1), and then proceeds to describe how the transparency now perceived as indispensable for market discipline to be effective was to be produced (section 2). This is followed by a section excavating the mechanisms of reward and punishment that the disciplinary power of the IFA is predicated upon (section 3), a consideration of the tactics of the IFA (section 4), and a few concluding remarks (section 5).

RECASTING MARKET DISCIPLINE

"The discipline of the market is not always welcome", said Robin Cook, former British foreign secretary, "but it is a powerful ally of truth, efficiency and transparency". "The markets always know", Cook continued,

commenting on the Asian crisis, "and they impose a heavy penalty". This interpretation of the Asian crisis was common among Western policymakers and academics. Not all observers were equally convinced that the Asian crisis expressed 'market wisdom', however; it "did not exactly provide convincing testimony to the wisdom of the market", argued Burkett and Hart-Landsberg (1998:445–446). Why did mainstream economists not ask themselves "why so much core-country capital had been available for short-term investment in the miracle countries and other emerging countries"? (ibid.). Such questioning might have forced mainstream economists to "more fundamentally reconsider their allegiance to capitalist 'market forces'", Burkett and Hart-Landsberg reasoned (ibid.). If a crisis occurred in South East Asia only after these countries liberalized their capital accounts in the early to mid-1990s, was the Asian crisis not, at least in part, a crisis of market mechanisms and global financial integration? For 'mainstream economists', this was clearly not the case. The Asian crisis was in no way caused by integration with global financial markets but was rather the result of a failure on the part of the afflicted Asian economies to undertake concurrently the necessary upgrading of their financial regulatory and supervisory framework. This became the new conventional wisdom in mainstream economic discourse: financial policies, practices and institutions need to be properly 'up-graded' to the requirements of global finance before liberalisation of the capital account can be undertaken without 'excessive risk'. The process of financial *integration* must be sequenced in relation to the process of financial *up-grading*. This 'sequencing thesis' soon became a standard element in IMF and G7 policy discourse:1

Economic theory aside, experience has demonstrated that liberalizing the capital account before the home country financial system has been strengthened can contribute to serious economic problems … [A] country opening its capital account must do so in an orderly, gradual, and well-sequenced matter (IMF 1999b: 5–6).

We [G7] recognise that the opening of capital markets in emerging economies must be carried out in a careful and well-sequenced manner if countries are to benefit from closer integration into the global economy. In particular, financial sectors and regulatory and supervisory regimes must be robust and adequate to deal with risk. The international financial institutions should play a constructive role in the process of orderly opening the capital account (G7 1998:14).

This sequencing thesis was closely related to a rethinking of the notion of 'market discipline'. Key to the notion of market discipline is the assumption of a particular relationship between the market and the economy. This relationship is characterised, first, by observation and assessment and, second, by reward and punishment. "The market recognizes, judges and shows if

an economy is sound", Ute Tellmann comments, and in so doing it is as if the market "knows the 'real truth' about an economy" (Tellmann 2000:13; Tellmann 2003). Through the mechanism of capital flows, the market then rewards or punishes economies according to this knowledge about their 'true' condition. Economic discourse expects 'the market', in other words, to exert a disciplinary power upon economies as it 'observes' them. Market discipline is to make economies more efficient as they become more compliant, and conversely.

With the IFA initiative however, a recasting of the disciplinary role accorded to financial markets has taken place. Financial markets are no longer seen as capable of 'knowing' economies and of allocating resources *per se*. The ability of financial markets to allocate resources efficiently is now seen to dependent on 'transparency', without which, data can be misleading and financial markets may hence be deceived by them. The importance now accorded to transparency is intimately related to a particular interpretation of the Asian crisis, as illustrated by the following passage from a paper by two World Bank economists:

The findings suggest that these countries [Indonesia, the Philippines, the Republic of Korea, and Thailand] did not follow International Accountancy Standards and that this likely triggered the financial crisis. Users of the accounting information were misled and were not able to take precautions in a timely fashion … [S]ocieties' preferences should favor greater openness and transparency … [Disclosing] financial information directs capital to its most productive uses, leading to efficiency and growth (Vishwanath & Kaufmann 2001:44, 51; emphasis added).

Only on the basis of transparency will financial markets be able to 'trust' data. And only then will they be able to know the truth about economies, and discipline them accordingly.

Market discipline was not only central in explaining and 'rationalizing' the Asian crisis, it also took centre stage in the shaping of the IFA initiative. When the G7 Finance Ministers presented a report on the Strengthening of the International Financial Architecture at the G7 Summit in Cologne, in June 1999, the relationship between transparency and "well-functioning" markets was stressed:

The availability of accurate and timely information is an essential ingredient for well-functioning financial markets and market economies. Such information is necessary for market participants and should be used by them to make good decisions. It also provides greater incentives for policy-makers to implement sound economic policies. Improved information will help markets to adjust more smoothly to economic developments, minimise contagion and reduce volatility (Report of the G7 Finance Ministers, cited from Kaiser et al. 2000:239).

Market discipline was, said the IMF, a key presumption of the FSAP (IMF, 2000:2). The provision of data through FSAPs and ROSCs would assist in building market discipline, thus enabling "markets to form judgments as to a country's economic condition and prospects". Compliance with standards was expected not only to "assist countries in strengthening their economic institutions" but also to "inform market participants so as to allow for more effective market discipline" (ibid.).

PRODUCING TRANSPARENCY

With the launching of the IFA, the ability of financial markets to know the truth about economies—and thus to allocate capital to its most efficient uses—was no longer seen as 'natural' and 'automatic', but as *contingent*. Thus, for instance, if countries were to "reap the full benefits of the global capital market", the contention now was that their corporate governance arrangements had to be "*credible* and *well understood* across borders" (OECD 1999:3, emphasis added). Transparency was ultimately a matter of representing economies *in recognizable form*, in other words. By recasting 'market discipline' in this manner, the IFA effectively presumed that the problem underlying the financial crises in East Asia, and other recent financial crises, was not the mechanism of market discipline itself. Rather, in Foucauldian terms, it was a problem of *visibility*.

To ensure the 'visibilization' of economies, the FSAP was crucial. Rendering economies visible, accountable and governable was to be ensured by techniques of hierarchical observation and normalizing judgment. The apparatus of observation and corrective training organized in and around the FSAP was to function like a 'microscope of conduct' operating the new analytical categories of 'financial soundness' and standards of 'best practice'. The hierarchized surveillance exercised through FSAPs and ROSCs should not be seen in isoloation, however, but as as part of a wider 'machinery', a disciplinary machinery that places economies in a permanent and continuous field of visibility. Results from FSAPs and ROSCs reports were thus to the fullest possible extent to be published electronically on the IFA websites of the World Bank and the IMF for the convenience of "financial markets and other users": Through the publicizing of FSAP and ROSC findings, economies were to be made visible in terms of their deviation from standards, norms and benchmarks.

In Foucaultian terms, systems of disciplinary power combine the techniques of an 'observing hierarchy' and those of a 'normalizing judgment' in the instrument of the 'examination'. In the IFA, these techniques meet in the market place: the reactions of financial markets to compliance efforts by economies are what constitute 'examination' in the disciplinary system of the IFA. Integration with global financial markets means entering a process

of 'infinite examination'. To render economies susceptible to this infinite examination in the market place, international governmental organizations (IGOs) and their private, regional and national partners place economies in a field of surveillance, situate them in a network of registration, and engage them in a whole mass of assessments that capture and fix them. Examination in the market place is preceded, in other words, by a system of intense registration and documentary accumulation. This has two main effects. First, it makes possible the reconstitution of the economy as an object describable and analysable in terms of its *vulnerabilities*, its deviation from standards and benchmarks. As such, economies are maintained in their individual features, in their particular evolution, under the gaze of a permanent corpus of knowledge. Second, it makes possible the constitution of a *comparative* system—measuring, comparing, hierarchizing and determining gaps and distributions, in and among different groups of economies.

In terms of the Panopticon metaphor, FSAP and ROSC data produce the effect of 'backlighting'.2 Without this backlighting, exposing economies in terms of their deviation from standards and benchmarks, and of their differences from one another, economies would not be visible to financial markets in a manner allowing for market discipline. The IFA attributes to the FSAP the role of the 'perfect eye'. The FSAP is that which is to render it possible for a single gaze to see everything constantly, being both the source of light illuminating everything, and a locus of convergence for everything that must be known.

REWARD AND PUNISHMENT

At the heart of the envisaged disciplinary system of the IFA is a penal mechanism serving to make departures from the 'proper' economy subject to punishment. With the IFA, it is the whole indefinite domain of non-compliance with the 'proper' economy that is rendered punishable. The envisioned disciplinary penality of the IFA is to punish non-observance of standards as well as deviation from FSI benchmarks. Punishment strives to be corrective in the sense that it is concerned with increasing compliance, with reducing gaps. But this system of corrective punishment is only one element of a double system in which reward is the flip side of punishment, and where rewards should, ideally, be more frequent than penalties.

The IFA is a system of disciplinary power whose effect would be maximized only to the extent that certain signals in the system would trigger off the corresponding required behaviours. The IFA evokes a relationship between economies on the one hand and supra-national authorities and markets on the other, which in a double sense implies a relation of 'signalization'. Assessments of compliance signal the extent to which IGOs deem efforts to increase compliance in certain areas necessary. Ideally, these signals work directly upon economies. Moreover, they are intended to work indirectly as

well, through financial markets. Capital flows and the price of capital are to provide transmitted and enhanced signals. More specifically, the assumed disciplinary mechanism of the IFA was the following:

IGOs make data on compliance with standards and with FSI norms and benchmarks in individual countries available to financial markets. Financial markets then reward or punish economies according to their degree of compliance with standards and financial soundness benchmarks. Countries with a high degree of compliance receive higher amounts of foreign capital at a lower price (interest rate), as compared to countries that have a low degree of compliance. The overall disciplinary mechanism assumed by the IFA, linking compliance with reward or punishment in terms of access to foreign capital, may be depicted graphically as follows in figure 10.1.

The purpose of surveillance and assessment is to place economies in a 'world of signals', in other words. For each signal there is a 'single, obligatory response'. For each FSAP or ROSC, there is a reaction from financial markets in terms of changes in the relaive costs of capital, and a reaction from countries in terms of increased compliance. These relations of 'signalization' would compel economies to strive to conform, the IFA assumed.

A key characteristic of disciplinary power is that it works by compelling subjects to be governed to discipline themselves; it compels them to become 'their own guardians', in the words of Foucault. For such self-disciplining to occur, the disciplinary power exerted must be at the same time visible and unverifiable, Foucault argued. In the case of the disciplinary power of the IFA, the cost of foreign capital is the key reward and punishment mechanism. International capital flows, and differences in the access economies have to them, is thus what renders the disiciplinary power of the IFA *visible*. At the same time, however, this power is unverifiable. It is extremely difficult, if not impossible, to isolate and observe the impact on the cost of foreign capital of increasing compliance or financial soundness in some

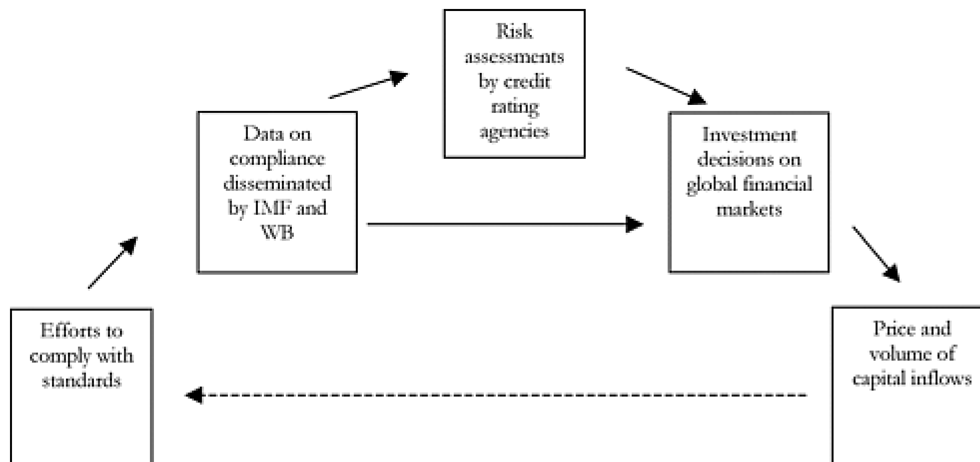

Figure 10.1 Reward and punishment in the IFA

areas. The disciplinary power of the IFA is hence both highly visible and yet unverifiable, in Foucauldian terms. In this sense, the IFA is predicated upon a dissociation of the 'see/being seen' dyad: financial markets may observe governments, banks and firms at all times, but these subjects of its disciplinary power may never observe the degree to which reward and punishment mechanisms are operating as envisaged.

By the effect of backlighting, one can observe from the tower, standing out precisely against the light, the small captive shadows in the cells of the periphery. They are like so many cages, so many small theatres, in which each actor is alone, perfectly individualized and constantly visible (Foucault 1991b: 200).

Economies therefore have to behave *as if* surveillance, assessment, and normalizing judgment–rewarding and punishing according to compliance is perpetual and total. Behaving *as if* financial markets observe, assess and reward or punish them continuously, *as if* the power exerted by international capital flows is perpetual, economies 'become their own guardians'.

TACTICS

One of the key principles of the tactics of disciplinary power is to obtain the exercise of power at the lowest possible cost, whether economically, in terms of the expenditure it involves, or politically, in terms of the resistance is may arouse. There is little doubt that part of the reason why 'the international community' found the IFA such an attractive supranational initiative was that it was seen to agree with these principles.

Compared to structural adjustment programmes, the rhetoric of the IFA is much 'lighter'. The rhetoric of 'transparency' is a rhetoric of 'truth'; who can oppose a quest for truth? It is a rhetoric of ensuring the 'proper' functioning of economies and of promoting the stability and resilience of the international financial system; who could be against stability and resilience? Further, it treats economies as 'equals' in the sense that *all* economies—small or large, European, African, Asian or American—are subjected to the same standards and reformatory techniques. Finally, allusions are made to the importance of the IFA for the future prosperity of the world's poor. When legitimizing the need for a global standard of corporate governance, for instance, the World Bank referred to the substantial social costs of the financial crises of the 1990s:

Corporate governance was lent new urgency by the global financial crises which unleashed unprecedented volatility in markets, led to devaluation, default and capital flight, *with the brunt borne by the poor*. Reform on governance can no longer be viewed as a national or local issue for any corporation: globalization has brought in its wake

the need for international coordination of effort to *ensure that growth is sustained and shared* (World Bank 1999, emphasis added).

The rhetoric of the IFA is well-aligned, in other words, with a tactics of power that emphasizes the minimization of political 'resistance'. But perhaps most importantly when it comes to the 'low political costs' of the IFA is the fact that it leaves 'judgment calls'—the actual rewarding or punishing—to 'the market'. Hence, though the IFA entails substantial supranational bureaucracy, the main power exercised is not a governmental, centralized and 'bureaucratic' one, but a politically anonymous, decentralized and private one.

The IFA also minimizes on *economic* costs. First, it does not introduce taxes on capital flows, which 'the international community' would see as expensive in terms of efficiency and growth foregone as a result of the 'distortions' such taxes would (allegedly) create. Second, the IFA does not propose any expensive new global financial governance institutions (as some 'radical' proposals suggested). Instead, the effects of the IFA are based on encouraging processes of self-disciplining, with most costs come directly by the Central Banks and Finance Ministries of the countries enlisting in FSAPs and ROSCs. The IFA was, both politically and economically, a low-cost solution, in other words.

With regard to the principle of bringing the effects of disciplinary power to their maximum in terms of intensity as well as in terms of extension, the IFA also fully agreed. As will be further discussed in Chapter 13, the objects of suprational governmental intervention in the name of financial stability were no longer only countries that temporarily experienced balance-of-payment problems, but indeed *all* economies, at all times. Further, with regard to the third and final principle of the tactics of disciplinary power, the IFA clearly endeavours to create a link between the 'growth of power' that it represents and the 'productivity' of its governmental objects. Standards and indicators are governmental technologies that not only represent but intervene: as an economy 'observes a standard' or strives to reach an indicator benchmark, it restructures in the image of that standard or benchmark, as we shall see in Chapter 10.

CLOSING REMARKS

A system of disciplinary power operates according to a twin mechanism of 'binary division' and 'differential distribution', said Michel Foucault. So too did the IFA. Economies were depicted as 'proper' or 'improper', and measured and distributed in terms of their degree of deviation from standards and benchmarks. In and through this twin mechanism of binary division and differential distribution, the IFA defined not only what a 'proper' economy is, how it should be characterized and recognized, but also how constant surveillance was to be exercised over it, and

how it should be organized and regulated. At the end of the day, it was the operation of this twin mechanism that was to ensure that economies were rendered visible to financial markets in a manner that allowed for market discipline. Thus, whereas originally countries were expected only to observe and comply with a fairly limited set of 'sound' macroeconomic policies loosely connected with the 'Washington consensus', compliance became much more demanding with the launching of the IFA.3

The IFA claimed to make economies safe, not by providing a strong, solid architecture around them—but by making them visible from the inside out. The strategy is to make economies safe by bestowing visibility upon them. Once this visibility is achieved, mechanisms of 'market discipline' will guide and pull economies toward safety, the contention goes. This new 'architecture'—ensuring visibility and providing guidance—purports to transform the economies it shelters; by making it possible to know their vulnerabilities, it makes it possible for them to become 'proper' economies.

With the IFA, in other words, a new modality of power in international economic governance was born, which endeavour to produce 'docile' economies. The IFA endeavoured to establish in economies a constricting link between increased aptitude and increased domination, evoking the standards of a 'proper' economy. The disciplinary power of the IFA thus aims both to increase and decrease the forces of economies: it seeks to *increase* the forces of the economy "in economic terms of utility", and to *diminish* them "in political terms of obedience". From this perspective, then, the global financial market is to the formation of docile economies what the disciplinary institutions of the school, the prison and the hospital were to the formation of docile bodies: it is in and through the global financial market that economies are to be observed, examinated and disciplined.

11

So What is a 'Proper' Economy?

INTRODUCTION

"The proper governance of companies will become as crucial to the world economy", declared James Wolfensohn, then President of the World Bank, "as the proper governing of countries" (Wolfensohn, cited in Singh 2003:377). Wolfensohn's remarks, made in 1999 when the World Bank launched its website on corporate governance, was but one of many examples. The standards and codes launched through the IFA brought into being something new and remarkable: a norm for the 'proper' organization and regulation of economies. In and through the IFA, banks and corporations had come to the fore of supranational governmental attention. The governmental technologies devised to render the norm operational ranged from standards of accounting and auditing to principles of good governance in private corporations. Indeed, an international governmental programme had taken shape which—to paraphrase Michael Power —was 'without precedent in its attempt to reach into the micro-managerial world' of banks and companies (Power 2005:583)1.

In policy discourse, standards are depicted in a 'technocratic' language which does not convey much information about the actual nature of the standards. Standards are embedded in a sanguine rhetoric of the 'proper' and the 'sound', and presented as "the only practical way" of addressing problems of global financial risk (Eichengreen 1999:35). In their seminal work, however, Mary Douglas and Aaron Wildawsky (1983) argued that one should never take risks, nor their management, at face value. Rather, one should investigate what forms of social organization are being defended or attacked in and through notions of risk. This dictum is all the more important in the context of the IFA, given that the standards of the 'proper' economy are evoked as a global norm against which economies worldwide should be measured and restructured.

There are two main questions that need to be addressed. First, what is this norm, and how can we characterize it, beyond merely accepting it as 'international best practice'? Second, what effects is the promotion of this norm, through the IFA initiative, likely to have in terms of the organisation and regulation of economies? A tempting hypotheis

with respect to these questions is that the standards impose an AngloAmerican model of capitalism as normal and that the IFA initiative hence entails a globalization of this particular model of capitalism. This chapter addresses these overall 'hypotheses' by examining a case study of the relationship between accounting standards and models of capitalism (section 2), before proceeding to a more general characterisation of the IFA standards using the comparative capitalism literature as interpretative framework (sections 3 and 4). This leads to the conclusion that IFA standards do indeed 'normalize' Anglo-American capitalism. The analysis also suggests, however, that normalization and globalization are two quite different things. 'Normalization' of Anglo-American capitalism does not, at least not in the short to medium term perspective, entail a global convergence upon this particular model of capitalism (section 5). First of all, however, the chapter provides an overview of the accounting component of the IFA initiative (section 1).

ACCOUNTING STANDARDS AND THE FSAP

A key part of the evaluation of a country's financial market infrastructure is an assessment of its accounting and auditing standards (2005a: 245). Further, these intersect with corporate governance standards in the sense that a "core component of good corporate governance" is "accurate disclosure" based on "high-quality accounting and auditing standards" (ibid.). Only if accounting and auditing practices are of "high quality" will disclosure of financial information to relevant stakeholders be "reliable and transparent" (IMF 2005a: 247). Such disclosure crucial, the IMF stresses, for "informed financial decisions, efficient resource allocation, and effective functioning of markets" (ibid.). Indeed, [A]ccounting, auditing, and disclosure requirements of high quality for financial institutions are regarded as one of the key basic areas of financial reform *necessary to prevent a financial crisis* (IMF 2005a: 247, emphasis added). Ultimately, 'high-quality' accounting and auditing influence the cost and availability of capital, the IMF explains, and hence "foster financial stability through strengthened market discipline" (IMF 2005a: 248). In many emerging market and transition economies, the IMF notes, such high quality standards are not implemented, and many of these countries in fact do not "require the reporting of key financial data by individual institutions" (ibid.). "This gap can hamper the ability to filter out healthy from unhealthy institutions", the IMF warns (ibid.). Without "appropriate information", the task of monitoring financial institutions and their risk-taking is difficult if not impossible, the IMF contends (ibid.).

Accounting and Auditing Assessments

Against this background, the IFA endeavours to assist countries in "implementing international accounting and auditing standards for strengthening the financial reporting regime" (World Bank 2006). There are two overall objectives of IFA accounting and auditing (A&A) assessments. First, the objective is to "analyze comparability of national accounting and auditing standard" with international standards and assessing the "strengths and weaknesses of the institutional framework in supporting high-quality financial reporting" (ibid.). Second, the objective is to "assist the country in developing and implementing a country action plan for improving institutional capacity", for the overall purpose of "strengthening the country's corporate financial reporting regime" (ibid.). The World Bank stresses that its reviews are conducted "at the invitation of a country" and are carried out in close cooperation with "stakeholders" (ibid.). The reviews strive to make such recommendations "that can lead to a country action plan" (ibid.) By 2006, A&A review reports for a total of 39 countries had been published on the World Bank website (World Bank 2006).2

The World Bank stresses that there are "no international regulatory standards for accounting and auditing" and that therefore World Bank staff draw on "their own experience and international best practices", using the IAS and ISA as benchmarks (World Bank 2004). The basic contention underlying A&A country reviews is that "achieving conformity" with the IAS and ISA benchmarks "promotes *sound* financial reporting in an economy" and that it is therefore important to "identify gaps" (World Bank 2004, emphasis added). The formulation and improvement of accounting and auditing standards is not in itself enough, however, the World Bank points out. "Corporate stakeholders depend on access to highquality financial information", and thus *enforcement* of standards "is even more important" (ibid.). Reviews therefore include assessment and advice with regard to "effective and efficient" mechanisms to "ensure compliance" with accounting and auditing standards (ibid.). In and through the assessment of the "strength and weaknesses of existing institutional frameworks that underpin financial accounting and auditing practices", the World Bank reviews provide overviews of key legislative and regulatory issues, the history and current state of the accounting and auditing *profession*, the strengths and weaknesses of accounting *education*, the accounting and auditing *standard-setting process*, and arrangements for *ensuring compliance* with standards (World Bank 2004, emphasis added).

A&A reviews are made on the basis of a "participatory approach", the World Bank stresses, involving "policymakers and other country stakeholders" (ibid.). This is reflected both in the central role accorded to a National Steering Committee (NSC), consisting of key national stakeholders, and a due diligence exercise "capturing primary experiences of practitioners and other facts on professional accounting and auditing

practices in the country" (ibid.). The A&A review thus begins by identifying "the country stakeholders who have an interest in accounting and auditing matters" (ibid.), and typically includes "representatives from the Ministry of Finance, securities market regulator, banking regulator, insurance companies and other non-banking financial institutions regulator, higher education institutions, professional accounting and auditing bodies, auditing firms, and institutional investors" (ibid.). The NSC acts as "an intermediary" in relation to the country's government when it comes to "getting approval for publication of the final report", and "oversees the implementation of the country action plan" (ibid.).

The World Bank team prepares a draft report "presenting the factual findings arising from the review" and making policy recommendations "to help the country enhance its accounting and auditing standards and practices" (ibid.). The NSC "reviews the draft report", and the final draft report take into account "comments received from the NSC" (ibid.). The report is then submitted to country authorities "for comments, approval, and permission to publish" (ibid.). When agreement has been reached, the report is published on the World Bank website.

This is by no means the end of the process, however. In fact, it is merely the beginning of it. "After approval of the final report by the country authorities", the Bank explains, the NSC meets to develop a country action plan on the basis of the report's findings. Though the NSC may request assistance from the World Bank in developing the country action plan, the Bank stresses that the success of the plan derives "from country ownership" (ibid.).

Both the A&A report and the country action plan "can contribute", the Bank observes, "to the design of loans", the preparation of "key policy documents", and "the design and monitoring of technical assistance and capacity-building programs" (ibid.). With regard to the action plan, the country may, again, request assistance from the World Bank, including the important question of "gathering resources for implementation" (ibid.). "It is worth mentioning here", the Bank explains, "that long-term developmental programs are necessary for achieving results from accountancy reform initiatives" (ibid.).

Accounting Standards

At first, international accounting standards were developed by the International Accounting Standards Committee (IASC). More recently, this task has been taken over by the International Accounting Standards Board (IASB). The focus of A&A assessments is on International Financial Reporting Standards (IFRSs), which encompass both International Accounting Standards (IASs) developed by the IASC, and IFRSs issued by the IASB. Currently, there is a total of "36 effective IAS–IFRS standards", the FSAP Handbook notes (IMF 2005a: 248), which "are accompanied by

documents providing the framework for the preparation and presentation of financial statements, as well as guidance on interpretation" (ibid.):

The framework defines the objectives of financial statements, identifies the qualitative characteristics that make information in the statements useful, and defines the basic elements of financial statements and the concepts in recognizing and measuring them (IMF 2005a: 248).

The FSAP Handbook highlights a few of these accounting standards as "particularly important in financial sector assessments" (IMF 2005a: 249). IAS 1 is particularly important because it "deals with the content of financial statements generally" (ibid.). IAS 32 and IAS 39, on the other hand, are important because they explain how financial instruments should be measured and accounted for, and how information on these should be disclosed. IAS 39 requires that assets are measured in terms of their 'fair value' (more on this below), and as such "may have significant effect on the volatility of earnings, levels of provisioning, and various observed prudential ratios", the IMF notes (ibid.). Finally, the Handbook highlights IAS 30 as particularly important to financial sector assessments, as it "applies to the disclosures by banks and other similar institutions of their income statement, balance sheet, and contingencies and commitments, including other off-balance sheet items" (ibid.).

It is, of course, beyond the scope of this book to explain in detail all accounting standards, or even a reasonable sub-set. What is possible, however, is to discuss briefly two exemplary cases, the IAS 32 and the IAS 39. More will be said about these in the case study below, but let us begin with a brief summary of how the IAS 39 is presented in the FSAP Handbook:

IAS 39

IAS 39 requires that financial assets be classified in one of the following four categories to determine how a particular *asset* is recognized and measured in financial statements: Financial assets at fair value through profit or loss; Available-for-sale financial assets; Loan and receivables; Held-to-maturity investments. The general principle is that available-for-sale financial assets are to be valued at fair value, whereas heldto-maturity may be valued at amortized cost. IAS 39 recognizes two classes of financial *liabilities*: Financial liabilities at fair value through profit and loss; Other liabilities measured at amortized cost using the 'effective interest' method.

IAS 39 has been a source of debate within financial markets, especially among commercial banks. IAS 39 requires entities to value derivatives, shares, and bonds at fair market value, not at historical costs, but does not recognize macro-hedging and internal-risk transfers. However, banks are heavy users of macro-hedging and inter-group transfers of

risks. Not recognizing macro-hedging would mean that marked-tomarket changes in the value of derivative position would be booked to earnings and would raise volatility. If recognized, derivative position would be booked to equity and not earnings. Consequently, a number of European banks, especially in France, have opposed IAS 39 because they believe that it could damage their risk management practice.

Source: IMF 2005a: 250.

The Head of the International Accounting Standards Board, Sir David Tweedie, made an unusual remark in 2004 after the EU had decided to make the adoption of IASB standards mandatory for all publicly listed companies: "There will be blood all over the streets", he said, referring to the expected uproar from companies that might object to the new standards if they felt they would show their accounts in less favourable light. He made it clear, however, that accounting reforms were more than "book-keeping exercises". He believed they could influence the way companies did business, "improve market efficiencies", and "lower risk premiums". "Harmonising" global accounting standards could also stimulate greater cross-border transactions. "This is world trade", Sir Tweedie explained; "that's what it's all about".3

Resistance to FVA standards was no surprise to accounting regulators, in other words. Such resistance was considered to be a self-interested resistance, however, indeed, a cowardly self-interest, against the higher interest of society. In the face of such resistance and protests, Sir Tweedie stresses, it is essential that policy-makers keep in mind that standardization is a fundamentally benign process that brings economies in 'harmony' with one another and promotes world trade. The case study that follows briefly provides a somewhat different perspective on resistance to FVA standards.

ACCOUNTING AND CAPITALISM

The case study presented in the following depicts the global push for Fair Value Accounting (FVA) and the 'clash of capitalisms' that unfolded as a consequence in Germany in the period from 2005 to 2007.4 Before proceeding to the case study, however, some general remarks on the relationship between accounting and capitalism are warranted.

Accounting, Sociology, and Capitalism

In the classic work of sociologists such as Max Weber and Werner Sombart, accounting was accorded a key role in explaining the emergence and maturation of capitalism as a particular social ordering of production and consumption.

Sombart even argued that the invention of double-entry book-keeping was essential to the birth of capitalism (Sombart 1902). The accounting theme was also pursued by Max Weber, although his focus in explaining the emergence of capitalism was the 'protestant ethic', which he saw as essential to the 'spirit of capitalism' (Weber 1905). The relationship between accounting and capitalism has remained a key theme among accounting scholars. Later work by accounting scholars indicate that Sombart's original thesis was too strong. Up until the nineteenth century double-entry book-keeping was one among several accounting models used by capitalist enterprises, and only in the course of that century did double-entry book-keeping become standard accounting practice (Lemarchand 1994). This is not to deny the relationship between accounting and different modes of organizing production, however. In his analysis of the classic work of Karl Marx, R.A. Bryer shows that Marx's theory of the transition from feudalism to capitalism can be expressed in terms of a transition of calculative mentalities—from feudal to capitalistic to capitalist—each of which is characterised by a particular 'accounting signature' (Bryer 2000a, 2000b). Although accounting scholars have maintained an active interest in the relationship between accounting and capitalist relations of production, it is noteworthy that sociologists and political economists seem to have lost interest in this theme (Miller 2000). This neglect of accounting is paradoxical given that accounting practice "both reproduces and shapes the nature of capitalist relations of production", thus being in fact "constitutive of the modern economy" (Miller 2000:16). In the comparative capitalism literature one finds little, if any, systematic exploration of the relationship between modes of accounting and modes of capitalism. In recent years, however, some case studies have emerged, on such issues. Particularly, the work of Andreas Nölke and colleagues makes an important contribution to this otherwise largely non-existent research area. The remainder of this section examines the work of Nölke and colleagues, relating it to the wider issues pursued in this book.

A New Paradigm: Fair Value Accounting (FVA)

In recent years, a shift in measurement paradigms has been propagated, particularly by the accounting profession and a number of international financial institutions. Whereas previously assets have been valued at their acquisition price in many countries, the argument in recent years has been that assets should be valued instead in terms of their current market price; Historic Cost Accounting (HCA) should be replaced by Fair Value Accounting (FVA), it is argued. In definitional terms, FVA is "the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction" (IASB 1999, IAS19, Section 7: definitions). As compared to historic-cost accounting, FVA "represents a significant shift in thinking because it removes the direct link between what a firm paid for an asset and the value the firm attributes to that asset in its statutory financial

statements" (Perry & Nölke 2006:562). The rationality behind FVA is that by replacing valuation anchored in *historical* values (acquisition prices) with valuation tied to *current* values, one achieves a more adequate, or fair, valuation of productive activities, assets and liabilities. *Fair* value is *market* value, in other words. In many instances, however, fair value accounting is complicated by the absence of knowledge of market values because the asset in question is not traded. In such cases, recourse must be taken to various forms of model-based estimations of market value. Irrespective of this complication, the rationality of FVA is that it contributes crucially to the efficiency of economies. Capital markets use financial accounting data to assess the likely future income streams of companies, and for this purpose FVA provides much more suitable data than does HCA. Whereas HCA is believed to 'distort' economic reality by 'under-reporting' asset values, "there is nothing more real than the value of an asset today", in the words of the vice-chairman of the IASB (cited from Perry & Nölke 2006:564). FVA is therefore expected to provide the best possible data to capital markets and this is crucial in today's global economy, for only by optimizing the quality of financial reporting data may the efficiency of resource allocation be optimal. FVA is the best possible estimation of the true value of assets and hence, in and of itself, it reduces uncertainty and risk in financial markets, and by extension reduces the cost of capital for society at large.

A number of reservations have been expressed with regard to FVA. First, some authors have argued that while it may in principle provide a better input for comparative risk assessments in capital markets, in reality it is itself based on so many complex and subjective assessments that financial statements based on it are not comparable between different firms, not to mention between different time periods (Bernstein 2002). Without such comparability, the envisaged efficiency gains will not result. Second, some have warned that the FVA paradigm "reduces the manager's voice in favour of the market's voice" (Barlev and Haddad 2003:384), shifts power from managers (executives) to shareholders (investors), and reduces the influence of stakeholders. Third, it is argued that FVA takes the perspective of finance, whereas HCA takes the perspective of production, and that FVA thus reflects and reinforces 'financialization', the process by which the "proportion of corporate profits made from financial activities rises sharply relative to that made directly from production" (Nölke and Perry 2007; Perry & Nölke 2006). These criticisms resurface in later sections. Now it is time to turn our attention to a case study showing how accounting standards are anything but 'innocent'.

FVA and the Clash of Capitalisms

Though the FVA may be considered part of a larger accounting trend, standardization by the IASB and various initiatives and decisions by supranational authorities such as the European Union and the IMF are absolutely

central to the increasing adoption of these new accounting practices. The accounting standards developed by the IASB introduce FVA to a range of different accounting areas (Perry & Nölke 2006:563), including intangible assets (IAS32), the measurement of assets and liabilities (IAS39), agricultural commodities (IAS41) and pensions (IAS19). We now analyse in some detail one of these 'fair value' accounting standards, the IAS39, to illustrate that accounting standards are by no means 'neutral' with respect to the organization and regulation of economies. Rather than merely *representing* economic reality, new accounting practices entail an *intervention* in economies, a *restructuring of* them.

Accounting varies from one model of capitalism to another. Accounting in the German economy is fundamentally different from accounting in the US economy, for instance. From the perspective of the models-of-capitalism literature, such institutional diversity neither reflects historical coincidence nor the fact that some capitalist economies are simply more 'mature', or developed, than others. Accounting practices are part of wider institutional configurations. The German economy is characterised by "rather conservative accounting standards", which go hand in hand with certain corporate governance and corporate financing arrangements to allow German companies to "follow long-term strategies", often based on long-term bank loans (Nölke and Perry 2007:11). This institutional configuration is of paramount importance to the comparative competitive advantage of German capitalism. In this model of capitalism, the role of accounting statements is not to inform judgements about the performance of firms, as presumed in Fair Value accounting. Instead, accounting first and foremost serves the purpose of reassuring bankers that a given firm has sufficient collateral to support its loans by providing an account of the firms' separable assets (ibid.). Financial accounting in the German model of capitalism is not primarily oriented towards capital markets, but towards the bank(s) providing loans for the firm, in other words. Accounting plays an altogether different role in a 'bank-based' financial system than it does in a 'market-based' financial system (more on this dichotomy below).

Accounting practices in Germany have traditionally been conservative, in the sense that they have allowed, if not encouraged, German firms to build substantial 'hidden' reserves. The FVA, however, makes prudent German accounting practices such as "low book values of assets, overstated liabilities and 'hidden reserves'" illegitimate (Perry and Nolke 2006:569). These 'conservative' accounting practices—which have enabled German firms to reduce the volatility of their earnings and thus avoid layoffs in difficult times—are intimately related to the German 'corporatist' model of capitalism, which is characterised by long-term investments in human capital and by the key role that labour unions play in companies. In this type of corporatist economy, the cost of layoffs is considerably higher than in a liberal market economy, where labour unions play a limited role. The shift towards FVA is thus not 'just' a shift towards a new mode of measuring activities,

assets and liabilities in firms; it exerts a significant pressure on models of capitalism based on bank-based financial systems in general and on corporatist capitalist economies such as Germany in particular.

"Whereas enterprise managers previously had considerable discretion over when to recognise unrealized gains and losses", Perry and Nölke explain, "the fair value approach calls for changes in the capitalized value of *future* income to be shown on the balance sheet immediately":

Financial analysts can now exert pressure on enterprise managers to put these resources to more productive, and often rather short-term, uses ... [T]hus, the well-known "pressures of short-termism that plague American and British companies—pressure from shareholders to maximize dividends by concentrating on quarterly results and short-range return on investment" (Sally, 1995:69) are likely to arrive alongside FVA (Perry and Nölke, 2006:570).

One of the most controversial aspects of FVA-related accounting standards is IAS32, which pertains to equity capital. If extended to SMEs as planned, this standard would require that equity capital paid in by the owners of these companies be reclassified as a financial *liability*. This reclassification would reflect the fact that, according to IFA principles, such paid-in capital would have be treated as potentially subject to repayment. Needless to say, this reclassification of equity capital as a financial liability would be at fair value. "The net effect would be", argues Nölke and Perry, "to strip most German small and medium-sized companies not only of their equity capital, but also significantly increase their liabilities", and as a consequence "severely constrain their ability to raise fresh credit" (Nölke and Perry 2007:12, 17). If IAS32 is extended to SMEs as planned, it would "significantly raise the borrowing costs of 900,000 German SME's" (Perry and Nolke, 2006:571). Endangering not just the liquidity but the survival of German SMEs, the IAS32 has a "very real potential to threaten the basis of the [German] capitalist model" (ibid.). Small wonder that the IAS32 has been one of the most hotly contested accounting standards since the IASB's mandate on standards development started in 2005. When plans to extend the IAS32 to all SMEs were made public, it led to a range of protests from German SMEs and industry organizations. These protests, many of which were made in writing during an official comment-by-letter phase, explicitly objected that the plans would threaten the survival of German SMEs. Nevertheless, the IASB draft report launched in 2006 took no notice of the protests. Political resistance intensified throughout 2007, however. As a consequence of increasing political protests, the EU Ministers of Finance in 2007 demanded that a "comprehensive assessment of the economic consequences of both existing and upcoming standards" should be made. And a few months later, in September, the EU suddenly declared that it had "no intention to make IFRS obligatory for SMEs" (Nölke and Perry 2007).

One is compelled to ask, however, whether this case study is the exception rather than the rule. Should we expect the adoption of standards to generally be more or less free of such conflict and tension? Or, should one expect such 'clashes of capitalism' to be inevitable phenomena of economic globalization? These essential questions are seldom raised. Instead, two opposing and somewhat simplistic views of the relationship between institutions and economic globalization dominate the debate (Amable 2003). On the hand, Amable explains, a 'naturalist' view contends that to the extent that institutions actually matter to economic performance, the forces of competition will *automatically* lead to the global adoption of international 'best practice'. On the other hand, an 'interventionist' view suggests that the 'international community' should compare institutions one-by-one, identify 'best practice' in key areas, and push for their global adoption. These two views are closely related to the Washington and the Post-Washington consensus, as will be discussed in more detail in Chapter 13.

With regard to the 'naturalist' view, Amable is doubtful that there has ever been 'natural' convergence toward 'best practice'. He is equally unconvinced, however, that countries can optimize their economic performance by 'picking and choosing' from a range of international 'best practices', combining the best elements from a range of different countries, as implied by the interventionist view. To Amable, both these views are too simplistic and insensitive to empirical analysis. To examine the relation between institutions and economic globalization, it is necessary first to understand what the main institutions of a capitalist economy are. Only by first specifying the main institutional areas of capitalist economies may one assess the extent to which the standardization of certain institutions leads to conflict and resilience, or to global convergence. To qualify further this discussion, a brief consideration of the comparative capitalism literature is called for.

THE COMPARATIVE CAPITALISM LITERATURE

Two general categories of approaches to undertaking a comparative analysis of capitalism may be distinguished: binary approaches and pluralist approaches. Binary approaches dominated in what may be termed 'first-generation' studies in comparative capitalism, whereas pluralist approaches prevail in 'second-generation' studies.5 Generally, one could say that in the 'first generation' of comparative capitalism studies, the overarching theme was the excellent economic performance in the 1980s of economies such as France, Germany and Japan, as compared to industrial decline in Britain and the US. The strong economic performance of such 'coordinated economies' remained the dominant theme in the literature until the late 1990s.

With the advent of the Asian crisis, however, popular conceptions of comparative capitalism changed completely. The Asian crisis re-established the hierarchy of competing models of capitalism, which had been dislocated by the impressive post-World War II economic performance of France, Germany and Japan. Now, again, the conventional wisdom was that the most efficient mode of economic organization was that of a 'liberal market economy'. In response to this re-establishment of the hiearchy of models of capitalism in conventional and popular opinion, the comparative capitalism literature reinvented itself. The trend for 'second- generation' studies now became that of engaging in studies that were comparative in a 'multidimensional' manner, differentiating capitalist economies along a number of institutional areas.

First Generation

The binary approaches of first- generation studies come in two main species. First, in some studies economies are characterised by their degree of deviation from an 'ideal state'. What this ideal state is varies from case to case, but often involves some conception of a so-called 'liberal market economy', or 'free market economy'. Second, another type of study predicates binary classification on two specific economies, juxtaposing, for instance, US vs Germany; US vs France; US vs Japan, etc.

The 'deviation-from-ideal-state' approach exists in two main variants, orthodox and heterodox. The orthodox version is closely related to neoclassical economics; here an economy is characterised in terms of its degree of deviation from a Walrasian model of 'perfect competition'. No economy is actually expected ever fully to 'become' a Walrasian model of 'perfect competition', but all economies are assessed against this norm. In the heterodox approach, by contrast, economies are characterised in terms of their proximity to an ideal, 'good-capitalism' model. By 'good capitalism', this literature usually means stable economic growth in combination with features such as low levels of poverty and crime, etc.6 The common characteristic of scholarly work in this tradition is that it broadens the criteria by which an ideal state is defined—it is no longer *only* a question of efficiency, as in the orthodox approach. In both orthodox and heterodox work of this type, the US model of capitalism is the key reference point. In the orthodox neoclassical approach, US capitalism is considered the best approximation to 'perfect competition', and thus evoked as positive benchmark for other countries. In the heterodox approach, again it is US capitalism that is the key point of reference, but now in negative terms; the US model of capitalism is here characterised by its high social costs, such as inequality, poverty, crime, etc. Thus, the further away from the US model of capitalism an economy is while still remaining capitalist, the better.

Studies patterned on binary classifications referring to specific countries often include an analytical categorisation also, in the sense that its typology

refers to ideal types which the countries are seen to exemplify. Hall and Soskice (2001), for instance, posit a dichotomy of 'liberal market economies' versus 'coordinated market economies'—with the US and Germany as the main examples. Ronald Dore (2000) juxtaposes 'stock market capitalism' and 'welfare capitalism', again using the US on one side of the comparison, but adding Japan on the other side, to supplement Germany. Some of the most classical and most cited works in the comparative capitalism literature belong to this category of binary work. Much work in this literature is formulated in explicit opposition to the orthodox view that US capitalism represents the closest a country can get an 'ideal state', and that therefore the wisest thing a country can do is to imitate the US model of capitalism. In what is often considered the first contribution to the comparative capitalism literature, Schonfield (1965) undertook a comparative analysis of the US and France. His starting point was his bemusement with French 'modernization', characterised by surprisingly rapid productivity growth. According to Schonfield's analysis this rapid growth occurred not *in spite of* France's deviation from US capitalism but *because* of that deviation; it was the high degree of public intervention in the French economy that made this rapid growth and catching-up with the US possible so quickly after World War II. Michael Albert (1991) pursued a similar overall theme in comparing not France but Germany with US capitalism. A central observation made by Albert was that whereas everything follows a short-term financial horizon in US capitalism, the opposite seem to apply for German capitalism, which seemed to be a key reason behind Germany's impressive post-World War II economic performance.

Whereas the two-country literature tends to favour the 'non-US' country in the equation, i.e. France or Germany, the liberal vs coordinated market economy approach of Hall and Soskice is less simplistic, or definitive. Hall and Soskice introduced the concept of 'comparative institutional advantage', arguing that liberal market economies and coordinated market economies each have comparative advantages, each in their types of industries. Liberal market economies have a comparative advantage in industries characterised by 'radical innovation' whereas coordinated market economies have a comparative advantage in industries characterised by 'incremental innovation'.

Second Generation

Much of the original comparative capitalism literature had been articulated in explicit opposition to the notion that US capitalism was somehow 'naturally' superior. How did this research tradition react when this 'conventional wisdom' re-established itself after the advent of the Asian crisis? A key feature of the response was that studies endeavouring to transcend binary classification began to proliferate from the late 1990s onwards.7 A key example of such non-binary work is Schmidt's (2002), distinguishing between three ideal-typical models of capitalism: market capitalism,

managed capitalism, and state capitalism. To each of these three idealtypes of capitalism corresponded, Schmidt argued, a particular type of state—the liberal state, the enabling state, and the interventionist state, respectively—and industrial relations that are primarily market-reliant, coordinated, or state-controlled.8 The work of Bruno Amable (2003), identifying five different models of capitalism, also clearly belongs to this 'second generation' of comparative capitalism studies.

All work on comparative capitalism faces a fundamental dilemma, Amable notes. On the one hand, "categories that are too broad tell us very little about what brings countries together in a specific group". At the other extreme, however, we may end up "having as many types of capitalisms as there are countries", and then we achieve little more than presenting "a series of country-specific case studies". Although such country-specific case studies may be important, they do not contribute much, Amable stresses, to a comparative analysis of capitalism. So what does Amable do in the face of this dilemma? He identifies what he considers the main institutional areas in capitalist economies (Amable 2003:14): product market institutions; labour market institutions; financial system institutions; social protection institutions; and education system institutions. Further, on the basis of an extensive literature review, previous empirical research and various bodies of institutional theory, Amable predicts the existence of five different models of capitalism: market-based capitalism; social-democratic capitalism; Asian capitalism; continental-European capitalism; and South-European capitalism.9

In further depicting these five models of capitalism, Amable deploys a notion that is central to second- generation studies, that of 'institutional complementarities'. Institutional complementarity refers to situations where "the functionality of an institutional form is conditioned by other institutions" (Höpner 2005). A key claim of comparative capitalism studies is that different models of capitalism display strong complementarities between a set of different institutional domains, "such that each institution depends on the others in order to function effectively" (Soskice 1999:110). This concept of institutional complementarities suggests that tensions are likely to result when different institutions imply conflicting principles of rationality (Jackson & Deeg 2006:12).

A key finding from Amable's analysis relates to the alleged existence of a Continental-European model of capitalism. His theory predicted the existence of this model, but his empirical analysis found inconclusive evidence of it. This latter result makes Amable wonder whether this particular model of capitalism is slowly disappearing, and if it is, what might be replacing it in Continental European countries. Ultimately, Amable's main concern is with the convergence-divergence theme. For Amable the most likely interpretation of his data is that European integration efforts exist in a *tension* between a neoliberal and a 'social-democratic' project, and that this may be creating a convergence of Continental-European countries towards a 'social market economy' model—a hybrid model, that is, combining

elements from market-based capitalism with elements from social-democratic capitalism; and centred on the concept of 'flexicurity' (easy hire and fire, combined with high social protection). Be that as it may, Amable's research indicates that institutions are not 'innocent' and that processes of institutional homogenization are unlikely to be 'neutral' with regard to existing models of capitalism. In this sense, Amable's work indirectly confirms the findings of the case study. Since the institutions making up a capitalist economy are interdependent, changes in one institution must generally be expected to have an influence on other institutional dimensions (Jackson and Deeg 2006:36), whether in the form of creative assimilation, painful tensions or head-on resistance and conflict. As we shall see in the following section, institutions pertaining to financial systems are highly unlikely to be an exception in this regard.

IFA STANDARDS AND FINANCIAL SYSTEMS

A common definition of the role of financial systems in economies is that they "channel household savings into investment in the productive sector" (Jackson and Deeg 2006:13):

There are two basic channels between savers and investors; the first channel is mediated by institutions (usually banks) that aggregate savings, match the maturities of savings and investment in order to minimize liquidity risks, and evaluate and monitor investment risks. The second channel is a direct transfer from savers to borrowers via securities markets (Jackson and Deeg 2006:13–14).

Just as was the case for the comparative capitalism literature more generally, the comparative literature on financial systems can be divided into binary contributions, and studies that endeavour to transcend binary division. Perhaps the most widespread typology of financial systems distinguishes between 'bank-based' and 'market-based' financial systems, "depending upon which channel is dominant" (Jackson and Deeg 2006:14). Bank-based systems are often associated with Coordinated Market Economies (CME), whereas market-based financial systems are typically associated with Liberal Market Economies (LME). Transcending binary division, Zysman (1983) launched a typology based on three types of financial systems. Depending on the roles played by financial institutions, industry and the state, financial systems were classified by Zysman as either capital market systems (US, Britain), 'negotiated' credit systems, (Germany, Sweden), or credit-based systems with a high degree of state ownership and/or state control over investment (Japan, France). Amable (2003) similarly endeavoured to transcend the traditional dichotomy between market-based financial systems and bank-based financial

systems—which, in his view, over-simplifes. Instead, he selected a number of dimensions along which he wished to analyse financial systems and a set of variables for which he then collected empirical data. On the basis of these data, he conducted *cluster analysis*, i.e., analysis observing the degree to which countries tended to group in 'clusters'. Amable identified four such clusters of financial systems (Amable 2003:145–149): Decentralized finance (USA, Canada, the Netherlands, the UK, Australia); Bank-based, but 'passive' banks (Belgium, Denmark, Sweden); Foreign-bank dominated (Finland, Korea, Norway, Ireland); and 'Active' bankbased (Germany, Japan, France, Italy).

IFA standards are closely related to the rationality of a market-based financial system. More specifically, they are predicated upon the idea that the allocation of capital should take place, to the greatest possible extent, via capital markets—and with largest possible 'market sensitivity'. This criterium of 'market sensitivity' is perhaps more to the point in describing IFA standards than the traditional 'market-based' versus 'bank-based' dichotomy. Whether in terms of accounting practice or of risk management, IFA standards endeavour to promote 'market sensitivity'. More will be said about market-sensitive risk management in Chapter 12. For now, suffice it to note that what is promoted in and through IFA standards is a type of financial system that endeavours to make the allocation of capital and credit as 'market-sensitive' as possible. As the case study suggested, and as will be confirmed in the next chapter, a financial system pursuing the largest possible 'market sensitivity' tends to be a pro-cyclical rather than counter-cyclical financial system. The comparative capitalism literature suggests that financial system institutions are particularly important, if not dominant, in the configuration of modern capitalist economies (Jackson and Deeg 2006:32). Hence, although IFA standards relate primarily to the 'financial system' dimension, adopting them is likely to affect a range of other institutional domains. Sigurt Vitols (1996, 2001) has demonstrated how two key dimensions of financial systems are linked to a much broader set of institutions, thus highlighting "the extensive embeddedness and potential interdependencies between financial systems and other key institutional domains too (Jackson and Deeg 2006:14). So-called short-term finance, for instance, which is usually associated with liberal market economies, "requires quick entry and exit from business activities" and is usually seen in conjunction with "industrial relations systems that allow inexpensive hiring and firing of labour" (Jackson and Deeg 2006:23). To the extent that the IFA succeeds in enforcing the adoption of standards of 'best practice' in economies worldwide, in other words, it is not just institutions in the area of financial intermediation and corporate governance that are involved, but models of capitalism as such. To put it bluntly, taking the financial system institutions of one model of capitalism and 'applying' it to other models of capitalism cannot be done mechanically, or 'smoothly'.

GLOBALIZATION OF ANGLO-AMERICAN CAPITALISM?

If accounting standards create a 'clash of capitalisms', as illustrated by the case of Fair Value Accounting and the German model of capitalism, it is pertinent to ask whether this holds more generally for IFA standards. Are IFA standards associated with a particular model of capitalism, and if so, does their adoption threaten the existence of other models of capitalism? The case study of FVA in Germany tells us two things about processes of economic standardization and globalization. First, it provides an illustrative example of processes by which a *homogenization* of the organization and regulation of economies is strived for. Second, it illustrates that such processes, at least in some cases, encounter considerable political-institutional *resistance*.

But what is the relationship, one is compelled to ask, between this particular case study and the wider trajectory of the German model of capitalism? In a review of the comparative capitalism literature, Jackson and Deeg argue that although many studies of Germany have shown that the country has "experienced an Anglo-Saxonization", it nevertheless "remains a Coordinated Market Economy" (Jackson and Deeg 2006:32–33; Vitols 2004). In this view, the German model is constantly changing, and is now very different from what it was in the past—but at the same time it is *resilient* in the sense that it remains a CME-type economy, despite narratives about global convergence toward an LME-type economy. These results resonate with the findings of Bruno Amable (2003): a key conclusion of his analysis was that all European countries, except the UK, remain clearly distinct from market-based capitalism (2003:225), again contrary to narratives about the global spread of Anglo-American capitalism.

It should be stressed, however, that Amable's cluster analyses are performed on the basis of data from the latter half of the 1990s, and thus precede the process of global disciplining that the IFA entails. A recent study by Thatcher (2007) found in fact that generally *policy forms* of internationalization are more important than technological and economic forms of internationalization because they become part of domestic decision-making and institutional re-engineering. The IFA in effect encourages economies worldwide to reform and restructure in the *image* of Anglo-American capitalism, a process that is likely to have implications far beyond finance and corporate governance. Needless to say, the regime of global disciplining launched witht the IFA inititiative will not in any straightforward manner render economies Anglo-American in their organization and regulation.10 In several economies there is considerable institutional and political resistance against such impetus. The point remains, however, that a universal standard has been set, against which economies today measure their deviation. Though seen as universal, these standards—whether for financial accounting, auditing or corporate governance—correspond to an Anglo-American mode of capitalism. To

'strengthen the international financial system' in and through these standards is to *normalise* an Anglo-American mode of organising and regulating economic activities. The standards define how properly to organise and regulate an economy, including how properly to conduct, organize and regulate business and credit. In short, they define a universal norm for a 'proper' economy. To the extent that standards are accepted and adopted, they constitute powerful, disciplinary mechanisms. The end result of such processes remains uncertain, however. Not only do standards invariably meet some degree of resistance and/or creative adaptation; Anglo-American capitalism is itself 'an evolving set of institutions, not a constant' (Dore 2001:103). So whereas it is safe to say that the past decade has seen a *normalization* of Anglo-American capitalism—in the sense of being evoked as the global norm of 'proper' economy—it would be going too far to claim that a *globalization* of Anglo-American capitalism is occurring. Perhaps one could speak instead of a *totalization* of Anglo-American capitalism, deploying a concept coined by Ronen Palan:

There is a subtle but important difference between totalising processes and the concept of a totality. Totalising means a system of thought and practices which seeks to universalize and dominate its surroundings; such systems are expansionary but they never truly obtain their goal: they never create a truly total system (Palan 2000:16).

12

More Heat Than Light Anatomy of a Regulatory Failure

INTRODUCTION

A banking crisis broke out in the Dominican Republic less than a year after its FSAP had been completed. FSAPs have not always led to "timely changes to forestall problems", the IMF's Independent Evaluation Office noted (IEO 2006a: 12). One may see such 'missed opportunities' as a sign that the FSAP is not and never will be 'bullet-proof'. Or one may regard such instances as the result of 'exceptional' circumstances beyond the gaze of an FSAP. This latter option is the course taken by the IEO in the case of the banking crisis in the Dominican Republic. The Dominican banking crisis was "triggered by the discovery of massive fraud", the IEO notes, and as an FSAP cannot be "expected to detect accounting fraud", it cannot be blamed for not foreseeing the crisis (IEO 2006a: 40). In fact, the FSAP *did* diagnose "severe and widespread vulnerabilities in the Dominican banking system", the IEO stresses; these conclusions just never had the effect on policy that they should have had (ibid.). On one hand, the IEO argues that an FSAP cannot possibly detect the types of problems that triggered the Dominican banking crisis. On the other hand, it argues that the Dominican FSAP did in fact identify "severe vulnerabilities" and flag "warning signs"—and that by ignoring these the Dominican government set itself up for the crisis (ibid.). The inconsistency of the IEOs account—arguing that the FSAP couldn't possibly identify severe vulnerabilities but did in fact do so is troubling in itself, of course. Even more troubling, however, is the overall gist of the narrative: absolving the FSAP and the international institutions behind it of blame, and attributing blame one-sidedly to the local authorities.

'Missed opportunities' such as the Dominican FSAP should instigate efforts to examine whether there are inherent features of the FSAP that make them ineffective in assessing financial sector vulnerabilities and warning signs as envisaged. Contrary to the account given by the IEO, I argue in the following that the failure of the Dominican FSAP, and other similar occurrences, are not coincidental, but rather the result of an approach to financial risk regulation that —paraphrasing Avinash Persaud—not only *does* not work, but *cannot* work (Persaud 2004b: 190).

The intention in what follows is not to 'explain' the failure of the Dominican FSAP, but to identify the 'blind spots' of FSAP financial stability analysis. The analysis is not confined to such blind spots, however. The following endeavours to provide a critical review of the IFA initiative more generally—and thus includes analysis of problems relating to the promotion of compliance with standards, country enrolment in FSAPs, and the use of FSAP data by a range of agents, including financial markets and the IMF itself. In undertaking this critical analysis of the FSAP, I include material from a number of IMF and IEO evaluations.1 Further, I draw upon observations and criticism offered by a number of finance scholars.
There are two main components in the IFA's approach to the regulation of international finance. One is crisis prevention by means of restructuring economies to become 'proper' economies, in and through standards of 'best practice'. The second component is crisis prevention by means of increased 'market-sensitivity', in terms of both 'early warning systems' operated by authorities and new, more market-sensitive risk management practices of banks and other financial institutions. The time horizon of these two components, or strategies, differ in the sense that whereas the former is presumed to be effective in the short run, the latter is likely to be effective only on a medium to long-term basis, giving that the implied restructuring efforts take time. The two main sections of the chapter correspond to these two main components, identifying the limitations or difficulties of each. This is followed by some general reflections on the IFA as a regulatory failure and on the future of the FSAP.

LIMITS OF THE STANDARDS APPROACH

Formal Enforcement Mechanisms

Initially, the G7 countries envisaged a strong enforcement regime, with a key role played by the IMF and the World Bank (Thirkell-White 2007). The World Bank and the IMF endeavoured to design operational procedures that would allow FSAPs to deliver on a number of different objectives, related particularly to the two mother institutions.2 Compliance with standards and codes were to be enforced not only through FSAPs and ROSCs themselves. Operational procedures were designed so that FSAPs would "feed into the IMF's Article IV consultation process through close linkages with IMF's surveillance activities" and "serve as input into Bank's social and structural reviews, country assistance strategies, and other operations of the World Bank" (IMF 2005a: 326). More specifically, three 'formal' enforcement mechanisms were intended to supplement FSAPs and ROSCs: Conditionality, the Contingent Credit Lines

scheme and, as mentioned, Article IV consultations. For each of these enforcement mechanisms however, there were, substantial difficulties.

Conditionality

Conditionality refers to the practice of giving loans only on the basis of certain conditions, which first began in 1952. Since then, conditionality has been a key mechanism for the IMF in enforcing particular types of policies. Usually, an IMF loan is divided into phases, which means that the borrowing country will only be able to access the second part of the loan if the conditions agreed upon are met by a certain date.3 When the standards initiative was launched in 1999, the idea was to incorporate the degree to which countries complied with standards of 'best practice' in loan conditionality: only if countries did this would IMF approve the later phases of the loan.4 The G24 countries were in ardent opposition to this, however, and eventually successfully resisted proposals to include standards of 'best practice' in loan conditionality.

Article IV Consultations

The degree to which member countries adopted standards of 'best practice' was thought to be a key issue in 'Article IV consultations'. These consultations refer to the annual audit undertaken of each member country by the IMF. G7 Finance Ministers had given a "high priority" to "developing a system for surveillance of implementation of the codes and standards, built on the Article IV process of the IMF … [and] systematic incorporation of information on a country's observance of transparency standards in the Fund's regular Article IV surveillance reports" (Kaiser et al. 2000:241). A recent IMF evaluation observed, however, that seven years later recommendations from FSAPs had "not yet been fully mainstreamed into Article IV assessments" (IEO 2006a: 10). The report asserted that this was due to the use of "cautious language" in FSSAs, a "loss of candor" at the "critically important stage" of transforming FSSAs into staff reports for the Article IV consultations, and continued emphasis on *macroeconomic policies* in Article IV consultations.5 Whatever the reasons, the under-utilization of FSAP data by the IMF itself is a rather grave problem from the perspective of standards enforcement. This problem of the under-utilization of IMF data by IMF economists extends to the IMF's activities in the area of 'multilateral surveillance'. Based on internal survey data, an evaluation of IMF multilateral surveillance established that only 4 percent of the Fund's Area Economists use the Global Financial Stability Report 'regularly' in their country work (IEO 2006b: 3). Needless to say, this low degree of utilization of various forms of financial assessment data by the IMF itself represents a major setback to the IFA initiative.

Contingent Credit Lines (CCL)

In the spring of 1999, the IMF introduced Contingent Credit Lines (CCL) in response "to the rapid spread of turmoil through global financial markets during the Asian crisis of 1997–98" and the subsequent Russian crisis (IMF 2004, Kenen 2001:94). The CCL was particularly targeted at countries with "sound policies", which were therefore "not at risk of an external payments crisis of their own making", but only of becoming "vulnerable to *contagion* effects from capital account crises in other countries" (ibid., emphasis added). Countries were to sign up for the CCL *in advance* of any payments crisis, and hence only if a country met CCL criteria would it be eligible for this particular type of financing should it be afflicted by a crisis. Countries that did meet the "eligibility criteria" would, on the other hand, be able to draw on a "large pre-specified amount of resources if hit by a financial crisis due to factors outside of the member's control" (ibid.). Criteria to be met included "a positive assessment of policies and progress toward adherence to internationally accepted standards" (ibid.).6 The rationale of the CCL was that by incorporating standards in its qualification provisions, countries would be required to comply with standards at all times, or risk losing access to financial support from the IMF in a crisis. In their 1999 report, G7 Finance Ministers anticipated that the CCL would "play an important role in promoting international financial stability" by "protecting from contagion" those countries that were perceived to have "reasonable debt structures, sound macroeconomic and structural policies", and were "engaged in an appropriate process of consultation with private creditors" (Kaiser et al. 2000:251).

Eventually, however, no countries signed up for the CCL, and the facility was abandoned by the IMF in 2003.7 This complete failure of the CCL was a surprise to the IMF. Reflecting on the reasons, IMF Directors contended that "potentially eligible countries may have lacked confidence that a CCL would be viewed as a sign of strength rather than weakness" and "may also have been concerned about the risk of negative fallout if they were to be considered ineligible at a future date" (IMF 2003b).

In sum, none of the three envisaged enforcement mechanisms was effective. At the end of the day, the adoption of standards hence rested entirely upon voluntary participation in ROScs and FSAPs, with some potential motivating role played by 'market discipline'. Reliance on market discipline as the key motivating factor was problematic, however. Soon after the launching of the IFA, Peter Kenen of the Washington-based Institute of International Economics expressed scepticism about its reliance on 'market discipline'. "The official community appears", Kenen observed, "to count heavily on market discipline to foster compliance with these codes" (Kenen 2001:110–111). "Thus far, however", he continued, "the private sector seems to know little about the various standards and codes or the Fund's

efforts to publicize its findings concerning compliance with them" (ibid.). "For this and other reasons", he concluded", "it may be imprudent to rely mainly on market discipline" (ibid.).

Market Discipline Revisited

Since none of the formal enforcement mechanisms functioned well, if at all, the disciplinary power of the IFA came to rest more or less exclusively on 'market discipline'. There are a number of reasons, however, why one must question whether the new 'transparency-enhanced' market discipline constituted a well-functioning reward and punishment mechanism as envisaged.

The recent experiences of Argentina and Malaysia show that, at times, financial markets punish economies that comply with IMF advice and standards and reward economies that do not. Argentina for many years strictly followed IMF macro-policy recommendations and was one of the first emerging market economies to make considerable efforts to comply with standards. For these latter efforts, Argentina received considerable praise from the IMF (Rodrik 2003). Yet, in 2001 international investors withdrew capital on a large scale, leaving Argentina in deep financial crisis.8 Malaysia, on the other hand, when afflicted by the Asian crisis in 1997, did the opposite of what the IMF advised (imposing capital controls, etc.), and made little effort to comply with standards. Yet, soon after the onset of the Asian crisis foreign capital flowed plentifully into Malaysia again, which indeed became the economy that recovered most rapidly from the Asian crisis. Argentina, which strove to comply with standards, was punished by the financial markets, whereas Malaysia, that did nothing to comply, was rewarded.9

This absence of a positive link between, on the one hand, the degree to which the policies pursued by countries were perceived as 'sound' by the IMF and the World Bank and, on the other hand, foreign capital flows is not a recent phenomenon. When Chile achieved huge capital inflows in the 1850s and 1860s, it was attributed to 'free market reforms'—but similar capital inflows were received simultaneously in Russia, the Ottoman Empire, Egypt, Colombia, Tunisia, Spain, Austria-Hungary, Peru, Romania and the Confederate States of America. "It is hard to argue", Michael Pettis stresses, that these countries "followed a common set of policies", rewarded by foreign investors (Pettis 2001:191). On a more recent note, if capital flows did indeed reward domestic policy, one would have expected those to Mexico, Chile, Brazil, and Argentina in the past three decades to be correlated with reform implementation. Yet, "in spite of the huge timing differences in the reform process", Pettis observes, "the timing of capital flows … was virtually identical: the massive capital inflows of the 1970s were wholly cut off in 1982–83 and resumed again in 1989–91 to reach their apogee in 1995–1997" (Pettis 2001:50).

In light of this absence of a link between, on the one hand, compliance with perceived 'sound policies' with standards of 'best practice' and, on the

other hand, 'market discipline', even in times of liquidity abundance and investment optimism, it should be no big surprise that when a shock to 'investor confidence' occurs, one observes little if any influence of domestic policy on the degree of capital outflows. When a financial crisis occurs, Avinash Persaud explains, "fund managers sell off assets in places that *resemble in any way* the trigger spot" (Persaud, cited in Williams 2006:162, emphasis added). Hence contagion, the phenomenon by which a financial crisis spreads to neighbouring countries (Desai 2003, Eichengreen et al. 1996, Sell 2001, Frenkel & Fendel 2004, Eatwell & Taylor 2000). In this perspective, contagion is likely to occur regardless of the degree of compliance with standards in neighbouring countries. The compliance-with-standards approach has little to offer in terms of countering the problem of contagion, in other words. A serious disincentive problem results, of course: why strive to comply "if the good and the bad are both caught" (Kumar & Persaud 2002:21)?

Even in periods of relative stability—in the absence of strong cycles of 'mania' and 'panic' (Kindleberger 1978; Mosley 2003)—financial markets are more interested in 'traditional' macroeconomic policy indicators than in compliance-with-standards data. A recent evaluation of the IMF's financial sector assessment programme (FSAP) concluded that "while many authorities identified the 'signalling role' to markets as one of their motivations for participating in the FSAP exercise, the impact of FSSAs on the views of financial market participants appear *modest*" (IEO 2006a: 13, emphasis added).10 In fact, interviews with a wide range of market participants indicated that most had "limited knowledge" of FSAPs and the data disseminated through them. In 2006, IMF directors expressed "disappointment" that the use of compliance data by market participants "remained low" (IMF 2006:52).

Given this 'modest' interest and 'limited knowledge', it is no surprise that quantitative studies examining the impact of compliance with standards on the cost of foreign capital have failed to demonstrate the assumed significant link. A number of studies have adopted the methodology of examining the impact of compliance with standards on the cost of foreign capital, measured by interest rates on foreign currency-denominated government bonds. Econometric studies on the impact of FSAP data "generally suggest a small impact, at best, on market spreads", noted the Independent Evaluation Office at the IMF. Though one of the more comprehensive of these studies—carried out by IMF economists—argued that compliance with standards does indeed reduce the cost of foreign capital (IMF 2003a: 6), it was apparent at closer scrutiny that there was only a robust impact with regard to one of twelve areas of standardization, namely standards for property rights protection (IMF 2003a: 16). A significant impact was found also for accounting standards, but this impact disappeared when the analysis focused on post-Asia crisis data.12

Overall, the evidence in support of the presumed existence of an effectively operating mechanism rewarding or punishing countries according to their degree of compliance with standards is not exactly overwhelming. 13

Self-Disciplining

Even in the absence of well-functioning mechanisms of reward and punishment, the IFA may nevertheless be effective in promoting compliance, at least in the short run. In systems of disciplinary power, self-disciplining plays a key role. Because disciplinary power is visible but unverifiable, perhaps it doesn't matter too much whether market discipline is an illusion or not? Perhaps countries' belief that market discipline is at work is enough to make them behave as if it was, and hence discipline themselves? At any rate, it is important to avoid seeing global disciplinary power as an 'imposition', from a centre, on more or less 'unwilling subjects'. It is a key lesson of Foucault's analysis of disciplinary power that it mobilizes the will and efforts of those to be disciplined; that individuals or economies to be disciplined become their own guardians, their own educators. A brief illustration of the spirit of such self-disciplining in the case of the Asian crisis is warranted. Mr Sonakul, then Governor of Bank of Thailand, stressed that when the financial crisis hit Thailand, he had felt that "our problem was structural" (Sonakul 2000). "Now [in 2000], I am even more convinced that I was right", he said, "and we have indeed pursued that path of restructuring and rediscovering ourselves (ibid.).14

Despite the failure of formal enforcement mechanisms and the absence of effective market discipline, the FSAP has in fact achieved considerable coverage. In the period from 2001 to 2006, FSSAs were made for 120 countries (Balino and Calari 2005:10; IMF 2007b). Participation varied significantly, from "virtually complete coverage of European economies" to substantial "under-representation of East Asian economies" (Balino and Calari 2005:9). At times countries would be enrolled not in a full FSAP, but only in an assessment of their compliance with one or more of the standards of 'best practice', published as ROSCs. By the end of 2006, 130 countries had undertaken at least one ROSC, and a total of 600 ROSCs had been made; 71 in Africa, 81 in Asia and the Pacific, 286 in Europe, 81 in the Middle East and Central Asia, and 81 in the Americas (see Table 12.1). China, one of the world's largest economies, has not participated at all, and although India's participation exceeds that of China, it remains modest vis-à-vis the logic and rationale of the IFA. Among the countries afflicted by the Asian crisis, participation varies considerably too. The participation of Thailand has been modest, that of Malaysia almost non-existent, whereas the participation of South Korea has been substantial.

What may appear at first to be a considerable coverage, at closer scrutiny is not quite so impressive. It seems, in brief, that the appetite in emerging market countries for engaging in FSAPs has been modest. Add to this the fact that the countries that *have* undertaken FSAPs are reluctant to engage in FSAP updates. The IEO recently stressed that not only was it likely that "current incentives for participation" were insufficient to ensure coverage of countries that

Table 12.1 Report on Observance of Standards and Codes

Standard	*Africa*	*Asia and Pacific*	*European*	*Middle East and Cent. Asia*	*The Americas*	*Total*
Data Dissemination	17	11	29	13	16	86
Fiscal Transparency	12	13	31	13	14	83
Transparency in Monetary and Financial Policies	7	7	32	9	6	61
Banking Supervision	10	9	43	13	12	87
Securities Market Regulation	1	7	30	6	4	48
Insurance Regulation	1	5	33	4	2	45
Payment and Settlements Systems	3	6	32	6	6	53
Anti-Money Laundering	6	5	19	3	6	39
Accounting and auditing	9	7	18	6	8	48
Corporate governance	4	11	16	8	5	44
Insolvency and creditor rights	1	0	3	0	2	6
Total	71	81	286	81	81	600

Source: IMF 2007d.

have not yet participated in the FSAP, they were also insufficient to motivate countries that have done FSAPs in the past to embark on FSAP updates (IEO 2006a: 7). The reluctance, on the part of member countries, to engage in FSAP updates is particularly disturbing from the perspective of the IFA, since its logic is predicated upon continuously updated assessments of countries' compliance to be publicized for the use of financial market participants. On account of this reluctance, "a significant proportion of FSAPs ... are becoming dated", the IEO evaluation stresses, to the extent that "actual participation is not in line with the broader objectives of the initiative" (ibid.).

The reluctance to engage in FSAP updates has most likely not decreased since the credit crunch of 2007–2008, which destabilizes any confidence one might have that the LME finance constitutes the best approach to ensuring the stability and resilience of financial systems. As recently noted by Stiglitz, "US credibility and the credibility of US financial markets is zero everywhere in the world":

Table 12.2 ROSCs for 18 Emerging Market Economies, 1999–2006

	Banking supervision	*Securities*	*Insurance and paym. Systems*	*Anti-money laundering*	*Accounting and auditing*	*Corporate govern.*	*Insolv. and creditor rights*
Argentina	Apr 99						Dec 02
Brazil				Jun 05			
Chile	Aug 04	Aug 04		Mar 05	Dec 04	May 03	Dec 04
China							
Colombia					Mar 04	Aug 03	
Egypt					Jun 03	Sep 01, Mar 04	
India					Jun 05	Jan 01, Jun 04	
Indonesia					Sep 06	Sep 04	
Malaysia					Dec 00, Jun 06		
Mexico	Oct 01	Oct 01	Oct 01	Dec 05	Mar 04	Sep 03	
Pakistan	Jul 04	Jul 04			Jan 06	Feb 06	
Peru					Jan 06	Aug 04	
Philippines	Apr 04	Mar 04	Jan 05		Jan 02, Jun 06	Sep 01	
Russia	May 03	May 03	May 03				
S. Korea	Mar 03	Mar 03	Mar 03		Nov 04	Mar 03	
S. Africa				Apr 04	May 03	Jul 03	
Thailand						Sep 05	
Turkey						Apr 01	

Source: IMF 2007d.

Anybody looking at this from the outside says, 'There's been a lot of hot air coming out of the US, so why should we listen to these guys when they didn't know how to manage risk?'15

Closing Remarks

Foucault emphasized that for disciplinary power to be effective, a double system of reward and punishment must be in place, and that rewards should be more frequent than punishments. Are rewards more frequent than punishments, in fact, in the disciplinary system of the IFA, one is compelled to ask? Reward in the IFA comes in the form of foreign capital flows and lower cost of obtaining them. As noted, there is no evidence that compliance is rewarded as envisaged. A further problem is that it is not always clear that foreign capital flows are in fact a good thing for developing countries. This is only the case to the extent that foreign capital inflows can be productively absorbed in the economy. In the case of East Asia, the countries afflicted by the financial crisis were already 'awash with savings', as one observer phrased it, and thus had little possibility of productively absorbing the huge inflows of foreign capital. When emerging markets have difficulties productively absorbing foreign capital inflows, these inflows carry with them nascent punishment rather than reward, for the withdrawal of these short-term foreign funds is then only a matter of time,16 especially since evidence suggests that capital flows to developing countries are closely related to 'liquidity cycles' in developed countries (for more on this, see Chapter 18).

In sum, having looked at formal enforcement mechanisms, market disciplining and self-disciplining, an overall assessment of the effectiveness of the standards component of the IFA turns out quite negative: there is little reason to believe that this component has contributed much if anything to the stability and resilience of the international financial system.

LIMITS OF FSAP FINANCIAL STABILITY ANALYSIS

Blind Spots

Liquidity Risk

The international financial system is stable and resilient, Johannes Priesemann argues, when "auto-referential feedback mechanisms … lead back to stability as a response to shocks", but unstable and lacking in resilience when shocks lead to sustained instability because of the presence of "autocatalytic processes" (cited from Goodhart 2006:3420). In early 2007, the IMF's Global Financial Stability Report (GFSR) noted that although "financial markets may well adjust smoothly" in a transition from favourable liquidity conditions to "to historically more normal levels", there is "a risk

that the adjustment will be less smooth" (IMF 2007c: 29). The credit crunch that started unfolding later that year may be said to be, at least in part, the expression of such an 'adjustment process'. The adjustment is ongoing and though much remains to be seen, it seems safe to say that 'smooth' is not the word for it. Be that as it may, it is important to stress that the crucial factor determining whether an adjustment is smooth or not, orderly or disorderly, is liquidity; the potential absence of liquidity may severely "amplify the market effect of external shocks" (Goodhart 2006:3421).17 Against this background, it is disturbing that the currently fashionable approach to financial regulation neglects liquidity risks. This tendency to neglect liquidity risk is evident in the IFA initiative as well. Only in 4 out of a sample of 28 FSAPs had stress tests addressed liquidity risk (IMF, 2003c: 6–7). FSAP stress tests had focused instead on interest-rate risk (25 out of 28), exchange-rate risk (24 out of 28), and credit risk (26 out of 28). It is important to stress that this problem is not confined to FSAPs. It holds more generally that, by focusing "unrelentingly on bank capital adequacy", central banks have effectively "taken their eye off liquidity" (Goodhart 2006:3421). "The capital that an institution is *forced* to maintain to meet regulators' requirements is *not free* to be used to meet adverse eventualities", Goodhart stresses (ibid.).

Exclusive Focus on Banks

The functional dividing lines between banks and other financial intermediaries have become increasingly blurred over the past decade. As a consequence non-bank financial institutions may be as crucial to financial stability as banks themselves. Given these developments, FSAPs would have to focus not only on banks but also on non-bank financial institutions, such as insurance companies, hedge funds and pension funds, if they were to adequately assess financial sector vulnerabilities. The IMF was aware of this quite early on. Thus, in one of the first IMF policy documents on the FSAP, a main conclusion was that there was a need to focus not just on banks, but also on a number of other "sectors and markets that have proven relevant in assessing financial vulnerabilities", including mutual funds, pension funds, insurance companies, and hedge funds (IMF 2000:12). Nevertheless, in the vast majority of cases, FSAPs carried out stress-testing of banks only. Only in 7 of 28 FSAPs were stress tests made for non-bank financial institutions (IMF 2003c: 9). This relative neglect of non-bank financial institutions in stress tests was further reinforced in the process of identifying a 'core' set of financial soundness indicators; all core FSIs targeted banks, whereas non-bank financial institutions were covered only through the wider set of 'encouraged' indicators.

Off-balance Sheet Positions

Current stress-testing methodology "relies almost exclusively on balance-sheet data" and therefore "has serious shortcomings as regards the assessment of

risk exposures of complex institutions with substantial derivatives positions", the IMF acknowledges (IMF 2003c: 16). Because stress tests "largely do not take account of the effect of derivatives positions", even the "*direction* of exposures to financial shocks derived from balance-sheet positions can be misleading because off-balance sheet positions can qualitatively and quantitatively alter on-balance-sheet exposures" (ibid.). Indeed, whereas for long it was conventional wisdom that banks successfully sliced up and solid on their credit risks—thereby making them and, by extension, the financial system as such, safer—the recent turmoil in financial markets suggests that the picture is not quite as neat. Is it not rather the case, asked *The Economist*, that although "banks have shown risks out the front door by selling loans", they may have "let them return through the back door" through other dealings, such as prime brokerage, the net effect of which no one seem to fully grasp? (the Economist, August 11, 2007).

Domestic Inter-linkages

Stress tests carried out in the context of FSAPs tend to be 'macro/micro'. Such stress tests assess how the positions of an individual financial institutions "would respond to a given chosen change in some macro-variable" (Goodhart 2006; Eatwell 2004). In assessing stress-testing efforts, it is important to distinguish between the role of an individual bank supervisor, such as the UK Financial Services Authority (FSA), and the role of a central bank. For the former type of authority macro/micro stress tests are in principle satisfactory, but for a central bank, which is responsible for *systemic* stability, are, at best, of limited value. A macro/micro test is usually a single factor exercise, assessing the impact of, for example, a rise in interest rates on a single financial institution. "But such a rise", notes Charles Goodhart, will affect not just the financial institution examined, but "all other banks, financial institutions, borrowers, and other economic agents", and how the individual financial institution is to "assess the resulting inter-linkages within the whole economy is left unclear" (Goodhart 2006:3417). "What may appear sound at the micro-level", he continues, "may be quite fragile and flawed at the macro level" (ibid.). While "much attention has been given to the micro stress testing of individual banks", he continues, "there has been relatively little empirical work aiming to do a similar exercise for the banking system as a whole" (Goodhart 2006:3418). The IMF has been aware of this problem too. Among the key problems highlighted in an internal IMF review of the FSAP was that "linkages among different financial institutions are often complex and little understood" and that accordingly, "there is a risk that potential systemic vulnerabilities related to linkages among sub-sectors or non-financial institutions may be overlooked" (IMF 2003c: 20). Despite this awareness, FSAP stress-tests have been carried out for the entire banking system only in a minority of cases, and not once for an economy as such. Ultimately,

what are needed are macro/macro stress tests, argues Goodhart, which examine "the economy as a whole"—including the real economy, as well as the banking sector and the non-bank financial sector—in respect "of the effect of a given shock on all main component sections of the economy simultaneously" (Goodhart 2001:3418; Borio 2006).

Supra-national Dimensions of Financial Risk

A focus on the domestic economy *as a whole* would by no means be a sufficient revision of the FSAP, however. Systemic risk is not confined to the domestic economy. In the words of the IEO, FSAPs "have generally been limited to the segments and risks of the financial system that have domestic implications" and "made limited inroad into the broader global and regional dimensions" of financial risks—and thus, in terms of "identifying and highlighting potential spill-over channels and effects", the contribution has been "limited" (IEO 2006a: 35). It is not without irony that despite the rhetoric of 'globalization' and processes of 'international financial integration', the FSAP remains firmly confined to nation states, both administratively and conceptually, thus neglecting more or less systematically *global* systemic risks.

Procyclicality

While many believe that the response of the G7 countries to the financial crises of the last two decades has been "inadequate", few have argued against its three overall objectives—risk management, prudence and transparency—notes Avinash Persaud, former head of research at JP Morgan and State Street Bank (Persaud 2001:57). To Persaud, it is these overall objectives, as much as the ways in which they are pursued, that makes the new regulation of finance not just futile but "dangerous" (Persaud 2004b: 194).

A key aspect of the IFA is the attempt to make financial market participants more sensitive to market volatility in their risk management practices. The "growing fashion in risk management" is to "move away from discretionary judgments about risk" toward "more quantitative and market-sensitive approaches" (Persaud 2001:60). This increased market sensitivity is sought in two ways: by promoting transparency and by promoting tighter and more quantified risk management procedures. Transparency is important, it is argued, because only if banks and investors have the best possible information about companies, as well as about economies more generally, may they assess risks properly. And with regard to risk management, the adoption of tighter, more market-sensitive risk management procedures will significantly reduce the likelihood of excessive risk exposures, the contention goes. The problem is, however, that this approach fails to take adequate account of herding and contagion, two of the most salient features of globally integrated financial markets.

'Herding' denotes what investors or bankers do when they "buy what others are buying, sell what others are selling, and own what others own", rather than making investment decisions based on their own evaluations of the risks involved.18 "In a herding environment", Avinash Persaud explains, "tighter market-sensitive risk-management systems and more transparency actually make markets *less* stable and *more* prone to crisis" (Persaud 2004a: 85). "The key problem is", argues Claudio Borio, Head of Research and Policy Analysis at the Bank for International Settlements (BIS), that "actions that may appear compelling and fully rational from the perspective of individual market participants can lead to undesirable aggregate outcomes for the market as a whole" (Borio 2004:234). Although much work has been done to "address market distress by improving the *market infrastructure* and the risk management at *individual* financial institutions", Borio stresses, the "link between collective actions of individual market participants and market dynamics" remains largely unexplored (Borio 2004:237). Persaud takes the argument a step further, contending that the exclusive focus on the risk management of individual institutions not only *may*, but with certainty *will*, be counter-productive at the macro-level:

The observation of safety creates risk (as the herd chases after what was safe and investors become overly concentrated) and the observation of risk creates safety (as the herd avoids what was risky). In this way, market-sensitive risk-management systems could in one sense be said to manufacture risk and they certainly add to the pro-cyclicality of capital flows (Persaud 2004a: 98).19

This "perplexing dilemma", Persaud argues, is rooted partly in the homogenization of market-sensitive risk-management systems—which make individual institutions invest according to the same models, on the basis of the same data on past volatility and correlation—and partly "by the use of short-term windows to report returns" (Persaud 2004a: 100). If success is measured on a short-term basis, a narrow group of strategies will generate positive returns and "investors will converge to those strategies adding to illiquidity, and to related phenomena such as bubbles and crashes" (ibid.). The problem is, in brief, that the current approach to international financial regulation, with its focus on homogenizing the risk management of individual institutions, effectively makes "investors identify and then select the same optimal investment portfolio" which —when all pursue it—"will no longer be high-return, low-volatility and low-correlation assets, but the *precise opposite*" (Persaud 2004b: 181). When everyone seeks out investment positions which had high returns, low volatility and correlation in the past, these will inevitably "become overvalued assets, incapable of outperforming others in the long run and vulnerable to bad news" (ibid.). "Joining a crowded hunt for the portfolio that had the right balance of risk and return in the past, in the hope that it will deliver the same in the future, is not

futile", Persaud stresses, "it is dangerous" (Persaud 2004b: 194). The move towards more quantitative, market-sensitive risk-management practices reinforces herding behaviour and market volatility in a "vicious circle".

The IFA contributes further to these problems, for it homogenizes not only economies—and the banks and companies that are their key constituent elements—but also the data available about them. The effect that this homogenization of data will have on financial market risk assessments is that the diversity of opinion about economies is reduced, which in itself is likely to contribute to greater financial instability (Metcalfe & Persaud 2003:177). In addition to *homogenization* of data, transparency involves an *intensification* of data: economies are encouraged to publish data on foreign exchange reserves *on a daily basis*, while companies—through standards of 'good practice' in financial accounting—are required to increase the frequency of their financial statements to meet the Anglo-American norm of quarterly financial reporting.20 Both the homogenization and the intensification of data are likely to exacerbate processes of herding and self-feeding market volatility.21

FUTURE OF THE FSAP

The FSAP was from the outset characterised by two inherent dilemmas. First, while participation in FSAPs is officially and formally voluntary, this voluntary nature of the programme was rather 'inconvenient' and indeed at odds with the rationale and objectives of the programme. Proceeding in the terrain of this inherent dilemma was not easy, and led at times to 'delicate' formulations, such as when the FSAP Handbook speaks of the need to "balance the voluntary nature of participation in the FSAP with the need to … encourage countries to participate" (IMF 2005a: 326). Second, although the FSAP guaranteed confidentiality with regard to sensitive information, the very rationale of the the IFA—and hence also of the FSAP—was to increase transparency by publicizing as much data as possible.

Further, FSAPs soon proved to be resource-intensive and costly. In the first years, FSAPs conducted "principle-by-principle assessments of international standards and codes" (IMF 2005a: 334). A key recommendation of the 2003 FSAP review was "to exercise greater selectivity in the numbers of standards and topics assessed in detail so as to reduce the average resource costs while tailoring the assessments to country-specific circumstances" (ibid.). Since it was still seen as important that assessments of compliance with standards were as comprehensive as possible—not least to "minimize the risk of missing key vulnerabilities"—the preferred solution which emerged was to endeavour to "spread out the assessments over time so that some of the standards or topics not initially assessed in the first FSAP engagement could be taken up as part of future FSAP updates" (ibid.). But, as we have seen in the preceding, the FSAP encountered severe problems in motivating countries to engage in FSAP updates.

Through surveys conducted by IMF staff, financial market participants argued that "substantial changes" had to be made for compliance data to be useful, including "*quantitative* measures of compliance" and the conduct of "substantive updates at *annual frequency*" (IMF 2005:24, emphasis added). The IMF itself does not seem too optimistic, however, about attracting more attention from financial markets. Frequent updating of compliance data is considered "too costly", and while the Board of Directors saw "merit in maintaining the initiative", it contended that "the objective of informing market participants would likely remain challenging" (IMF 2006:52). The pessimism with regard to increasing the interest that financial market participants might take in compliance data is not surprising given the fact that even *within* the IMF there has been little use of these data. So far, the envisaged process of integrating the findings and recommendations from FSAPs in IMFs regular surveillance and consultation activities has not taken place. To the extent that FSAP issues are mentioned in these contexts, it has more the character of mere "reporting" than of "expanding the overall macro assessment" (IEO 2006a: 39). More generally, FSAP recommendations have most often taken the form of "a 'checklist' approach of enumerating measures rather than appraising whether the underlying vulnerabilities have been addressed" (IEO 2006b: 30); only FSAP updates "appear to have had the capacity to undertake an in-depth tracking of implementation in specific areas" (IEO 2006b: 11).

The ongoing reinvention of the IFA, shifting emphasis from qualitative assessments to numerical techniques and indicators, is a dangerous one. The novelty of the CCE initiative is, as noted in Chapter 8, that whereas data provided through ROSCs and FSAPs were mainly qualitative, the CCE endeavours to make quantified data on the financial soundness of economies available to financial markets. By publicizing a small set of indicators on its website, the IMF presents the financial soundness of economies to financial markets in the simplest and most easily accessible way possible. By providing a representation of economies in the form of just twelve numerical indicators—supported by its so-called 'outreach' activities, striving to 'raise awareness' in financial markets—the IMF may be successful in strengthening the IFA initiative in terms of the degree to which its data are used by financial market participants. This potential reinvention of the IFA, shifting its emphasis from qualitative assessments to numerical techniques and indicators, may prove more successful in interesting financial markets. However, this emphasis on reducing the representation of economies to a small set of indicators may undermine rather than strengthen the resilience of the international financial system. Making financial soundness assessment available in the form of just 12 numbers implies a homogenization of data about economies, which is likely to exacerbate processes of herding, volatility, and contagion. Ironically, the more successful the IFA is in the coming years in making financial market participants use financial soundness indicators in their risk assessments, the greater the pro-cyclical

impact of international financial regulation. It remains uncertain, however, whether increased and intensified publicizing of FSIs will have much impact on financial markets. As in the case of compliance data, it seems that even the IMF itself has difficulties in interpreting FSI data. The IEO evaluation concluded that financial soundness indicators had "generally not yet been used in a meaningful manner in most assessments", as a result of "problems with data" and problems with "interpretation of appropriate benchmarks for signalling vulnerability" (IEO 2006a: 8). "Although FSAP reports include tables on FSIs", the IEO explains, only in half of the 25 cases examined by the IEO "did the reports provide some interpretation in terms of the risk implications of the figures" (IEO 2006a: 30).22 If the IMF itself does not really know how to make sense of FSI data, it is probably not realistic to expect financial markets to make much use of them.

In its recent evaluation of the FSAP, the IEO recommended that the IMF considered making the FSAP mandatory for all member countries. A more appropriate response to current difficulties with the FSAP would be to fundamentally rethink international financial regulation; there is little point in engaging in the arm-twisting enrolment of countries worldwide in costly financial sector assessment exercises. In efforts to rethink and modify the FSAP, one should be cautious not to follow the lead given by the recommendations of financial market participants. When the IEO asked financial market participants what modifications of the FSAP they would recommend, a number of suggestions resulted: easier access to published documents; more accessible, franker language in key documents; greater focus on potential 'problem' countries; more timely published assessments; elimination of the voluntary nature of the exercise; and more concise, summary assessments, preferably with greater use of quantitative ratings (IEO 2006a: 59). It is important to stress that each of these initiatives would further increase homogenization and thus further reinforce processes of herding and self-feeding volatility. This same problem applies to the ongoing refocusing of the FSAP in shifting the emphasis from qualitative assessments to a small 'core' set of financial soundness indicators. Ironically, the more successful the IMF is in the coming years in making financial market participants use financial soundness indicators in their risk assessments, the less resilient the international financial system is likely to be to volatility shocks in the future.

The FSAP is based on behavioural assumptions that do not seem to accord well with the dynamics of financial markets. Neither the IMF nor the IEO (its internal evaluation office) sees it as their task, however, to evaluate the FSAP in terms of its effectiveness in regulating international finance. "We do not evaluate", explains the IEO, whether the current regulation of international finance "is better than other possible approaches, since *such questions go well beyond the role of the IMF*" (IEO 2006a: 17, emphasis added).23 One must look elsewhere, in other words, for genuine reform initiatives.

CONCLUDING REMARKS

The FSAP has missed the target in a number of ways. First, the focus is entirely on banks, despite the fact that today insurance companies, hedge funds and pension funds are equally important to financial stability. Second, in addressing banks the FSAP overlooks their substantial off-balance sheet positions. Third, stress-testing exercises not only focus on *individual* banks rather than financial systems as such—thus neglecting spill-over effects among and between domestic institutions as well as cross-border contagion issues—but even do those far too narrow stress tests in a manner that turns the dynamics of financial market behaviour upside-down, and thus are, at best, of limited value. Fourth, there has been a general tendency to neglect liquidity risk, as shown by the largely unforeseen credit crisis from summer 2007 onwards. Fifth, the general thrust of the FSAP is to promote homogenization—not only of financial risk management practices, but also of data available about economies and of economies themselves—all of which reduces rather than increases the resilience of the international financial system, which thrives on diversity. Sixth, despite being embedded in the promotion of 'global financial integration', the FSAP remains firmly confined to nation states, both administratively and conceptually, thus neglecting more or less systematically global systemic risks.

The first economic cycle of the 21st century witnessed loans in default or distress around the world to rise to a record high of USD 900 billion, an accumulation of losses not seen since 1932 (Persaud 2004c: 195). At first commercial banks seemed to pull through this period "without major mishap" (ibid.). Even in the absence of the destabilizing impact on banks that the credit crunch has caused over the last year, it would have been a grave mistake to see the prior absence of commercial bank failures as evidence of a more stable, better functioning and more resilient international financial system.

The explosion of the credit derivatives market has involved banks slicing up and selling on credit risks, known as the 'originate to distribute' model. The 'originate and distribute' model entails passing on credit risks and the costs of volatility to other actors in the financial system, including insurance companies and pension funds, which in consequence are increasingly exposed to volatile equity markets. The costs of this volatility are thus "increasingly falling on pensioners", stresses Persaud (2004b: 181; 2004c: 204).24

It was from the beginning quite "unlikely" that this process would somehow make the financial system "a safer place"; as David Shirreff notes "there is little evidence" that the originate and distribute model did "much more than push the risk" into other parts of the financial system (Shirreff 2004:76). Banks are no longer "a buffer against economic downturns and commercial hardship", argues David Shireff, but rather have "become part of the transmission mechanism that quickly channels changes of sentiment and fortune away from themselves and towards other risktakers" (Shirreff

2004:81). “The substantial credit derivative activities of some large institutions” and the resulting “risk transfer between different sectors of the financial system domestically and internationally” makes it unclear, Claudio Borio notes, “where credit risk ultimately resides” (Borio 2004:236). The current approach to international financial regulation tends to bestow *visibility* on the least risk-exposed and vulnerable institutions in today’s financial systems, with the adverse effect of creating a false sense of robustness and effectively rendering substantial risks and costs more or less *invisible*. The IFA has merely made risk less visible and less governable, which is not without irony in light of the ‘transparency’ rhetoric.

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13

The Post-Washington Consensus

INTRODUCTION

"Life used to be simple for the peddlers of policy advice in the tropics", notes Dani Rodrik (Rodrik 2006:973). "Observing the endless list of policy follies to which poor nations had succumbed", he continues, "any well-trained and well-intentioned economist could feel justified in uttering the obvious truths of the profession: get your macro balances in order, take the state out of business, give markets free rein" (ibid.). Today, by contrast, confusion prevails, if we are to believe Rodrik.1 "Proponents and critics alike agree that the policies spawned by the Washington consensus have not produced the desired results", and the debate is thus not "over whether the Washington consensus is dead or alive, but over what will replace it" (ibid.). Rodrik's paper favourably reviews a report by the World Bank (2005), noting that it is remarkable in explicitly denouncing universalist policy prescriptions in favour of an "explicitly diagnostic approach that recognizes that the binding constraints on growth differ from setting to setting" (ibid.).2 Rodrik observes, however, that there are "competing perspectives", including one "trumpeted elsewhere in Washington", which favours a universalist approach to institutional reform rather than a pragmatic, diagnostic approach (ibid.). Though not denying the existence of competing perspectives, particularly in the realm of development policy *ideas*, I argue that there is significantly more unity to the current development policy *practices* of the World Bank and the IMF than portrayed by Rodrik. For one thing, the World Bank report Rodrik reviews is anything but representative of World Bank operational work. In fact, Rodrik himself reports having been involved in efforts to bring the championed diagnostic approach "to bear on the country operational work at the Bank", only to realize "how difficult it is to wean the Bank's country economists away from the Washington consensus, laundry-list, best-practice approach to reform" (Rodrik 2006:977). While it is important to highlight and support, as Rodrik has, efforts within the Bank to break with universal and dogmatic policy prescriptions, it is equally important to endeavour to understand the gravitation that prevents such efforts from having much impact on actual development policy practice. And if indeed the

Post-Washington consensus replaces the "getting-the-prices-right" approach with a "getting-the-institutions-right" approach, as Rodrik and others argue (Chang 2001; Rodrik 2006), then we should not shy away from analyzing in more detail what this latter strategy entails, above and beyond a recognition that "institutions matter".

Whereas Chapter 11 focused on the relationship between standards and models of capitalism, this chapter takes a broader perspective on the IFA, seeing it as part of a wider shift from the Washington to the PostWashington consensus. A question frequently asked in the debate on the Post-Washington consensus is the classic one of whether or not it is "oldwine-in-new-bottles".3 There are, however, important continuities as well as key discontinuities, and identifying *both* is of paramount importance if one is to assess the current state of development policy practice in a solid manner. Previous chapters have demonstrated how the concept of transparency connected with wider ideas about how to "properly" organize and regulate economic activities through the notion of standards of "best practice". Further, it has been shown that such standards are intimately related to the Anglo-American model of capitalism. The commitment of the Post-Washington consensus to a particular *model* of capitalism, through extensive "institutional re-engineering", is a novelty when compared to the Washington consensus. This finding is an important antidote to the misguided notion that the Post-Washington consensus "does not carry a set of precise policy prescriptions", but seems to be little more than "agreement on the failure of its predecessor" (Krogstad 2007:81). Even more importantly, however, a wider shift has taken place in the character and magnitude of governmental interventions pertaining to the world economy. Despite the radical character of this shift, it has been subject to very little critical debate. I argue that what we are seeing is a shift from the idea of "the economy"—as a domain of reality a thing, that can and should be manipulated, *or not*, by economic policies—towards the idea of a "proper economy", a norm for the practices of economic agents, and for the monetarization and marketization of their relations, including a system of surveillance of compliance with this norm. A shift is taking place, in other words, from a problematic of whether or not—and how to—*manage* economies, to a problematic of how to *discipline* economies. Telling this story is particularly important because there is a real risk that these fundamental changes will go unnoticed. Economists tend to see the IFA as simply the "necessary" response to the financial crisis of the 1990s. In the words of Barry Eichengreen, "the development and promulgation of international standards are *the only practical way* of addressing these problems" (Eichengreen 1999:35, emphasis added).

This chapter first provides a brief account of the Washington consensus (section 1) and the Post-Washington consensus (section 2), before re-examining the IFA in terms of the shift from the former to the latter, from a Foucauldian perspective (section 3). This leads to a characterization of the Post-Washington consensus that highlights both those aspects of the

Washingon consensus that remain unchanged, even if they appear different, and the ways in which it has revolutionized international economic governance, although few if any have noticed this (section 4). The last section offers a few concluding remarks (section 5).

THE WASHINGTON CONSENSUS

The notion of a "Washington consensus" was first coined in 1990 by the British economist, John Williamson (Williamson 1990). Williamson, for years an employee of the Washington-based think tank, the Institute of International Economics, noticed that a major change in policy norms had occurred in the latter half of the 1980s (Wade 2007a: 1). In the wake of the debt crises of that period, Latin American governments, along with the World Bank and the IMF concluded that the previous development strategy of import substitution and state-led economic development should be replaced by one predicated instead upon macroeconomic stabilization, free trade and privatization. More specifically, the emerging consensus about economic policies for Latin America included the following list of policy recommendations: "fiscal rectitude, competitive exchange rates, free trade, privatization, undistorted market prices, and limited intervention" (Williamson 1993:1332–1333; Rodrik 1996:9). After the publication of the list, however, the term "Washington consensus" "escaped the control of its originator", Williamson argues (Williamson 2005:4), to gain a life of its own.4 Decoupled from Williamson's original list, "the Washington consensus" came to include new elements like low taxes and rapid liberalization of cross-border financial flows (Wade 2007a: 1–3).5 In this process, the Washington consensus was detached also from its original *regional* origin; it was no longer seen as specific to the Latin American context, but as applicable to all developing countries, including the "transition economies" of Eastern Europe. The emergence of this revised Washington consensus was referred to by the "official" historian of the IMF, James Boughton, as the "silent revolution" in development policy (Boughton 2001). It soon "coursed through the echo chamber of the Washington-based organizations, including the IMF, the World Bank, the US Treasury, USAID and think tanks; through transatlantic components including the *Financial Times*, *The Economist* and the UK Treasury; and into finance and development ministries in many developing countries" (ibid.).6
The key elements of the Washington consensus now came in two main categories: "macroeconomic policies aimed at economic stability", and "liberalisation policies aimed at structural reform and growth" (Rodrik 1996:11), the latter category including capital account liberalisation, which Williamson himself had explicitly argued against (Williamson 2005:7). It was commonplace, however, to conflate these two groups of policies, Dani Rodrik observes. This was unfortunate, he contends,

for "maintaining the distinction reminds us that the consensus on what constitutes appropriate structural reform is based on much shakier theoretical and empirical grounds than is the consensus on the need for macroeconomic stability" (Rodrik 1996:11). In the absence of this distinction "stabilize, privatize, and liberalize" became the mantra of a generation of technocrats (Rodrik 2006:973). Compared with the previous period, the Washington consensus changed development policy practice in two main ways. First, it represented a shift from previous state-led *dirigisme* towards market-oriented policies. Second, it represented a shift from a "historicist" development paradigm—focusing on stages of capitalist development—to a mode of development policy practice predicated upon "ahistorical" performance assessments, for which "the central criterion was current or recent GDP growth rate", thus substituting a focus on short-term growth for the previous concern with "the dynamics of long-term transformations of economies and societies" (Gore 2000:794). In combination, these two shifts marked the birth of "ahistorical universalism" in development policy practice. This universalism was central to the so-called "counter-revolution" in development economics. Deepak Lal and others criticised "traditional" development economics, which had endeavoured to devise policy strategies specifically suited for development economies, for "falsely [denying] the universal applicability" of orthodox economic principles (Lal, cited in Kregel 2008:4). Thus, on the basis of the counter-revolution in development economics, Williamson characterised earlier development theory as "a sort of global apartheid which claimed that developing countries came from a different universe" (Williamson, cited in Kregel 2008:4).

Countries that adopted Washington consensus policies did not achieve the expected benefits in terms of economic growth and development. Often the economic performance of these countries was worse than during the "era of 'bad' import-substituting industrialization" as well as worse than those countries that did not adopt them, or adopted them only to a limited degree (Wade 2007a: 4). Latin America had successfully lowered inflation, strengthened public finances, liberalized the financial sector, privatized a significant number of public enterprises and opened itself up to foreign trade and investment. But despite being the region that had embraced Washington consensus reforms "most enthusiastically and carried them furthest", the economic growth in Latin America through the 1990s was at rates only "half of those observed in the period of state-led development, from 1930 to 1970" (Buira 2003a: 2). Furthermore, Asian countries like China, India and Korea, which pursued an interventionist model of development—combining protectionism, subsidies, and tax incentives with less open capital accounts—attained much higher rates of growth in the 1990s than did the Latin American countries pursuing neoliberal "free market" policies (Buira 2003a: 2).7

Outcomes such as these were increasingly seen as bearing witness to the "failures" of the Washington consensus. Even Williamson admitted that

results were "disappointing ... particularly in terms of growth, employment, and poverty reduction" (Williamson, cited in Kregel 2008:10).

The Washington consensus was further destabilized with the advent of the financial crisis in East Asia. Many economists, including Stiglitz (2002) and Williamson (2005), contended that "premature capital account liberalization"—a key component of the *institutionalised* Washington consensus—was the factor "primarily responsible for the catastrophe of the Asian crisis that overtook the [Asian] tigers in 1997 and interrupted the East Asian miracle" (Willamson 2005:7). With the Asian crisis the way was paved for a full-blown critique of the Washington consensus.

THE POST-WASHINGON CONSENSUS

In destabilizing the Washington consensus, Joseph Stiglitz—former Senior Vice President and Chief Economist of the World Bank, and Nobel Laureate—has been accorded a key role. Ben Fine argues that "if one event can be pinpointed as having prompted" the shift, it is the speech made by Stiglitz in January 1998, in which he "explicitly [rejected] ... the Washington consensus and offered a Post-Washington consensus in its place" (Fine 2002:2). "Although the Washington Consensus provided part of the foundation for well-functioning markets" it was nevertheless, Stiglitz stressed, "incomplete and sometimes even misleading" (Stiglitz 1999:33). "Making markets work", he argued, required more than deregulation policies and low inflation (ibid.). In the absence of "a robust financial system, which the government plays a huge role in creating and maintaining", Stiglitz continued, the allocation of capital would not be efficient, as assumed in the Washington consensus (ibid.).

In an interview with the *Financial Times* on the topic of the Asian crisis, former Undersecretary of the US Treasury, Larry Summers, made a remark characteristic of the emerging new consensus. "The problems that must be fixed", he said, "are much more microeconomic than macroeconomic, and involve the private sector more and the public sector less" (February 1998, cited in Singh 1999:9). To Ha-Joon Chang the key feature of the Post-Washington consensus was that it replaced previous "getting-the-prices-right" policies with "getting-the-institutions-right" policies (Chang 2001). A first characterisation of the shift from the Washington to the Post-Washington consensus may be depicted schematically as in Table 13.1.

Soon the contention spread in Washington that the reason why Washington consensus policies were not having the envisaged effects was that they were implemented in countries where institutions were "unfriendly" to markets (ibid.).8 Today, economists in the World Bank and the IMF tend to see the Post-Washington consensus as more or less a "natural extension" of the Washington consensus; it merely reflects the contention that

Table 13.1 From Washington to Post-Washington Consensus

	The Washington consensus	*The Post-Washington consensus*
Issues problematized	Macro	Micro
Key sector targeted	Public	Private
Policy solution	'Getting the prices right'	'Getting the institutions right'
Policy process	Deregulation	Upgrading
Policy nomenclature	Structural adjustment	Structural reform

"institutions matter".9 It is worth remembering, however, that initially Stiglitz's critical remarks on the Washington consensus were highly controversial. His attack had made him "persona non grata" in the IMF and in the US Treasury, and thus when James Wolfensohn opted for a second term as World Bank President, the US Treasury made it clear that this would be conditional on Wolfensohn not renewing Stiglitz's position as the Bank's Chief Economist. Wolfensohn agreed to this—and thus in November 1999, Stiglitz's resignation from his position was announced.

At first, Stiglitz did not leave the Bank entirely, but became a "special advisor" to Wolfensohn. In April 2000, the US Treasury insisted that Wolfensohn fired Stiglitz from his position as special advisor, on account of a rather harsh criticism that Stiglitz had made of the IMF in the *New Republic*. Stiglitz's piece included the following remarks:

Next week's meeting of the International Monetary Fund will bring to Washington, D.C., many of the same demonstrators who trashed the World Trade Organization in Seattle last fall. They'll say the IMF is arrogant. They'll say the IMF doesn't really listen to the developing countries it is supposed to help. They'll say the IMF is secretive and insulated from democratic accountability. They'll say the IMF's economic 'remedies' often make things worse—turning slowdowns into recessions and recessions into depressions. And they'll have a point. I was chief economist at the World Bank from 1996 until last November, during the gravest global economic crisis in a half-century. I saw how the IMF, in tandem with the U.S. Treasury Department, responded. And I was appalled (cited in Wade 2000:9).

At his farewell reception at the World Bank, a colleague made an ironic speech on the "top ten reasons" why Stiglitz was leaving. One of these reasons particularly well conveys the magnitude of the controversy involved in Stiglitz's comments on the Washington consensus: Stiglitz thought, his colleague joked, that "after convincing the IMF on the need for capital controls as a prophylactic against hot money, it would be relatively easy

to go on to reform the Vatican's views on birth control" (cited in Wade 2000:8). Against this background, one is compelled to ask how Stiglitz's originally controversial emphasis on the limitations of "free markets" could be fully embraced by the Bank and the Fund themselves in the course of just a couple years? The answer to this question is closely related to the way in which the IMF and the World Bank "reinvented" themselves in response to mounting criticisms in the late 1990s.

A FOUCAULDIAN PERSPECTIVE

From a Foucauldian perspective there is more at stake with the Post-Washington consensus than a recognition that "institutions matter". As demonstrated in Chapter 11, the IFA initiative involves the normalization and attempted globalization of an Anglo-American mode of capitalism. But the IFA marks a number of even more fundamental ruptures in international economic governance. First, there is a shift in the modality of power, from "exceptional" discipline to "generalized" surveillance and disciplining. Second, there is a shift in how economies are conceived, analysed and intervened in, replacing the "mechanical" economy of the Washington consensus with an "organic" economy, and with a global project for the formation of docile economies.

From Exceptional to Generalized Discipline

The operational logic of the IMF was always one of surveillance and disciplining. The pressure to adhere to standards has been an institutionalized part of the IMF since its inception (Peet 2003:64). The disciplinary power introduced with the IFA is therefore not the first instance of a mode of international economic governance subscribing to notions of discipline. What occurred with the rise of the IFA was not the invention of discipline, but a shift from "exceptional" to "generalized" discipline. Whereas originally codes of conduct pertained only to exchange rate management, the IFA initiative vastly expanded the range and scope of normalized and codified conduct. The expansion of the range of codified conduct was accompanied by an expansion of the "jurisdiction" of disciplinary techniques. With the IFA, efforts to discipline economies moved from being limited to certain situations and circumstances to being permanent and all-pervasive. The focus of the IMF's attention hence is no longer on companies in balance-of-payments crises; the IMF is concerned with the disciplining of *all* economies, in the best interests of the "proper functioning" of individual economies as well of the international financial system as such. "Exceptional discipline", targeting economies in balance-of-payments crises, has been replaced by the "generalized" surveillance and disciplining of all economies.

Structural adjustment programmes were "negative" in the sense of being expected to fix or neutralize the dangers associated with balance-of-payments crises, and to roll back as many government "interventions" in the economy as possible by processes of deregulation and privatization. The disciplinary power of the IFA, on the other hand, came to play a "positive" role, seeking to shape and reshape "proper" economies by a process of "political-institutional engineering". Whereas previously mechanisms of power had, in a sense, proceeded by "deduction", the IFA introduced power mechanisms that were "generative", endeavouring to enhance the productive efficiency of economies *from within*. A form of power consisting in *dismantling* certain aspects of "body polities", aspects considered malign, was replaced by a generative form of power *investing* economies with "proper" modes of organizing and regulating economies.

With the rise of the IFA, the power exerted upon economies became more anonymous and more functional. Power was now exercised more by surveillance and less by "intervention". Foucault noted that in the case of governing individuals, the generalization of disciplinary power involved not only a generalized surveillance and disciplining, but also a "lighter, more rapid, more effective, subtle coercion". The shift from the IMF's structural adjustment programmes for countries in crisis, to a generalized system of standards of "best practice" similarly entail a shift towards a lighter, more subtle coercion. We may speak of two images of discipline, then, in international economic governance. The first is that of the "crisis-struck" economy, subjected to structural adjustment programmes in exchange for emergency financing. The second is that of the international financial architecture, a supranational governmental effort that endeavours to improve the exercise of power by making it "lighter", but permanent and pervasive in its scope and its effects.

The disciplinary power of the IFA is opposed to the more "judicial" power of the Washington consensus. Structural adjustment programmes operated not by *differentiating* economies, but by specifying acts according to a number of general categories, such as deregulation and privatization; not by *hierarchizing*, but quite simply by bringing into play the binary opposition of the permitted and the forbidden; not by *homogenizing*, but by condemning certain modes of state "intervention" in the economy. With the disciplinary power of the IFA the simple binary division of the permitted and the prohibited, as practised in penal forms of justice, is replaced with a distribution between a positive pole and a negative pole. In this sense, the Post-Washington consensus, with its continuum from "improper" to "proper" economy, marks a shift from a "judicial" to a disciplinary form of penality in international economic governance.

A New Anatomy of the Economy

The disciplinary power of the IFA was written simultaneously in two dimensions, one "anatomical", the other "technico-political". In its anatomical

dimension, the IFA evoked a norm of "proper" economy, depicting how an economy should be organized and regulated. In its technico-political dimension, on the other hand, it defined and launched a set of procedures to assist countries in becoming "proper" economies. In the former dimension, the IFA was a question of functioning and explanation, whereas in the latter, it was one of submission and reform. On the one hand there is a docile economy and on the other hand an intelligible economy. The two dimensions overlap, however. At the centre reigns the notion of "standards of best practice", essential both in defining the norm and in creating a path towards it. In and through these standards of good practice, the analysable economy joins the manipulable economy. This docile and intelligible economy, both analysable and manipulable, was a radical departure from "the economy" of the Washington consensus. The IFA initiative conceives of economies as "organisms"; they are "exercised" economies—economies that are to be "shaped and trained", economies that are to "obey, respond, become skilful" and thereby increase their forces. Compliance with the requirements of the "proper" economy replaces the simple mechanics of "getting the prices right". Through the invention of the micro-analytical gaze and its anatomical and political applications, a new object has come into being. The "mechanical" economy has been superseded by the "organic" economy. Contrary to the mechanical economy, the organic economy is the bearer of forces and the seat of duration; it is susceptible to specified operations, which have their order, their stages, their internal conditions, and their constituent elements. This new "organic" economy is in constant evolution, vis-à-vis the set of standards and indicators developed to delineate the norm of the "proper economy". The "organic" economy of the Post-Washington consensus is quietly replacing the economy of "rational mechanics", which dominated the preceding hundred years of macroeconomic discourse (for more on this, see Chapter 17).

A New Modality of Economic Governance

It is not the first time "the economy" has become the object of "imperious and pressing investments". There are, however, a number of ways in which the techniques of the IFA are new.

First, there is the *scale of control*: no longer is it a matter of treating the economy *en masse*, "wholesale", as if it is an indissociable unity, but rather of working it "retail", replacing a macroeconomic with a microeconomic gaze. Second, there is the *object of control*: no longer is it macroeconomic performance—expressed in terms of balances and imbalances—that is the object of control, but rather the internal organization of its relations. Third, there is *the modality*: instead of supervising the *result* of economic policies, now it is the *processes* of a wide range of governance activities that is subject to control, exercised according to the multi-dimensional codification of the "proper" economy.

These new techniques aim to make possible the meticulous control of the operations of the economy, to assure the constant subjection of its forces,

imposing on them a relation of docility-utility. What is being formed is a "policy of coercions" that act upon the economy, a calculated manipulation of its elements, its organization and regulation. Through these techniques, through this "policy of coercions", the economy enters a machinery of power that explores it, breaks it down, and rearranges it.

To sum up, the IFA marked a new regime in international economic governance. From a regime predicated on the binary division between economies that are in crisis and economies that are not, to one predicated upon the binary branding of proper vs improper economies, from localised and confined interventions dealing with economies transgressing the permitted-prohibited boundary to the constant measuring and governing of economies against the norm of a "proper" economy. Whereas economies in balance-of-payments crises were met with separation, the IFA approaches all economies with segmentations, multiple separations, individualizing distributions, being an organization in depth of surveillance and control involving the intensification and ramification of power.

THE POST-WASHINGTON CONSENSUS REVISITED

Debates on the Post-Washington consensus often hinge on the question of whether it represents a genuine rupture with the Washington consensus, or is simply "old wine in new bottles". Clearly the continuity-discontinuity issue is a crucial one. Framing the problematic as an "either-or" matter carries the risk, however, that one overlooks important insights. The Post-Washington consensus represents, I argue, a radical rupture with the past, *as well as* a strong reinforcement of key elements of the Washington consensus.

Discontinuity

The shift from the Washington consensus to the Post-Washington consensus entails shifts in the *objects and modes of governmental intervention*: with the Post-Washington consensus the focus is more on the microeconomic, less on the macroeconomic, and it is more the private and less the public sector that is targeted. Further, the overall objective is not so much "getting the prices right" as it is "getting the institutions right" (Chang 2001), and thus an "institutions fundamentalism" seems to be replacing the former "market fundamentalism" (Rodrik 2006:10). With regard to *policy rhetoric*, the main changes are from (macroeconomic) "stabilization" towards (financial system) "resilience", and from "liberalization" to "transparency". The term "transparency" is, if possible, even more misleading than its predecessor, "liberalization". It suggests that little more is required than removing the "veils" that hide the truth of an economy from financial market participants. In fact, efforts to ensure the "transparency" of economies involve massive standardization, calculation and reporting.

These shifts—in policy rhetoric as well as in objects and modes of governmental intervention—are closely related to a recasting of the notion of "market discipline". Before the launching of the transparency regime, the role of disciplining economies was entrusted to financial markets alone. Today, a far more comprehensive system of surveillance has been set up, involving four layers of surveillance: the surveillance of states and their economies by the IMF and the World Bank; the surveillance of the private sector by each member state; the surveillance of "the economy" by financial markets; and, finally, so-called multilateral surveillance, by which the IMF observes not just individual economies but also potential "spill-over" effects from one country to others.10 In addition to this *multiplication* of surveillance, the SIFA initiative involves a *generalization* of surveillance. The focus of the IMF's attention is no longer countries in balance-of-payments crises but the disciplining of every single economy in the world in the interests of the "proper functioning" of individual economies as well of the international financial system as such. There is a shift, in other words, from "exceptional intervention", targeting only economies in balance-of-payments crises, to "generalized surveillance" and the attempted disciplining of *all* economies.

New guidelines for IMF loan conditionality were prepared and approved in response to the mounting criticism of the IMF in the late 1990s. The new guidelines emphasized "parsimony" and the "tailoring" of conditionality to the specific country in question, as opposed to the application of a more or less standard set of conditionalities in all cases, which had been the predominant practice in the period of the Washington consensus. In parallel, however, the promotion of the adoption of standards of "good practices" represented a development in the exact opposite direction: as one form of intervention loses salience, new forms of intervention are invented. The Post-Washington consensus seems to represent, in other words, a discontinuity in the sense that the balance is shifting away from direct enforcement mechanisms—such as loan conditionality and Article IV consultations—towards more indirect mechanisms, such as promoting the adoption of standards of "good practices".

In sum, the analysis of the IFA initiative, and the various ways in which the IMF has attempted to enforce standards of good practices, focuses attention on five particular ways in which the Post-Washington consensus departs from the Washington consensus. First, the shift from "liberalization" and "deregulation" to "transparency" and "standards of good practices" represents a fundamental *reversal* of the attitude to regulation: the previous anti-regulation stance has been replaced by a vast international, regulatory bureaucracy, aiming at ensuring the "proper" governing of economies worldwide. The ambition of *limiting* government regulation as much as possible has been replaced by the effort to *globalize* a particular set of regulatory practices across a wide range of domains. Second, whereas the Washington consensus was certainly committed to the promotion of capitalism—or the "free market economy"—the Post-Washington consensus is committed, unlike the Washington consensus,

to a particular *form* of capitalism. More specifically, the regulatory practices normalized in and through the SIFA initiative are closely related to the AngloAmerican model of capitalism. The Post-Washington consensus does not merely involve a recognition that "institutions matter', in other words, but the contention that the most effective way to stimulate economic growth and to reduce the risk of financial crisis is to imitate the Anglo-American mode of organizing and regulating economic activities. Third, in the effort to restructure economies worldwide in the image of Anglo-American capitalism, banks and companies have become the prime targets of international governmental intervention, and a multitude of new governmental tools and technologies have been mobilized to render their investment and risk management practices visible and governable. Fourth, the Post-Washington consensus marks the emergence of a project involving the multiplied and generalized surveillance and disciplining of *all* economies, thus replacing the previous system of "exceptional" intervention vis-à-vis countries in balance-of-payments crises.

Continuity

On the basis of Hall and Soskice's (2001) dichotomy of models of capitalism—distinguishing between liberal market economies and coordinated market economies—one is compelled to ask whether the shift from the Washington consensus to the Post-Washington consensus represents a shift from promoting the liberal market economy, praising deregulation and natural market adjustments, towards promoting a more coordinated market economy, acknowledging the importance of institutions and attributing a much more central role to the state. The answer is no. In fact, the Post-Washington consensus represents an intensified effort to make coordinated market economies more like liberal market economies by means of a range of new governmental technologies. Thus, the Post-Washington consensus by no means represents a swinging back of the pendulum, from market-oriented policies towards the state-led *dirigisme* that prevailed prior to the rise of the Washington consensus. Nation states are not accorded a central role in the sense of actively directing and spurring economic growth and development in the Post-Washington consensus. Rather, the role of nation states is reduced to one of endeavouring to ensure that a range of policy guidelines and standards of good practices defined elsewhere—by the FSF, the IMF, the World Bank and the OECD—are observed and implemented in the public and private sectors of their economies.

By drawing up a new set of conditionality guidelines emphasising "parsimony" and "tailoring", the IMF gave the impression that it was moving away from detailed and standardized policy prescriptions. It is noteworthy, however, that the previous set of guidelines, approved in 1979, also emphasized parsimony. The problem was not so much the guidelines, in other words, as the fact that IMF economists didn't adhere to them in practice. There are some signs that this pattern is repeating itself.11 Be that as it may,

an important continuity must be stressed with regard to this issue of IMF conditionalities. Even though the new guidelines for conditionality speak of the importance of "tailoring" it to the specific country in question, it is in the very nature of the IFA initiative that it is a "one-style-fits-all" approach; whether small or large, European, African, Asian or American, all economies are subjected to the same norms, standards, and reformatory techiniques. The Washington consensus and the Post-Washington consensus share the contention, in other words, that the same set of policy prescriptions will help *all* economies prosper, regardless of their condition and position in the global economy.12 In this sense, the Post-Washington is in striking concordance with the spirit of the "counter-revolution" as it pertained to development economics; the "proper" economic development strategy is the same for all economies. It is noteworthy, in this regard, that with its emphasis on universal standards, the IFA initiative departs in a fundamental way from Stiglitz's initial thoughts on the changes needed in development policy practice, emphasizing the need to give countries "scope to experiment, to use their own judgment, to explore what might work best for them" (Stiglitz 2004:12).

Stiglitz saw it as a key objective to challenge the Washington consensus in such a manner that "the momentum of an expected swing of the pendulum of opinion against openness" would be prevented (Gore 2000:800).13 Though his intervention emphasized the decoupling of free trade and free finance, and the need to distinguish between short-term and long-term international capital flows, Stiglitz's challenge thus remained safely within the boundaries of "a strong commitment to the fundamental principles of a liberal international economic order" (ibid.). In addition to noting this continued commitment to the free mobility of capital, one can question whether the decoupling of free trade and free finance became a permanent element in the Post-Washington consensus, or was just a passing fad. So far it seems that this decoupling was more permanent in the thinking of academic economists than it was in actual development policy practice. Indeed, "many champions hoped", Robert Wade argues, that financial reforms would in fact "strengthen regulation sufficiently that opening the capital account could again become a top global priority" (Wade 2007a: 4–5). In terms of development policy practice, it seems that the new consensus is that financial integration must be sequenced carefully with the process of financial institution-building—which clearly marks a reaffirmation of the belief in the universal beneficence of free capital, rather than a departure from it.

A final important continuity is that the Post-Washington consensus reinforces the belief in the fundamental *rationality* of financial markets; there is no irrational behaviour that needs to be addressed explicitly by regulation, but merely problems with the information that financial markets have at their disposal. Von Furstenberg notes that the "cry for ever more, and more transparent, data" is a "cry that is raised after every major crisis", thereby

providing a "convenient alibi for those who might otherwise be charged with poor Judgment And Malfeasance" (Von Furstenberg 2000:103).

CONCLUDING REMARKS

What new light does this analysis shed on the fact that Stiglitz's originally controversial emphasis on the limitations of "free markets" was so rapidly embraced by the IMF and the World Bank? The key point to make here is that what appeared, at first, to be a profoundly disturbing attack on the principles of the "free market economy" soon revealed itself to be easily susceptible to principles of market capitalism: the World Bank and the IMF replaced their advocacy of "free market economy" with an advocacy of the "proper economy"—in and through notions of "transparency", standards of "good practices" and a "strengthening of the international financial architecture". Though initially experienced as a severe attack on their belief systems, the "shock" was soon absorbed by economists in the Bank and the Fund, as new ideas of the "importance of institutions" became embedded in a comprehensive strategy for promoting Anglo-American capitalism. The IMF and the World Bank reinvented themselves in a manner that reasserted the belief in the universal beneficence of the free mobility of capital but *inverted* the means through which it was to be pursued.

A key feature of the IFA is that it renders Anglo-American capitalism the norm towards which economies worldwide should strive. This constitutes a key difference between the Washington consensus and the Post-Washington consensus: the latter is firmly wedded to the promotion of a particular *form* of capitalism, which the former was not. This has had two important implications for the role of international governmental interventions in economic development. If development strategy prior to the Washington consensus consisted in *leading* the markets, and during the Washington consensus in *leaving it to* the markets, the developmental strategy recommended in the Post-Washington consensus may be said to consist in *levering* the market in the particular Anglo-American way. Further, the Post-Washington consensus entails a striking shift from "exceptional" interventions in relation to specific countries with temporary balance-of-payment problems, to the generalized surveillance and attempted disciplining of *all* economies. This fundamental change has combined with a reaffirmation of the ahistorical "one-size-fits-all" universalism of the Washington consensus to form a new paradigm for development policy: the promotion of Anglo-American capitalism as a sort of "permanent preventive medicine".

The shift from the Washington consensus to the Post-Washington consensus is a shift from "exceptional" to "generalized" surveillance and disciplining, in Foucauldian terms. Just as Foucault observed that the generalization of disciplinary power targeted at individuals was accompanied by a shift from a "mechanical body" to an "organic body" (Foucault

1991b: 155), we may observe that the disciplinary power of the IFA is being accompanied by a shift from a "mechanical" economy to an "organic" economy—an economy that is observed, analysed, and corrected. The shift from the Washington consensus to the Post-Washington consensus is a shift from a mechanical conceptualisation of the economy—a system of macrobalances and automatic adjustment mechanisms—towards a conceptualisation that is micro and organic. It involves breaking up the economy into its constituent elements—notably firms and banks—registering and training each carefully, in their modes of governance, their relations with one another, and with themselves. Foucault noted that the shift in disciplinary power involved a shift in emphasis from the "discipline-blockade"—where "evil" was dealt with in enclosed institutions—towards the "discipline-mechanism", which involved not only a generalized surveillance, but also "lighter, more rapid, more effective, subtle coercion". The shift from structural adjustment programmes to a generalized system of codes and standards of "best practice" similarly entails a shift towards a lighter, more subtle form of coercion. But as we have seen, the disciplinary power of the IFA remains, nevertheless, *ineffective* if not counterproductive with regard to its objective of increasing the stability and resilience of the international financial system.

Part III

The End of Liberalism?

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What is Liberalism?

INTRODUCTION

The rise of a regime of global disciplining, a regime of the political-institutional engineering of 'proper' economies worldwide, in what is supposedly the heyday of neoliberalism and free market economies constitutes a paradox. Are 'free market economies' becoming a thing of the past, gradually being replaced by 'docile economies'? Are we witnessing the end of liberalism as we know it?

Only by first grasping classical political economy and early liberalism may an understanding of the current state of affairs be developed. Recent work in the history of economic thought has challenged the widespread notion that Adam Smith may be considered the founding father of *laissez-faire* liberalism (Brown 1997, Hundert 1994, Tribe 1999, Samuels & Medema 2005, Winch 1996). Smith's views on the proper role of government in a market society have been severely misrepresented, it seems. If the predominant interpretation of Adam Smith has indeed been misguided in this sense—and there is compelling evidence in support of this thesis—is this an isolated occurrence or part of a larger tendency in modern interpretations of classical liberalism? This chapter endeavours to demonstrate that this is indeed the case. With Quentin Skinner (1998) and Philip Pettit (1997), it can be argued that the history of *early liberalism* has been placed in oblivion, not only in the history of economic thought, but in intellectual history more generally. What has been lost in this oblivion is not just an important part of our intellectual and political history, but also a sensibility to what is implied by current and past notions of liberty, freedom, government, and liberalism.

The structure of this chapter is as follows. First, the understanding of Adam Smith as an economic liberal and the literature criticizing this view are discussed briefly. This section establishes that the contemporary notion of an inverse relationship between freedom and government—and the associated hostility to government—can only be attributed to Adam Smith by misinterpretation and an absence of methodology in the study of intellectual history. The next section discusses the work of Quentin

Skinner (1998) and Philip Pettit (1997), which traces the occurrence in classical liberalism of a shift in the conception of liberty, from a conception of liberty that sees the role of law as that of ensuring freedom, to one that sees any law as an impediment to liberty. This section identifies, in other words, the historical emergence of the notion of an inverse relationship between freedom and government. A key part of this history revolves around the issue of American independence from Britain. At the time, a controversy on the true meaning of freedom arose. Those defending the liberal position argued that the true meaning of freedom was freedom *from* the law not, as the republicans argued, freedom *by* the law. Eventually, the liberal conception of liberty defeated the republican one. This is an important part of the history of classical liberalism, but by no means one that fully captures the implied relationship between freedom and government. For political rhetoric is one thing—the everyday reality of techniques and mentalities of government is another. Thus, the following chapter analyses Michel Foucault's analysis of the emergence of classical political economy, from which analysis it becomes clear that government and freedom were—and remain—two sides of the same coin.

The chapter therefore consists of the following sections. First, a section examines recent work on the writings of Adam Smith (section 1), followed by an explination of the work of Pettis and Skinner on the history of liberal and republican conceptions of freedom (section 2), and a few concluding remarks pointing towards the two next chapters (section 3).

THE ADAM SMITH DEBATE

What is liberalism? For most economists, the answer is simple as is the question of its historical origin. Liberalism is, we would say, a doctrine formulated to protect the individual and the market from the interference of government. And the founding father of this doctrine was, of course, Adam Smith. To quote just one example here, the former president of the American Economist Association, George Stigler, argued that the thrust of Adam Smith's argument and advice was that "the conduct of economic affairs is best left to private citizens—that the state will be doing remarkably well if it succeeds in its unavoidable tasks of winning wars, preserving justice, and maintaining the various highways of commerce" (cited in Samuels & Medema 2005:219.) There is a long tradition of interpreting Adam Smith as "the Godfather" of *laissez-faire* liberalism (Samuels and Medema 2005:223; Tribe 1999:609). Recent years have seen an accentuation of this reading of Smith. The (alleged) "ascendancy of the market mechanism over the interventionist state in the 1990s" has been taken as a "practical vindication of Smithian arguments in favour of natural liberty, self-interest, and the beneficient outcomes of market forces: the name of Adam Smith is today firmly linked to free markets and open seas" (Tribe 1999:610). However, work in

the history of economic thought during the past two decades has challenged the widespread notion that Adam Smith can be considered the founding father of *laissez-faire* liberalism (Brown 1997, Hundert 1994, Tribe 1999, Samuels & Medema 2005, Winch 1996). While Smith was a proponent of commercial market society, his writings were a criticism of mercantilism in general and of the use of legislation to create monopolies in particular—not a doctrine against government as such, it is argued (Samuels & Medema 2005:221). Smith condemned the methods by which "merchants and manufacturers, acting in concert, had duped legislators into creating an illiberal programme of bounties, monopolies and other exclusive privileges designed to serve their interests at the expense of the rest of the society" (Winch 1996:92). But he also stressed that government had a crucial role to play in a range of areas. Again, let us cite just one example for purposes of illustration. In his discussion of the duties of the commonwealth he includes:

[T]hat of erecting and maintaining those publick institutions and those publick works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals, and which it therefore cannot be expected that any individual or small number of individuals should erect or maintain. The performance of this duty requires, too, very different degrees of expense in the different periods of the society (Smith 1976[1776], 723).

It is difficult to reconcile this statement with an anti-government stance, or even with an advocacy of minimal government. It seems rather to be a doctrine *for* public spending and government in areas where society may benefit from it, but cannot rely on the efforts of private citizens.

The emerging understanding in this history of economic thought on the position of Adam Smith with regard to laissez-faire may be summarized in three main tenets. First, Smith was highly critical, it is argued, of mercantilism and state reason, particularly of "monopolies and other exclusive interests designed to serve [the interests of merchants and manufacturers] at the expense of the rest of the society" (Winch 1996:92). Second, in general terms, Smith held that excessive government will mess up the "natural course of things" and impede economic growth and prosperity (Smith 1755, cited in Winch 1996:90). Third, Smith was not against government as such—quite the contrary, he considered government a prerequisite of the freedom of the individual, and of the proper functioning of the market as well as of society more generally. From the perspective of this body of research, it would be a gross mistake to extrapolate from Adam Smith's critique of mercantilism to a general 'anti-government' or laissez-faire stance. In Foucauldian terms, it would entail projecting the present on the past, and be seen as bearing witness to the absence of a well-conceived methodology for the study of intellectual history.1

The most important issues is not, however, that of 'understanding Adam Smith'. What is most important is to understand liberalism, in its past and present forms, and if we think that we can understand liberalism merely by arriving at the proper interpretation of Smith's writings, we are making a mistake. I will argue, however, that by understanding some of the key reasons for the misunderstandings of Smith mentioned above, one will receive an important indication of which direction to look for a more adequate and comprehensive understanding of classical liberalism. Thus, in the following I suggest some key reasons as to why Smith's writings have been so severely misunderstood. More specifically, I suggest that we need to consider three related and unfortunate tendencies in (most) histories of economic thought. First, when the intellectual history of classical political economy is written, it is most often done in the form of building a narrative that establishes a connection and logic between the past and the present through a series of canonical writers. Narratives construing a linear series of canonical writers are often based only on a small fraction of the writings of each of the authors. The majority of the literature about Smith's work has engaged only with the two first books of *The Wealth of Nations*, neglecting the last three, and indeed the rest of his writings, thus creating a distorted interpretation of his work.2 Secondly, this type of backward 'linear modelling' of the past rarely escapes a tendency to analyze the past 'in terms of the present'. When an anti-government attitude is read into what is a criticism of a particular form of government, the terms of the present are being projected onto the past, and little is achieved in terms of understanding that past. Finally, the third tendency—which reinforces and is itself reinforced by the first two—is that of writing the history of economic thought as a history of economic and political doctrine. Such an approach fails to take into account the crucial issue of the technologies and mentalities of government that economic and political doctrines are associated with. Which lessons may be drawn from this, that could be useful in the search for a more adequate and comprehensive understanding of classical liberalism? There at least two important lessons to be drawn.

First, one should avoid an approach that relies on a simple linear narrative, analyzing the past in terms of the present and identifying past writers as the heroes of much later developments. To avoid this one should undertake an analysis of the debates that authors had with their contemporaries. In this way, the likelihood of analyzing the writings of any author in terms of the present is significantly reduced. Such work on the history of classical liberalism has been carried out by many scholars, including Skinner (1998) and Pettit (1997).

Secondly, one should analyse not just political rhetoric of different types, but also the techniques and mentalities of government with which they are associated, and identify the important shift over time in rhetoric as well as in predominant governmental techniques and mentalities. Such work has been carried out by Michel Foucault.

In the course of this chapter and the next, a more adequate understanding of early classical liberalism will be pieced together drawing on two bodies of literature: the history of early modern political thought provided by the Cambridge School (Skinner 1998; Pettit 1997, Tribe 1999:617), and contributions made in the name of a history of 'techniques and mentalities of government' by Michel Foucault.

FREEDOM—WHAT'S IN A NAME?

"Contemporary discussions of social and political organization are dominated", Philip Pettit argues, "by a distinction … between what [Isaiah Berlin], following a late-eighteenth century tradition, describes as negative and positive liberty" (Pettit 1997:17). Negative liberty, according to Berlin (1958), is a conception of freedom as the absence of interference, whereas positive liberty, requires more than the absence of interference; "it requires the agent to take an active part in gaining control or mastery of themselves" (Pettit 1997:17). In Berlin's account, positive liberty is a thing of the past, whereas negative liberty is the truly modern ideal; "modern liberty is being left to the rule of your own private will, ancient liberty is sharing in the rule of a public, democratically determined will" (Pettit 1997:18). Pettit argues that this distinction, launched first by John Lind in the 1770s and made conventional wisdom by Berlin in 1958, has "served us ill in political thought":

It has sustained the philosophical illusion that, details aside, there are just two ways of understanding liberty: in one, freedom consists in the absence of external obstacles to individual choice; in the other, it involves the presence, and usually, the exercise of the facilities that foster self-mastery and self-fulfilment, in particular, the presence and exercise of those participatory and voting facilities whereby the individual can unite with others in the formation of a common, popular will (Pettit 1997:18).

Pettit argues that a third conception of liberty is overlooked by Berlin's dichotomy: the republican conception of freedom. This conception of freedom shares with Berlin's negative one a focus on *absence*, and with Berlin's positive one a focus on *mastery*: republican freedom is the *absence of mastery by others* (Pettit 1997:22). Pettit argues that in the republican version freedom is non-domination, whereas in the negative variant, described by Berlin, freedom is non-interference. Absence of domination and absence of interference are not the same, he stresses:

[I]nterference can occur without any loss of liberty. In particular, interference occurs without any loss of liberty when the interference is not arbitrary and does not represent a form of domination: when it is controlled by the interests and opinions of those affected, being required

to serve those interests in a way that conforms with those opinions ... [W]hile the properly constituted law—the law that answers systematically to people's general interests and ideas—represents a form of interference, it does not compromise people's liberty, it constitutes a non-mastering interferer (Pettit 1997:35).

Why is this distinction important? To appreciate its importance both Philip Pettit and Quentin Skinner analyse debates among philosophers, political economists and politicians in early liberalism. The consensus at the time of early liberalism was that freedom consisted in the *absence of constraints on individual action*, argue Pettit and Skinner. Within this general consensus there was, however, considerable disagreement, at the core of which was the question of *how* this absence of constraints was ensured. Some held that absence of laws ensured the absence of constraints. Others argued the opposite, that laws were the only means by which an absence of constraints on individual action could be ensured. Two opposing conceptions of liberty, one liberal, the other republican, to use Pettit's terminology.

Reforming to the question of where a man would enjoy most freedom—in the democratic city of Lucca or in the despotic city of Constantinople—Thomas Hobbes (1651) ridiculed the idea that if one lived in a republican city one would by implication be a more free man than if one lived under the sultan in Constantinople. What matters for freedom, he argued, is not the source of the law but its extent, and that "whether a Common-wealth be Monarchial, or Popular, the Freedome is still the same" (Hobbes, cited in Skinner 1998:85). In Hobbes's view, liberty begins where the law ends, and thus the question of freedom is not a matter of who is making the laws, but how many they are, and how far they reach. James Harrington (1656)—a key proponent of the other side of the debate, defending the republican conception of freedom—responded to Hobbes that freedom is less under the sultan in Constantinople than in the city of Lucca, for in Constantinople, whatever freedom you enjoy, will at the end of the day be wholly dependent on the sultan:

You will find yourself constrained in what you can say and do by the reflection that, as Harrington brutally puts it, even the greatest bashaw in Constantinople is merely a tenant of his head liable to lose it as soon as he speaks or acts in such a way as to cause the sultan offence (Skinner 1998:86).

This may seem a rather abstract discussion, and in some sense it was. Little attention was paid to the Hobbesian view of freedom until about a century after he proposed it. As American independence from the British became an issue of political debate in Britain in the 1770s, the Hobbesian view was revived. John Lind, writing in the capacity of political pamphleteer for the

Prime Minister, Lord North, argued fiercely against American independence on the grounds that people in Britain were no less, no more free than people in the American colonies, and that indeed, there is "nothing inherently opposed to freedom in a colonial system of law" (Pettit 1997:42).

It is as if the Hobbesian notion had been put on the shelf of historical curiosities, only to be reclaimed at a time when suddenly it promised to do important, ideological work: to help silencing complaints of servitude and domination—complaints of unfreedom—from those in Britain's American colonies (Pettit 1997:44).

In opposition to the revived Hobbesian view, supporters of American independence argued, along the lines of Harrington a century earlier, that man was only free if he lived in a free, republican state. In terms of relations between Britain and her American colonies, the conception of 'liberty *by* the law' won a victory, although only after a war for independence. John Lind had argued in vain, at least on this matter; America received its independence from the British in 1776. But on the general level of political thought, both Skinner and Pettit observe that a shift took place, from a republican conception of freedom—seeing freedom as *achieved through* law—towards the liberal one, seeing freedom as *impeded by* law.

Skinner and Pettit both suggest that the rise to predominance of the liberal conception of freedom was to a large extent a consequence of the new ideals of equality that were flourishing at the time. It was, in short, a conception of freedom that was practically compatible with the new political environment without too much disruption to the legal and political order. Pettit identifies Jeremy Bentham and William Paley as two of the leading proponents of the liberal conception of freedom, and cites Paley for what was a key issue in the debate, and in Pettit's view the decisive one. Paley argued that,

Those definitions of liberty ought to be rejected, which, by making that essential to civil freedom which is unattainable in experience, inflame expectations that can never be gratified, and disturb the public content with complaints, which no wisdom or benevolence of government can remove (Paley 1825:359).

The argument was, in brief, that the republican conception of liberty was "excessively demanding on government" (Pettit 1997:47)—indeed, "it went without saying … that the state could aspire to realize the [republican] ideal only for a small elite of males: the property-holding … males who made up the citizenry" (Pettit 1997:48):

How could anyone expect the state to ensure that employees—servants, as they were—would enjoy a non-dominated status, when the

prevailing notion of employment or service entailed subjugation to the master's will? … How could anyone expect the state to ensure that women would enjoy such a non-dominated status when the received view was that women were subject to the will of their father or husband? (Pettit 1997:48).

CLOSING REMARKS

Today we have little recollection, Skinner and Pettit argue, of the existence and predominance of a republican conception of liberty in early liberalism. Even to historians of political thought, as Pettit observers, this part of history has "become invisible" (Pettit 1997:50). Skinner contends that by re-appropriating this part of our history we may "stand back from the intellectual commitments we have inherited and ask ourselves in a new spirit of enquiry what we should think of them" (Skinner 1998:117). The value to us today of this story of the rise and fall of the republican conception of freedom is, Skinner contends, that "it reveals to us a conflict within our inherited traditions of thought about the character of the liberal state" (Skinner 1998:119). In the past, the modern West made a choice in this conflict, and by being aware of this choice, it becomes possible for us to ask the crucial question, "Did we choose rightly?" (Skinner 1998:120).

Although the new conception of freedom was not the demanding one of non-domination but that the 'lighter' one of non-interference, a challenge remained. The new political regime—of 'equality of men'—entailed that freedom was generalized to each and every man and woman. With freedom now being the 'natural right' of all men, a new problem emerged: how could social order be secured in this new regime of generalized freedom? It was Jeremy Bentham who first formulated the answer. It is not without irony that the same man who "reinvented Hobbes" (Pettit 1998:44–45)—and thus played a key role in bringing the 'liberty from law' conception of freedom to dominance—was the man who invented the modern form of government, namely government by norms, discipline and surveillance. On the other hand, perhaps it is only in our contemporary minds that there is any irony in this. For, at the time, the question for Bentham, and others on his side of the argument over the proper conception of freedom, was not whether or not government in some form was desirable, but rather how to govern with as limited use of the law as possible.3 This was the challenge that Bentham rose to when he devised the Penitentiary Inspection House and saw in this a general social technology capable of governing men. We are now closing in on the territory of Michel Foucault's analysis of classical political economy. Bentham and the Inspection House reappear on the scene as we move on to Foucault's analysis of liberalism.

15

Liberalism The Invention of 'The Economy'

INTRODUCTION

This chapter sets out Foucault's analysis of liberalism, drawing upon his 'governmentality lectures' given at College de France in the late 1970s.1 In these lectures on early liberalism, Foucault drew particularly upon the writings of Adam Smith, David Hume and Adam Ferguson (Gordon 1991, Lemke 2001). The attempt was not, however, to write an 'intellectual history' of the work of any author, or set of authors. Foucault's ambition was rather to write a social history of liberalism. More specifically, he wished to demonstrate a 'deep historical link' between three 'movements' in Western history: first, the movement that replaced the 'administrative' state with a 'governmental' state; second, the movement that brought about the emergence of 'the population' as a field of intervention and as an object of governmental techniques; and finally, the process which isolated 'the economy' as a specific sector of reality, and political economy as the principal form of knowledge of that field of reality. Foucault intended this work as a 'history of the present'. These three movements, he said, are not just of 'historical interest'. They constitute "a solid series", which "even today has assuredly not been dissolved" (Foucault 1991a: 102).

The structure of this chapter is as follows. The first section sets out Foucault's thesis that the rise of the governmental state was closely related to a recentring of the notion of 'economy' (section 1). This is followed by a summary of Foucault's reflections on what it meant to govern in the name of 'the economy' (section 2), and a section on his analysis of the relationship between freedom and government in modernity (section 3). A final section summarises the key aspects of the shifts from the administrative to the governmental state and identifies the main dimensions of liberalism understood as governmental rationality.

FROM 'ECONOMY' TO 'THE ECONOMY'

A seventeenth-century typology identifies "three fundamental forms of *government*, each of which relates to a particular science or discipline"

(Foucault 1991a: 91, emphasis added): the art of *self-government*, which was connected with morality; the art of properly *governing a family*, belonging to economy; and the science of *ruling the state*, which concerned politics. The notion of 'economy', which previously referred to "the correct manner of managing individuals, goods and wealth within the family,"2 now begins to take on a new meaning, however. This transformation of the notion of 'economy' marks the emergence of what Foucault terms the modern 'art of government', which, says Foucault, "is essentially concerned with how to introduce economy, how to introduce the meticulous attention of the father towards his family into the management of the state" (Foucault 1991a: 92). "To govern a state", he continues, from this point onwards meant to "apply economy, to set up an economy at the level of the entire state, which means exercising towards its inhabitants, and the wealth and behaviour of each and all, a form of surveillance and control as attentive as that of the head of a family over his house and his goods" (ibid.). Government was now concerned with a "plurality of specific aims", ranging from ensuring that "the greatest possible quantity of wealth is produced" to providing the people with "sufficient means of subsistence" and enabling the population to multiply (ibid.). In order to achieve these aims, Foucault argued, things had to be 'disposed', a term central to understanding the difference between sovereignty as a form of power and the modern art of government. With sovereignty, Foucault explains, "the instrument that allowed it to achieve its aim—obedience to laws—was the law itself; law and sovereignty were absolutely inseparable" (Foucault 1991a: 95). The modern art of government differed fundamentally:

[W]ith government it is a question not of imposing law on men, but of disposing things: that is to say, of employing tactics rather than laws, and even of using laws themselves as tactics—to arrange things in such a way that, through a certain number of means, such and such ends may be achieved (Foucault 1991a: 95).

In brief, with the emergence of this modern 'art of government', the key issue in the exercise of political power became that of "disposing things so as to lead … to an end which is 'convenient' for each of the things that are to be governed" (ibid.).

To Foucault, it is *raison d'état*, emerging in the sixteenth century, which is the starting point of the modern 'art of government'. Whereas prior to *raison d'état* principles of rule were considered part of, or subordinate to, "the divine, cosmo-theological order of the world", now principles of governing the state begin to be seen as immanent in the state itself. In order to rule a state, it became necessary "to *know* the state" (Gordon 1991:9, emphasis added). In the words of Botero, "a perfect knowledge of the means through which states form, strengthen themselves, endure, and grow"

(Botero, cited from Dean 1999:86) is necessary to rule a state. In other words, this new *autonomous* rationality of government, *raison d'état*, was intimately connected with an effort to know the state thoroughly so as to govern it. To *raison d'état* corresponded a science: *police science.*

According to Foucualt, however, the further development and maturation of this 'art of government' was impeded, by the "mental and institutional structures" of sovereignty (Foucault 1991a: 97), which prevailed until *raison d'état* and police science were recast and replaced by liberalism and political economy. Within the confines of *raison d'état* and police science the art of government was unable to develop fully, for as long as the institutions of sovereignty continued to be the basic political institutions, and as long as the exercise of power was conceived as the exercise of sovereignty, "the art of government could not be developed in a specific and autonomous manner" (ibid.). As an example of this, Foucault refers to mercantilism. Though mercantilism can be described as the first attempt to apply an 'art of government', and though in this sense mercantilism represented the first rationalization of the exercise of power *as a practice of government*, three factors impeded the full development of an art of government. First, the objective of government was still the might of the sovereign; second, the means of government were still the traditional weapons of sovereign rule—laws, decrees and regulation; and third, the family continued to be the model of government. Therefore, Foucault argues, until "the liquidation of the theme of mercantilism in the early eighteenth century, the art of government remained in a certain sense immobilised" (Foucault 1991a: 98).

During the course of the eighteenth century a new object upon which power relations could operate emerges, namely that of 'the population', now conceived as an object with its own regularities and dynamics, a new field of knowledge and intervention. The description of this new object, 'the population', becomes the main concern of a new *statistics*. Previously, statistics had worked "within the administrative frame and thus in terms of the functioning of sovereignty", but at this point it began revealing that "population has its own regularities, its own rate of deaths and diseases, its cycles of scarcity" and that "the domain of population involves a range of intrinsic, aggregate effects, phenomena that are irreducible to those of the family; such as epidemics, endemic levels of mortality, ascending spirals of labour and wealth" (Foucault 1991a: 99).

Thus, though a *problematic* of government emerges in the sixteenth century, in Foucault's analysis 'government' as a new modality of the exercise of political power only fully matures in the late eighteenth and nineteenth century in and through the invention of 'the population' as an object of political power. Along with the emergence of 'the population' as an object for the exercise of political power, new techniques and tactics of power emerges:

The perspective of population … renders possible the final elimination of the model of family and the re-centring of the notion of

economy … [P]rior to the emergence of population it was impossible to conceive the art of government except on the model of a family (Foucault 1991a: 99).

With the recentring of the notion of economy from the family on to the population, the word 'economy' undergoes a radical transformation. Whereas it used to signify a *form* of government—the form of government pertinent to the management of a household—it comes to designate "a level of reality, a field of intervention" (Foucault 1991a: 93). "The very essence of government", Foucault explains, now was to "have as its main objective that which we are today accustomed to call 'the economy'" (Foucault 1991a: 92). This transformation is what marks the era of 'the governmental state'. The rationality of the 'economy' is recast in relation to a different domain, namely the domain of population, eventually reifying that rationality as applied to its new domain, as a domain of reality in itself: 'the economy'. With this new domain of reality emerges also the science of its government. To 'the economy' as a field of intervention corresponds political economy—"the science and the technique of intervention in that field of reality" (Foucault 1991a: 102). To rule one no longer requires knowledge of the state, but rather knowledge of the autonomous processes and regularities of the new quasi-natural domains of 'population' and 'economy'.

GOVERNING 'THE ECONOMY'

In contrast to *raison d'état* and its "obsessive fantasy of a totally administered society", liberalism "confronts itself with realities … that have their own internal logics and densities, their own intrinsic mechanisms of self-regulation", Foucault contended (Rose 1996:43). "What was discovered at the time", Foucault argues—stressing that this "was one of the great discoveries of political thought at the end of the eighteenth century"—"was the idea of *society*" (Foucault, cited in Barry et al. 1996:9):

[G]overnment not only has to deal with a territory, with a domain, and with its subjects, but it also had to deal with a complex and independent reality that has its own laws and mechanisms of disturbance. This new reality is society. From the moment that one is to manipulate a society, one cannot consider it completely penetrable by police. One must take into account what it is. It becomes necessary to reflect upon it, upon its specific characteristics, its constants and variables (Foucault, cited Barry et al. 1996:9, emphasis added).

According to the governmental rationality of liberalism, government must be exercised in the light of a knowledge of that which is to be ruled—whether a child, a family, an economy, or a community. Each of these

objects of government "can be shaped and guided in order to produce desirable objectives" while at the same time respecting their autonomy, if this governing is based on a knowledge of their general laws of functioning (Rose 1996:44). As a governmental rationality, liberalism thus calls for *cautious* government, for government that is respectful of the autonomy of the individual and of the autonomy of civil society.

Liberalism breaks with *raison d'état* by contending that the activity of governing human behaviour "cannot be its own end" (Foucault 1994a: 74). The attitude of *raison d'état*, that *government was never sufficient*, is replaced with the attitude of liberalism, that government is always in excess—one must always "suspect that one governs too much" (ibid.).

The suspicion that one always risks governing too much is inhabited by the question: Why, in fact, must one govern? This explains why the liberal critique barely detaches itself from a problematic, new at the time, of 'society': it is on the latter's behalf that one will try to determine why there has to be a government, to what extent to determine why there has to be a government, to what extent it can be done without, and in which cases it is needless or harmful for it to intervene (Foucault 1994a: 74–75).

An essential part of liberalism as a governmental rationality was a certain ethos. It always seemed to be seeking to avoid the 'twin dangers' of governing too much and governing too little (Rose 1999:70). Governing too much entailed a danger of "distorting or destroying the operation of the natural laws of those zones upon which good government depends", whether families, markets, society, or personal autonomy (ibid.). Governing too little, on the other hand, entailed the danger of failing to "establish the conditions of civility, order, productivity and national well-being which make limited government possible" (ibid.).

The liberal mentality of rule is concerned with *balancing* the governmental ambition of maximizing the well-being of the population with the protection of the autonomy of the individual and civil society. By the construal of these domains —'the individual', 'the society', 'the family', 'the market'—*as domains*, whose autonomies must not be encroached on by governmental intervention, a knowledge of their 'internal' processes is made necessary. The liberal 'art of government' was the solution, one might say, to the problem of *regulating* both the autonomy of the individual and the autonomy of processes of population, which their construal as quasiindependent domains raises.

An important implication of this analysis relates to how one should understand '*laissez-faire*':

Laissez-faire is a way of acting as well as a way of not acting. It implies, in Foucault's words, an injunction 'not to impede in the course of

things, but to ensure the play of natural and necessary modes of regulation, to make regulations which permit natural regulation to operate'. … The permissive meaning of laissez-faire needs to be understood in an activist, enabling sense, no less than in its character of passive abstentionism (Gordon 1991:17).

The notion of *laissez-faire* was never an anti-government doctrine, in other words, but a doctrine of careful and cautious government, 'activist abstentionism', not of 'non-interference'.

With the constitution of these new governmental domains—society, the family, the market, etc.—and with the emerging bodies of knowledge pertaining to them, a new regime of power takes shape, a regime of power that is characterised by giving, for the first time, a political existence to life itself:

For the first time in history, no doubt, biological existence was reflected in political existence; the fact of living was no longer an inaccessible substrate that only emerged from time to time, amid the randomness of death and its fatality; part of it passed into knowledge's field of control and power's sphere of intervention. Power would no longer be dealing simply with legal subjects over whom the ultimate dominion was death, but with living beings, and the mastery it would be able to exercise over them would have to be applied at the level of life itself; it was taking charge of life, more than the threat of death, that gave power its access even to the body (Foucault 1998:142–43).

What Foucault is claiming is a fundamental shift in regime of power, from a regime dominated by sovereign power to one dominated by bio-power. Sovereign power was characterised by the exercise of power as a means of deduction, "a right to appropriate a portion of the wealth, products …, labour and blood, … levied on subjects", making power in this regime "a right of seizure—of things, time, bodies and ultimately life itself" (Foucault 1998:136). This regime of power was based, at the end of the day, on the right of the sovereign to "take life or let live" (ibid.). In the liberal regime of power, 'deduction' is no longer the major form of power, but rather one component among others, and subordinated to a new overall mode of power—"a power bent on generating forces, making them grow, and ordering them, rather than one dedicated to impeding them, making them submit, or destroying them" (ibid.). Parallel to this shift from a regime of power dominated by a 'deductive' form of power to one dominated by what one could term a 'generative' form of power is a shift with regard to the relationship of power to life and death. Power, in the modern regime, is no longer the right to take life or let live, but the right to *foster* life, a power to *invest* life. By calling this new regime the regime of bio-power, Foucault alluded to the centrality of 'life itself' in the exercise of power in this regime:

If one can apply the term bio-history to the pressures through which the movements of life and the processes of history interfere with one another, one would have to speak of bio-power to designate what brought life and its mechanisms into the realm of explicit calculations and made knowledge-power an agent of transformation of human life (Foucault 1998:143).

A key characteristic of the development of the regime of bio-power is "the growing importance assumed by the action of the norms at the expense of the juridical system of the law" (Foucault 1998:144). This is not to say that law has disappeared or become less important in the regime of biopower, but rather that the role of law has changed, from that of "a coercive technique of sovereignty" to one of being an instrument of "normalizing power" (Dean 1999:119). In Foucault's words, in the regime of bio-power, law "operates more and more *as* a norm" (Foucault 1998:144). This is how one is to understand Foucault's predicament that modern society is, more than anything, a "normalizing society" (ibid.).

FREEDOM AND GOVERNMENT

Foucault's analysis of the rise of bio-power and normalization comes with a particular perspective on the notion of 'individual freedom' or 'personal autonomy'. In this perspective, "personal autonomy is not the antithesis of political power, but a key to its exercise" (Rose & Miller 1992:174). Barry Hindess contrasts the liberal perspective on liberalism—seeing itself as a political doctrine defending the 'natural liberty' of the individual—with a Foucauldian one, seeing it as a governmental rationality promoting a certain form of existence.

[T]he sphere of individual liberty should be seen, not so much as reflecting the natural liberty of the individual but rather as a governmental product … as the effect of a multiplicity of interventions concerned with the promotion of a specific 'form of life' … centred on the regulative ideal of personal autonomy (Hindess 1996:65).

From this perspective, freedom and government are not opposites. On the contrary, the liberal mode of government is characteristic precisely by relying on individuals practicing their freedom in a regulated and orderly manner, as promoted by disciplinary and normalising techniques of government. Liberty is, in Colin Gordon's phrase, the "circumambient medium of governmental action" (Gordon 1991:20). From a Foucauldian perspective, disciplinary power "is not so much a matter of imposing constraints upon citizens as of 'making up' citizens capable of bearing a kind of regulated freedom" (Rose & Miller 1992:174).

Liberalism, in Foucault's perspective, is a rationality of government that depends on the social and human sciences and a range of disciplinary institutions in setting up and rendering operational a range of norms for self-government, as well as for cautious economic government. The sciences that help discipline the individual include medicine, psychiatry, psychology and criminology, whereas the sciences which are to enable the processes of the population and the economy include, notably, political economy and statistics. The human and social sciences are, from this perspective, essentially governmental. Their instrumentality with regard to governing individuals and populations are their very *raison d'etre*. From a Foucualtian governmentality perspective, then, scientific discourse is much more than 'merely contemplative'. Scientific narratives compose governmental fields, describing the world in a manner rendering it amenable to governmental interventions, and "inscribing reality into the calculations of government" (Miller & Rose 1990:7). Mitchell Dean links the emergence of the bio-political approach, the emergence of liberalism and the emergence of human sciences in the following manner:

It is only with what might be called the liberal critique of state reason that the rapid expansion of the sciences of human conduct and the practices of government will occur. The condition of this liberal critique will be the displacement of the house-holding approach by a bio-political one (Dean 1999:97).

CLOSING REMARKS

The emergence of liberalism, in Foucault's account, is closely related to the transition from 'the administrative state' to 'the governmental state', marked by the elimination of the family as a model of government, and evoking instead two new, autonomous domains, 'the population' and 'the economy'.

In the regime of *raison d'état*, disciplinary power was based on minute regulation and supervision of men and their affairs, Foucault observes. The move from *raison d'état* to liberalism was a move towards a regime of disciplinary power founded upon a new modality of surveillance, the *strength* and *economy* of which resided in its ability to install in those surveyed a *self-surveillance*. Disciplinary power renders operational a rationality "geared to efficiency and productivity", but, as Paul Rabinow notes, "[i]t offered a logic not only of efficiency", but also—and this was Foucault's main concern—"of normalization" (Rabinow 1984:20). By establishing normality as a rule of life for us all, the human sciences "simultaneously manufacture—for investigation, surveillance and treatment—the vast area of our deviation from this standard" (Philp 1985:67).

Table 15.1 Birth of 'the Economy' and the Governmental State

	The 'administrative' state (16th to 18th centuries)	*The 'governmental' state (end of 18th century to present)*
Rationality of rule	*raison d'état*	Liberalism
Model of government	The family	The population
Overall objective	Strength of the state; the happiness of each and all	Health and prosperity of the population
'Ethos'	Never enough government	Always too much government
Dominating form of power	The exercise of sovereignty in the form of a political pastorate	The exercise of government; disposing things "so a to lead to a convenient end"
Principal form of knowledge	Police science - knowledge of the state	Political economy - knowledge of the autonomous processes of 'the population'
'Economy'	A form of government	A level of reality, a field of intervention

Before proceeding to Foucault's analysis of neoliberalism, we may briefly summarize his analysis of liberalism as a governmental rationality by specifying its four key dimensions. First, in Foucault's analysis, the *means* and *end* of liberal government is personal autonomy in the form of disciplined freedom. Second, the liberal *principle* of government is that of striving never to govern too much, nor too little (Rose 1999:70, Dean 1999:21). Third, the liberal *mode* of governing is to govern through normalization, surveillance, and corrective reform. And finally, Foucault argues, the liberal *ethos* of government consists in a continual problematization of government, always suspecting that we are governing too much.

16

Neoliberalism Governing Through Markets

INTRODUCTION

Michel Foucault only lived to see the first years of the rise of neoliberalism. His lectures on neoliberalism were given in 1977–1978, and thus articulated neo-liberal governmentality at the very beginning of its seizing hold of Western countries. Nevertheless, his analysis remains exceptionally insightful and authoritative and, indeed, anticipatory of patterns of transformation in governmental rationalities. It is pertinent, however, to draw upon one further Foucauldian account of neoliberalism to fully capture later developments in the neoliberal era. For this purpose, a contribution by Nikolas Rose (1996) is discussed. The merit of this contribution is not only that it locates neoliberalism in relation to its predecessor, welfare liberalism, but also because it is a review of sorts of a vast body of governmentality literature.

In his analysis of neo-liberal governmentality, Foucault focused on two specific forms of neo-liberalism—German post-war liberalism and the liberalism of the Chicago School—which, although sharing some key, ideological premises, were quite different.1 Before discussing Foucault's analysis of these two 'schools' of neoliberal thought, a brief summary is given of the core ideas of Friedrich Hayek, often considered the 'founding father' of neoliberalism.

The structure of the chapter is as follows. The remarks on Hayek (section 1), is followed by Foucault's analysis of German neoliberalism and American neoliberalism (section 2). The chapter concludes with a section on Nikolas Rose's comparative analysis of welfare liberalism and neoliberalism (section 3).

ON THE WORK OF HAYEK

Along with Ludwig von Mises and Milton Friedman, Friedrich Hayek was one of the co-founders of the Mont Pelerin Society. The Mont Pelerin Society, founded in 1947, consisted of a small a group of academic economists, historians and philosophers who saw the "essential conditions

of human dignity and freedom" as being "progressively undermined by extensions of arbitrary power".2 The group contended that these developments had been fostered partly by the rise of a view of history that "denies all moral standards", and partly by a "decline of belief in private property and the competitive market", without which it would be "difficult", they argued, "to imagine a society in which freedom may be effectively protected" (Hayek 1980 [1945]). Hayek was a fervent critic of 'continental liberalism', which, he argued, was based on a "false, rationalistic individualism", characterised by its belief in 'designing' social order, instead of relying on the 'unplanned', 'spontaneous' outcomes of the actions of free individuals. It is worth citing Hayek at length on this distinction between the "true individualism of the British thinkers of the eighteenth century", and the "false individualism" of the "Cartesian school" in continental Europe (Hayek 1980:7–8). Hayek saw in these two strands of thought a wide difference.

[B]etween a view which in general rates rather low the place which reason plays in human affairs, which contends that man has achieved what he has in spite of the fact that he is only partly guided by reason, and that his individual reason is very limited and imperfect, and a view which assumes that Reason, with a capital R, is always fully and equally available to all humans and that everything which man achieves is the direct result of, and therefore subject to, the control of individual reason. One might even say that the former is a product of an acute consciousness of the limitations of the individual mind which induces an attitude of humility toward the impersonal and anonymous social processes by which individuals help to create things greater than they know, while the latter is the product of an exaggerated belief in the powers of individual reason and of a consequent contempt for anything which has not been consciously designed by it or is not fully intelligible to it (Hayek 1980:8, emphasis added). 3

As it appears, Hayek's distinction between true and false individualism is predicated upon two binary oppositions. First, there is a binary opposition between social order that is 'designed'—consciously planned by human reason—and social order that is 'spontaneous', the unintended, 'grown' outcome of the actions of individuals. Second, there is a binary opposition between social order that "rests on the enforcement of abstract principles" and social order that rests on "the enforcement of specific orders" (Hayek 1980:19). Hayek stresses that he does not deny "the necessity of coercive power", but that he merely wishes to underline the need to "limit it to those fields where it is *indispensable* to *prevent coercion by others* and to *reduce the total of coercion* to a minimum" (Hayek 1980:16–17, emphasis added). Hayek advocated a minimum of coercion in the form of the "enforcement

of abstract principles", in relation to which a certain degree of "voluntary conformity" is a virtue, if not in fact the precondition of a free society (Hayek 1980:26).

Hayek defined two principles as the "basic tenets" of true individualism. If a man is simultaneously to "use *his* particular knowledge and skill with the aim of furthering the aims for which *he* cares", and "in so doing … make as large a contribution as possible to needs which are beyond his ken", Hayek contends, then two things are "clearly necessary" (Hayek 1980:17, emphasis in original): first, that "he should have a clearly delimited area of responsibility", and, second, that "the relative importance to him of the different results he can achieve must correspond to the relative importance to others of the more remote and to him unknown effects of his action" (ibid.).

The "false", Cartesian form of individualism was 'dangerous', Hayek argued. "Rationalistic individualism always tends to develop into the opposite of individualism", he explains, "namely socialism or collectivism" (Hayek 1980:4). "While the design theories necessarily lead to the conclusion that social processes can be made to serve human ends only if they are subjected to the control of individual human reason, and thus lead directly to socialism", he continues, "true individualism believes on the contrary that, if left free, men will often achieve more than individual reason could design or foresee" (Hayek 1980:10–11).

FOUCAULT'S ANALYSIS OF NEOLIBERALISM

German Neoliberalism

Foucault accounts for German post-war liberalism by juxtaposing two different responses to a problem formulated by Max Weber. Weber shifted Marx's problem of the contradictory logic of capitalism, Foucault argues, to "a level where he discussed it as the irrational rationality of capitalist society" (Lemke 2001:192). The 'Frankfurt School' endeavoured to discover a "new social rationality" that would "overcome the irrationality of the capitalist economy", whereas the 'Freiburg School'—also known as the *Ordo-liberals*—"opted for the opposite approach", endeavouring instead to "redefine the economic (capitalist) rationality in order to prevent the social irrationality of capitalism from unfolding" (Lemke 2001:192–193).4 Foucault stresses that these two schools shared another problematic—the emergence of the Nazis and the collapse of democracy in Germany—the reasons for which both reflected upon. For the critical theorists of the Frankfurt school, these two problematics—the irrational rationality of capitalism and the emergence of the Nazis—were inextricably intertwined. A causal relationship between capitalism and fascism was evoked by these authors, and thus the 'solution' to both problems was the

replacement of capitalism by socialism. The *Ordo-liberals*, on the other hand, considered the fascism of the Third Reich not as a result of capitalist society but instead a "result of an *absence of liberalism*" (Lemke 2001:193, emphasis added). The *Ordo-liberals* held, in other words, that the Third Reich was the "inevitable result of a series of anti-liberal policies" (ibid.), and thus rejected the notion suggested by the Frankfurt School, that it all boiled down to making a choice between capitalism and socialism. For the *Ordo-liberals* the fundamental challenge was instead to promote liberal, economic order against state interventionism—whether in the form of socialism or Keynesianism—which was seen to undermine liberty and democracy.

In his account of the theoretical basis of the *Ordo-liberals*, Foucault stresses what he saw as their 'anti-naturalistic' conception of the market and their emphasis on the principle of competition. For the *Ordo-liberals*, a market economy is not a natural economic reality—"with intrinsic laws that the art of government must bear in mind and respect"—but is "constituted and kept alive" only by means of "incessant and active politics" in the form of legal measures and various other political interventions (Lemke 2001:193). The thinking of the *Ordo-liberals* thereby differs from the thinking of the classical liberals is that it abandons a *negative* conception of the state. For the *Ordo-liberals*, it did not make sense to distinguish "between a limited domain of liberty and the legitimate domain of government intervention" (ibid.). Instead, the state and the market economy are seen as standing in a relation of mutual constitution. Foucault argued that this anti-naturalistic conception of the market had a theoretical, historical and political dimension. First, in theoretical terms, it rejected the Marxian dichotomy of an economic base and a political-legal superstructure, on the grounds that "the economy is not a domain of a natural mechanism, but instead defines a social field of regulated practices" (Lemke 2001:193–94). Second, instead of a "unilateral causal connection", the *Ordo-liberals* posit an "incessant reciprocity" through which economic processes and institutional frameworks are "articulated, refer to and support each other" to account for the history of capitalism (Lemke 2001:194). Third, the logical consequence of the theoretical and historical dimension of the anti-naturalism of the *Ordo-liberals* was the adoption of the political stance that the survival of capitalism depends on a process of "social intervention and political regulation" that continuously changes and reinvents it (*ibid.*).

Foucault highlights two examples of the anti-naturalism of the *Ordoliberals* in the form of the stance they took against Schumpeter's views on capitalism and monopolization and against Sombart's views on capitalism and mass society. Contrary to Schumpeter, the *Ordo-liberals* did not see in the tendency towards monopolization "some irrevocable and inevitable process" endemic to capitalist society, but rather a social phenomenon that resulted from "a failed political strategy and inadequate forms of institutionalization" (ibid.). In similar vein, the *Ordo-liberals* rejected Sombart's

pessimistic contention that modern capitalism constituted an "irreversible development of a uniform mass society" characterised by the "immiseration of human relations" (Lemke 2001:195). The *Ordo-liberals* inverted Sombart's analysis, suggesting that the problems he depicted were the result not of capitalism but of "planning methods and bureaucratic apparatuses deployed by enemies of the market mechanism" (ibid.). Moreover, only neo-liberal forms of government could lead society away from the "homogenizing trends of a mass society" (ibid.).

Foucault then proceeds to identify the neo-liberal forms of government that the *Ordo-liberals* advocated. They stressed, Foucault argues, the need to devise a social policy that is not merely redistributive, but above all involves the creation of the social and institutional framework for what they term a 'social market economy'. The focus was not so much on "lessening the antisocial consequences of competition" as on blocking "the anti-competitive mechanisms which society can spawn" (ibid.). The forms of government advocated by the *Ordo-liberals* consisted in two main components, Foucault argued: (i) the universalization of the entrepreneurial form and (ii) the redefinition of law. The goal of the former was "to multiply and expand entrepreneurial forms within the body social" by generalizing—as a model for social relations—"the economic mechanisms of supply and demand, competition, etc." (Lemke 2001:195–96). The latter derives from the contention that political intervention is not an encroachment on the market economy that must be limited as much as possible, but a crucial prerequisite for anchoring "the entrepreneurial form at the very heart of society" (ibid.).

AMERICAN NEO-LIBERALISM

The American neo-liberalism of the Chicago School shared with German neo-liberalism, Foucault observed, an opposition to state interventionism and *dirigism*, and a criticism of what was seen as "the uncontrolled growth of bureaucratic apparatuses" (Lemke 2001:197). The American neo-liberalism differed substantially from the German one, however, in terms both of its conception of society and the political strategies advocated.

Whereas the *Ordo-liberals* maintained a distinction between the social and the economic domains, "with the concept of enterprise functioning as the intermediary", the Chicago School neo-liberals sought to elide any difference between the economy and the social by generalising the economic form (ibid.). Whereas the *Ordo-liberals* advocated that society should be governed in the name of the economy, the American neo-liberals attempted to redefine the social sphere altogether, so that the economy was no longer one domain among others but rather embraced all areas of human action, which were then perceived to be all characterized by rational-economic action and the allocation of scarce resources for competing goals. This generalization of the object of the economic was, Foucault argued, a key epistemological shift distinguishing American from German neo-liberalism, and

had two major implications. First, it meant that forms of human action that had not previously been analysed and dealt with politically in terms of economic rationality now were. Second, for the Chicago School, government is devised and evaluated by means of market concepts and thus itself becomes a "sort of enterprise whose task it is to universalize competition and invent market-shaped systems of action for individuals, groups and institutions" (ibid.). Instead of demanding of government that it respects the form of the market—which was the approach of the classical liberals—the Chicago school neo-liberals make the market the very *form* of government, "a kind of permanent economic tribunal" (Foucault, cited in Lemke 2001:198). To illustrate the generalization of the economic by the Chicago school Foucault cites two examples: the theory of human capital and the analysis of criminality.

The Theory of Human Capital

The staring point for the Chicago school theory of human capital is the contention that of the three production factors identified by classical political economy—land, capital and labour—it is only the former two that have been analysed and discussed adequately. Though the American neo-liberals share this contention with Karl Marx, their response differs substantially from that of Marx. Marx focused on "the division between concrete and abstract labour" and explained this "as a historical product of capitalist society" (ibid.). The neo-liberals, on the contrary, argue that the problem is not capitalist society but rather the way in which the economic process has been perceived and conceptualised. The American neo-liberals set out to ameliorate this deficiency in the conceptualization of labour, and in so doing took the vantage point of the employee as their starting point. "For a wage labourer the wage is by no means the price for selling his/her labour power, but instead represents an income from a special type of capital", they argued (Lemke 2001:199). Human capital is not like other forms of capital, they explained, for human capital—ability, skill and knowledge—"cannot be separated from the person who possesses them" (ibid.). Human capital consists, they argue, in an "inborn physical-genetic predisposition" and in "the entirety of skills" that a person has acquired as the result of his "investments" in nutrition, education, training, etc. (ibid.). From this perspective, a wage labourer is not an employee, dependent on a company, but an entrepreneur, an autonomous person who endeavours to create surplus value for himself, "with full responsibility for their own investment decisions"—a person, that is, who becomes the entrepreneur of himself (ibid.).

The Analysis of Criminality

The Chicago school neo-liberals analyzed criminality along similar lines. The criminal is seen as a rational-economic agent who "invests, expects a certain

profit and risks making a loss" (Lemke 2001:199). This approach distances itself from all previous forms of psychological, biological or anthropological explanations of crime. In this perspective, crime may not only be analysed in market terms—just like any other form of human action—but is simply considered one market among others. From the perspective of the Chicago School the criminal is "not a psychologically deficient person or a biological degenerate, but a person like any other", and there is "no fundamental difference between murder and a parking offence" (ibid.). The task of the penal system is, the Chicago neo-liberals argue, to limit "the supply of crime by negative demand", endeavouring to "strike a temporary and forever fragile balance between the positive supply curve for crime and a negative demand curve for sanctions" (ibid.). In the perspective of the American neo-liberals, the criminal is—"however pathological"—always to a certain degree a rational being, "sensitive to changes in the balance of profit and loss" (ibid.). The penal policy that the Chicago neo-liberals advocated focuses not on actual or potential criminals themselves, but on influencing the balance of profit and loss in the market for crime. For the neo-liberals the ideal is not a "disciplining nor a normalizing society", but a society that "cultivates and optimizes differences" (ibid.). From the perspective of the Chicago neo-liberalism, a society that exhibits "unlimited conformity" is not desirable—and rather than being "a sign of social dysfunction", "a certain degree of criminality" is, in fact, an integral part of an optimally functioning society, "regulating even the distribution of criminality" (ibid.).

THE NOVELTIES OF NEOLIBERALISM

Foucault identifies two major ways in which neo-liberalism breaks with classical liberalism. First, neo-liberalism redefines, Foucault argues, the relationship between the state and the economy. More specifically, neo-liberalism "*inverts* the early liberal model, which rested on the historical experience of an overly powerful absolute state" (Lemke 2001:200, emphasis added). Whereas in classical liberalism the proper role of the state was perceived to be that of defining and monitoring market freedom, with neo-liberalism the market itself becomes the "organizing and regulative principle underlying the state" (ibid.). With neo-liberalism it is, in other words, more the state that is "being controlled by the market" than "the market being supervised by the state"; "it is the market form which serves as the organizational principle for the state and society" (ibid.). Second, whereas in classical liberalism the focus was on preventing government from constraining the 'natural liberty' of individuals, with neo-liberalism the individual comes to be perceived as a "behaviouristically manipulable being"—no longer, that is, as an "external limit and the inviolable core of governmental action" (ibid.). Key to governmental action becomes, in other words, the design of an 'environment' in which the rational cost-benefit calculations of individuals lead to desirable, efficient outcomes—whether with regard to family or professional life, to health or crime, etc.

NEOLIBERAL MODES OF GOVERNING

"In the immediate aftermath of the Second World War", Nikolas Rose observes, "a number of European intellectuals" challenged the otherwise widespread contention that it was "feasible for the whole of the productive and social organization of a nation to be governed, in some way or another, by a central State" (Rose 1996:50). Notable among these challenges were, Rose suggests, the work of Friedrich Hayek. Hayek suggested that the logics of an interventionist State "were not only inefficient and self-defeating, but set nations on the very path towards the total State that had been manifested in Nazi Germany and could be seen in Stalin's Soviet Union" (ibid.). The interventionist state was "subversive of the very freedoms, democracies and liberties" it sought to enhance, Hayek argued (ibid.). Three decades later, Hayek's ideas combined with an economic criticism that spanned the entire political spectrum, Rose contends. The crux of this economic criticism was the argument that "the increasing levels of taxation and public expenditure required to sustain social, health and welfare services, education and the like, were damaging to the health of capitalism as they required penal rates of tax on private profit" (Rose 1996:51). Whereas welfare liberalism, with its emphasis on a combination of security and responsibility, had been perceived as a bulwark against "the twin threats of socialism and moral and social disintegration", these same strategies were now seen as threatening "the very survival of a society based upon a capitalist economy" (ibid.). The argument that the growth of the 'unproductive' welfare sector was increasingly at the expense of the 'productive' private sector, combined with other types of criticism, including criticism of "the arrogance of government overreach", of "the absurdity of politicians trying to second-guess the market by picking winners", and of "claims that Keynesian demand management stimulated inflationary expectations and led to the debasement of the currency" (ibid.). Further, it was argued that "measures intended to decrease poverty had actually increased inequality"; "that controls on minimum wages hurt the worst paid because they destroy jobs", that the growth of "welfare bureaucracies" manifested a "covert strategy for empire-building and the advancement of sectional interests"; "that it was actually the middle classes, rather than the poor, who benefited both from the employment opportunities and from the services of the Welfare State"; "that welfare services actually destroyed other forms of social support such as church, community, and family" and, finally, "that they did not produce social responsibility and citizenship but dependency and a client mentality" (Rose 1996:51–52).

Though it would be "misleading to suggest that the neo-conservative political regimes that were elected in Britain and the United States in the late 1970s were underpinned by a coherent and elaborated political rationality that they then sought to implement", it remains nevertheless true that a "relatively coherent mentality of government that came to be termed neo-liberalism" gradually emerged (Rose 1996:53). This neo-liberalism

reviewed “the sceptical vigilance over political government basic to classical liberalism”, which, however, by no means meant that “the will to govern” was abandoned (ibid.). “Despite posing itself as a critique of political government”, Rose explains, neo-liberalism retains “the presupposition that the real is programmable by authorities” (ibid.). “Failure of government to achieve its objectives” is not met by a denounciation of government as such, or even by efforts to minimize it, as one might expect, but by the attempt to invent “new strategies of government that will succeed” (ibid.). Paradoxically, neo-liberalism accords a key role to governmental authorities in rendering objects of government “thinkable in such a way that their difficulties appear amenable to diagnosis, prescription and cure” (ibid.). The way in which neo-liberalism governs is, however, new in a number of ways. Rose argues that one can detect a “durable transformation in rationalities and technologies of government”, observable “from Finland to Australia” and “advocated by political regimes from left and right”, in relation to a wide range of problem domains, “from crime control to health” (ibid.). Common to these new techniques of government is, Rose explains, that (i) they endeavour to “create a *distance* between the decisions of formal political institutions and other social actors”, (ii) “conceive of these actors in new ways as subjects of responsibility, autonomy and choice”, and (iii) “seek to act upon them through shaping and utilizing freedom” (Rose 1996:53–54, emphasis added).

Rose stresses that with neo-liberalism “the powers once accorded to positive knowledges of human conduct” are increasingly “transferred to the calculative regimes of accounting and financial management” (Rose 1996:54). “Budget disciplines, accountancy and audit” are the three “most salient” new techniques for “exercising critical scrutiny over authority”, he contends. Neo-liberalism marks, in other words, the rise of a new type of “claim to truth”, namely that of a range of “grey sciences”:

These know-hows of enumeration, calculation, monitoring, evaluation, manage to be simultaneously modest and omniscient, limited yet apparently limitless in their application to problems as diverse as the appropriateness of a medical procedure and the viability of a university department (Rose 1996:54).

These new techniques and their ‘grey sciences’ serve the purpose of creating a “distance between the political and the expert machines”, Rose argues. Regulatory power is to be shifted from ‘above’ to ‘below’, from “planning and compulsion” to a mode of governing that accords a key role to the “decisions of consumers” (ibid.). The ideal form of the neo-liberal mode of governing is that of a ‘free market’, “where the relations between citizens and experts are not organized and regulated through compulsion but through acts of choice” (ibid.). This involves—whether in the case of hospitals, schools or anything else—a “new way of ‘responsibilizing’ experts in

relation to claims upon them other than those of their own criteria of truth and competence", Rose stresses (ibid.). Such marketization of government is often accompanied by monetarization. Whether in the case of "operating on a patient", "educating a student" or "providing a social work interview for a client", it entails the transformation of activities "into cash terms" (Rose 1996:55). The focus on budgetary discipline, for instance, "transforms the activity of the budget holder" not only by "increasing choices" available, but also "by regulating them and providing new ways of ensuring the responsibility and fidelity of agents who remain formal autonomous", and thus "new diagrams of force and freedom are assembled" (ibid.). "Within these new strategies of government", Rose observes, audit "becomes one of the key mechanisms for responding to the plurality of expertise and the inherent controversy and undecidability of its truth claims" (ibid.). Rose refers to the work of Michael Power (1994), which suggests that "audit, in a range of different forms, has come to replace the trust [previously] accorded to professional credentials" (ibid.). Audit is, in other words, tailored to a mode of government in which "new distantiated relations of control"—"between political centres of decision" and "non-political" governmental institutions (schools, hospitals, firms, etc.)—predominate (ibid.). "In this process", Rose argues, "entities to be audited are transformed", for they have to be "made auditable" before they can be audited (ibid.). Though audit is a demanding governmental technology, it "travels well across space and time, is capable of being propagated in a multitude of locales" (ibid.). This generalized aptitude owes a great deal, no doubt, to its "apparently stable and yet endlessly flexible criteria such as efficiency, appropriateness, and effectiveness", which "renders it a versatile and highly transferable technology for governing at a distance" (ibid., emphasis added).

Neo-liberalism involves, Rose argues, a pluralization of social technologies as the other side of what he terms the "de-statization of government" (Rose 1996:56). With neo-liberalism one sees, Rose argues, a sort of decentralization of government, which detaches regulatory technologies from the centre and reinvents the role of central government. Central government now assumes the role of "shaping the powers and wills" of a range of "autonomous entities", whether "enterprises, organizations, communities, professionals, [or] individuals". The neo-liberal mode of governing replaces, Rose argues, norms "such as those of service and dedication" with new ones, "such as those of competition, quality and customer demand" (ibid.). In this new regime of government, a range of quantitative measures become central, underpinning "a claim that they now operate according to an apolitical agenda" (Rose 1996:56–57). Increased autonomy is thus accompanied by "contracts, targets, indicators, performance measures, monitoring and evaluation" to maintain a governing of the conduct of such deregulated organizations, whether a university, a public utility, or a hospital. The "reconfiguration of political power" involved cannot be adequately understood, Rose argues, "in terms of the opposition of State and market":

[S]haped and programmed by political authorities, new mechanisms are utilized to link the calculations and actions of a heterogeneous array of organizations into political objectives, governing them 'at a distance' through the instrumentalization of a regulated autonomy (Rose 1996:57).

The new distantiated mode of government, its calculative technologies of government and the 'grey sciences' upon which it relies, gives rise to a new specification of the subject of government, who is increasingly understood as a *customer*. Clients are now consumers—"of health services, of education, of training, of transport"—and are thus perceived as "active individuals seeking to 'enterprise' themselves, to maximize their quality of life through acts of choice" (ibid.). Instead of clients, dependent and obliged, one now has "actively responsible" persons who are, "in their essence, creatures of freedom, liberty and autonomy" (ibid.). The governmental challenge in this new regime is to "to find means by which individuals may be made responsible through their individual choices for themselves" (ibid.):

Contemporary political rationalities rely upon and utilize a range of technologies that install and support the civilizing project by shaping and governing the capacities, competencies and wills of subjects, yet are outside the formal control of the 'public powers' (Rose 1996:58).

With this "reconfiguring of the subject of government", a number of forms of government undergo "a mutation", Rose argues (ibid.). For example, the previously prevailing principle of "social solidarity" in the neo-liberal regime "gives way to a kind of privatization of risk management" (ibid.). With the rise of this "new prudentialism", Rose explains, "insurance against future possibilities of unemployment, ill health, old age and the like becomes a private obligation" (ibid.). This is, however, only one of many ways in which "the citizen is enjoined to bring the future into the present, and is educated in the ways of calculating the future consequences of actions as diverse as those of diet to those of home security", Rose continues (ibid.). The bottom line is that with neo-liberalism the subject of government is an "active citizen", that must "adopt a calculative prudent personal relation" to his or her future, which is now "conceived in terms of calculable dangers and avertable risks" (ibid.). Many of those subjects that were previously taken care of by welfare government programmes, in the neo-liberal regime find that benefits are decreased as responsibility for their situation is increasingly given to themselves. In Rose's perspective, this responsibilization of individuals for their own suffering entails an "intensification of misery and impoverishment" (Rose 1996:59). The "unemployed person has come to be designated a 'jobseeker' and the homeless person a 'rough sleeper'"—both of them "the authors of their own misfortune"—Rose notes, and he finds it difficult not to see in this a certain "cynicism and repugnance" (ibid.). However, Rose

observes, neo-liberalism shares in this respect "with strategies articulated form other political perspectives" a new conception of the 'excluded'. They are suddenly seen not so much as victims of society or victims of the economy, but much more as *victims of government*. They are, in Rose's words, "people whose self-responsibility and self-fulfilling aspirations have been deformed by the dependency culture, whose efforts at self-advancement have been frustrated for so long" that they now suffer from the combined misfortune of a "learned helplessness" and the destruction of their "self-esteem" (ibid.). As a consequence, if they are to be helped, they require not "benefit cheques", but to be engaged "in a whole array of programmes for their ethical reconstruction as active citizens":

[T]raining to equip them with the skills of self-promotion, counselling to restore their sense of self-worth and self-esteem, programmes of empowerment to enable them to assume their right place as the self-actualizing and demanding subjects of an 'advanced' liberal democracy (Rose 1996:60).

In Rose's perspective, neo-liberalism replaces the previous attempt to "govern *through society*" with strategies of rule that attempt as far as possible to "govern without governing society" (Rose 1996:61). Governing without governing society means to govern "through the regulated and accountable choices of autonomous agents"—be they "citizens, consumers, parents, employers, managers, investors" (ibid.). The 'freedom' of neo-liberalism is not, however, a "simple liberation of subjects from their dreary confinement by the shackles of political power into the sunny uplands of liberty and community", Rose argues (ibid.). But he stresses also that "neither is it merely an ideological fiction or a rhetorical flourish" (ibid.). In Rose's perspective, "the freedom upon which liberal strategies of government depend" is neither a "'natural' property of political subjects, awaiting only the removal of constraints for it to flower forth in forms that will ensure the maximization of economic and social wellbeing", nor is it merely "a sham" (Rose 1996:61–62):

The practices of modern freedom have been constructed out of an arduous, haphazard and contingent concatenation of problematizations, strategies of government and techniques of regulation. This is not to say that our freedom is a sham. It is to say that the agonistic relation between liberty and government is an intrinsic part of what we have come to know as freedom. And thus, I suggest, a key task for intellectual engagement with contemporary relations of power is the critical analysis of these practices of freedom (Rose 1996:62).

17

So is This the End of Liberalism?

A HAYEKIAN NIGHTMARE

It seems a commonly accepted fact that neoliberalism has prevailed and dominated the last quarter of a century, at least in the Western hemisphere. Hayek's ideas about what constitutes 'true individualism' and about the market as an institution that bears the promise of ensuring 'spontaneous order' have indeed been highly influential in the realm of political ideas. Rhetoric is one thing and reality another, however, for when it comes to the current regime of international economic governance Hayek's ideas have had no impact whatsoever, it seems. The IFA endeavours to *design* and *implement* a particular social order to be adopted by all economies throughout the world. It is difficult to see in this regime of global disciplining an attempt to 'prevent coercion by others' and to 'reduce the total of coercion to a minimum'. How can neo-liberalism have won, and Hayek lose? How did neo-liberalism become the mirror image of everything false and crooked in the eyes of its intellectual founding father?

From a Hayekian perspective, the IFA endeavours to create a social order based on an impossible mixture of incompatible elements, an individualism that is, at the same time, true and false, a social order that is at the same time 'spontaneous' and 'designed'. It is 'false' because it subscribes to the idea that social order must be promoted through a comprehensive system of supranational 'design' and 'implementation', of the 'proper' economy, yet 'true' because it promotes a social order in which economic agents are to be concerned exclusively with the well-being of themselves (and their kin), and only indirectly—through elusive 'trickle-down economics' and 'invisible hands'—with the well-being of others. There is 'spontaneous' social order in the sense of being based on the market, and 'designed' social order in the sense of it being based on standards for the 'proper' organization and regulation of economies, developed by the IMF and a range of other international organizations, as a vindication of Hayek's hypothesis that 'false' individualism would lead directly to 'authoritarianism'.

For the German school of *Ordo-liberals*, a key challenge was to conceive of forms of government that could lead society away from the "homogenizing

trends of mass society", and for the Chicago School liberals the governmental ideal was similarly *not* that of a "disciplining nor a normalizing society", but on the contrary a society that "cultivates and optimizes differences" (Lemke 2001:199). But isn't the current regime of a 'proper' economy, imposed and enforced globally, precisely a homogenization of societies? Isn't it the exact opposite of a society in which differences are cultivated and optimized? The notion that a universal norm for the organization and regulation of economies should be developed and enforced globally by supranational authorities is quite far from both the Ordo-liberal focus on countering homogenizing trends and from Hayek's hostility towards any form of 'designed' social order. It not without irony that efforts to promote global financial integration—and hence a sort of global 'free market economy'—has led to the creation of a supranational governance regime predicated upon precisely those three main enemies of 'true individualism' and 'market society' that Hayek identified: *rationalistic individualism*, its 'arrogant' belief in the possibility of *human planning and design*, and—as the 'inevitable' effect of these two—*totalitarian authoritarianism*.

'SOCIALISM FOR THE RICH'

A leading Austrian libertarian, Nouriel Roubini, had recently critisized the UK and US governments for the way that have dealt with troubled financial institutions during the ongoing credit crisis. Focusing particularly on the rescue operations launched for Northern Rock in the UK and for Countrywide in the US, he accuses the US and UK governments of practicing what he calls 'socialism for the rich'. I quote at length:

The lesson of this sad and sleazy episode is that when profits are privatized and losses are socialized we get sleaze capitalism and corporate welfare that becomes public bailout of reckless lenders. All this from a US administration that hypocritically praises every other day the virtues of private market capitalism. For all of us who do truly believe in free market economies where a variety of public goods are provided by governments and the financial sector is properly supervised and regulated this is not a capitalist system but rather socialism for the rich (Roubini 2007).

The practice of bailing out lenders, often with substantial amounts of taxpayer's money involved, while cutting no slack whatsoever to borrowers, is not an invention of the ongoing credit crisis. Its origins are to be found at least a quarter of a century ago.

The first Mexican crisis in the early 1980s marked a key point in the history of neoliberalism, Davind Harvey argues. It was at this point that a new governmental rationality for dealing with Third World countries in debt was invented. From this point onwards, it became standard policy

of the IMF and the World Bank to require the implementation of neo-liberal reforms—such as deregulation, privatization, reduction of welfare expenditure etc.—in return for debt rescheduling. This marked not only the invention of 'structural adjustment' programmes and "the 'purge' of all Keynesian influences from the IMF", as Stiglitz noted, but also the rise of a new era in international relations. In Harvey's view, this 'invention' marked a "key difference between liberal and neoliberal practice":

Under the former, lenders take the losses that arise from bad investment decisions, while under the latter the borrowers are forced by state and international powers to take on board the cost of debt repayment no matter what the consequences for the livelihood and well-being of the local population. If this required the surrender of assets to foreign companies at fire-sale prices, then so be it (Harvey 2005:29).1

One may indeed find it paradoxical that the neo-liberal state—for all its opposition to government 'intervention'—is so bound up with, and committed to, the interests of the financial sector that it "all too often guarantees the integrity and solvency of financial institutions at no matter what cost" (Harvey 2005:73). Moreover, the authority of nation states, and the money of their taxpayers, have repeatedly been used to "bail out companies or avert financial failures" such as the "US savings and loans crisis of 1987–8, which cost US taxpayers an estimated $150 billion, or the collapse of the hedge fund, Long Term Capital Management in 1997–98, which cost $3.5 billion" (Harvey 2005:72–73). "The habit of intervening in the market place", bailing out Western financial institutions "when they get into trouble", cannot, he argues, "be reconciled with neo-liberal theory" (Harvey 2005:74). Neo-liberal theory would call for "reckless investments" to be "punished by losses to the lender", but what happens instead is that lenders are made "largely immune to losses" (ibid.). Instead, Harvey observes, it is the borrowers that "have to pay up" (ibid.) Neo-liberal theory would warn, "Lender, beware", he argues, but neo-liberal practice is instead, "Borrower, beware" (ibid.).

The structural adjustment programmes through which the IMF and the World Bank were given full authority to "negotiate debt relief" in return for neo-liberal deregulation policies in effect meant "to protect the world's main financial institutions from the threat of default" (ibid.). Since this practice is indeed difficult to reconcile with neo-liberal theory, libertarian neoliberals did in fact argue that the IMF should be abolished, allowing market forces to operate and discipline both borrowers and lenders. Instead, however, the practice of "prioritizing the needs of the banks and financial institutions while diminishing the standard of living" of debtor countries has been institutionalized over the past two decades (ibid.). One consequence of this has been a substantial transfer of money from indebted

Third World countries to international banks and financial institutions in this same period. More specifically, a transfer of what corresponds to “fifty Marshall plans ($4.6 trillion)” has flowed from “the people of the Periphery to their creditors in the Centre” (Harvey 2005:162). “What a peculiar world in which the poor countries are in effect subsidizing the richest”, Stiglitz has remarked (Stiglitz, cited in Harvey 2005:74).

The responsibilization of the individual and the family, stressed in American neoliberalism, has not been accompanied by a responsibilization of banks and financial intermediaries, in other words. Since the early 1980s, it has been a widespread practice effectively to acquit banks and financial institutions of blame and responsibility by bailing them out, ultimately financed with tax-payers' money. The 'responsibilization' of individuals continues, the corrective reform of private firms and economies spreads across the globe—in parallel with a *de-responsibilizisation* of financial sector institutions.

AGAINST 'LAISSEZ-FAIRY TALES'

Why would the key distinction in analysis of social order be 'designed' versus 'spontaneous' order?2 Wouldn't it be more pertinent to say that social orders, usually or always, are partly 'designed' and partly 'spontaneous'—the unforeseen outcomes of attempts to plan, conjured up with a variety of 'spontaneous' processes? Wouldn't it be more pertinent to say that, *if* these categories are relevant, it is a matter of *degree*—a matter of 'both-and', rather than of 'either-or'? Hayek's distinction serves his political ends well—it provides a rationale for limiting governmental intervention as much as possible—but does it enable an understanding of liberalism, or of competing social orders?

In Foucault's analysis, social order is not a 'spontaneous' outcome predicated upon “voluntary conformity” in relation to the “enforcement of abstract principles” and reduced in scope and number to a minimum. Rather, social order is the result of very *concrete* mechanisms of disciplinary power. The freedom of the human subject, in Foucault's analysis, is a *disciplined* freedom, fabricated and facilitated by a number of disciplinary institutions, from the school to the factory and the prison. In this analysis, the distinction between 'designed' and 'spontaneous' order is abandoned. Liberal, social order is neither 'designed' nor 'spontaneous'. The challenge is to describe the generic mechanism through which individuals and the processes of society are *disposed* so as to produce desirable outcomes, including that of social order. From such a perspective the distinction 'designed vs. spontaneous' is little more than a *mystification* of social order. Besides being fundamentally utopian, and besides serving certain conservative political purposes, this dichotomy has very little to offer in terms of insight with regard to what a liberal social order is—whether in the past or the present.

Hayek excelled in the art of 'binary division and branding', and his political dream was indeed that of a 'pure community', of a 'spontaneous society' based on 'voluntary conformity', 'true individualism', and the enforcement of a minimum of 'abstract principles'. Though this utopian vision of a pure society served his political ends well, it failed to recognise that such 'purity' could never be achieved on the basis of 'binary branding' and 'abstract principles' alone. This is the insight that Foucault's analysis provides: binary division and branding is but one dimension of a twin mechanism. A social order based on disciplinary power requires not just marking of the bad, the false, the improper—but also analysis and distribution. To binary division and branding corresponds coercive assignment and differential distribution through a range of disciplinary techniques and institutions.

Discussing the utopian nature of Hayek's neoliberalism, one is compelled to mention briefly the work of Karl Polanyi, who saw the notion of a 'self-regulating market system", as indeed fundamentally utopian (Polanyi 2001:3, 220, 227, 238, 258, 266–267).3 "No society is possible in which power and compulsion are absent", Polanyi points out (Polanyi 2001:266). The so-called "self-regulating market system" was predicated on a range of governmental interventions. "There was nothing natural about laissez-faire", Polanyi insists; "free markets could never have come into being merely by allowing things to take their own course" (Polanyi 2001:145). Polanyi refers to the example of the cotton manufacturers —"the leading free trade industry"—which were created "by the help of protective tariffs, export bounties, and indirect wage subsidies" (ibid.). To this one should add all those techniques of dispossession and depriving of 'traditional rights' that were deployed to compel the rural poor, and their children, to take employment in urban factories—techniques that were enthusiastically praised by most 'laissez-faire', classical political economists (Perelman 2000). Polanyi notes that as long as the market system is not established, "economic liberals must and will unhesitatingly call for the intervention of the state in order to establish it, and once established, in order to maintain it" (Polanyi 2001:155). Polanyi's book demonstrates, Stiglitz argues, how "free market ideology was the handmaiden for new industrial interests and how those interests used that ideology selectively, calling upon government intervention when needed to pursue their own interests" (Stiglitz 2001: viii).

It may be worth noting that the current regime of global disciplining similarly presents itself as being in accordance with ideals of freedom and economic growth in the interests of all, not least the poor. When the IMF professes "belief in the free market system" and yet provides "funds to bail out foreign creditors" and pushes for "usurious interest rates that bankrupt domestic firms", there is, Stiglitz argues, an inconsistency at play—just as in the case of free trade, where "advanced industrial countries have been more adamant in opening up markets in developing countries than in opening their own markets to the goods and services that represent the developing

world's advantage" (Stiglitz 2001: ix). To Stiglitz, Polanyi's contribution was to "expose the myth of the free market: there never was a truly free, self-regulating market system" (Stiglitz 2001: xiii). To Polanyi, the notion of laissez-faire and the concomitant accusation that one's opponents are guilty of "interventionism" is an "empty slogan" (Polanyi 2001:156)—which may be used, however, for a range of political purposes. In America, for instance, "the South appealed to the arguments of laissez-faire to justify slavery", Polanyi notes (ibid.). To Polanyi, the liberal utopia of a social order based on laissez-faire and a self-regulating market system constituted a "moral obstacle" to the realization of an "era of unprecedented freedom", because of the associated tendency for the "idea of freedom" to "degenerate into a mere advocacy of free enterprise" (Polanyi 2001:265). Today, it is not the freedom of enterprise that is defended—for today only one mode of organizing economic activities is considered 'proper'—but the spatial freedom of capital.

THE END OF LIBERALISM?

Economists often perceive freedom and government as opposites: to increase freedom in our societies, we must decrease government. Government policy is often described negatively as 'interventions' that create 'distortions' in the natural functioning of 'free markets'. Correspondingly, the project of 'rolling back' government—formulated in doctrinal form in the Washington consensus—was described as a process of 'liberalization'. Michel Foucault's analysis of liberalism and the work of other scholars in this tradition destabilizes the notion that freedom and government are, and ever have been, opposites. Foucault's analysis shows us that what occurred with the emergence of political economy was not only a critique of mercantilism and a new discourse on freedom, but also the emergence of a new regime of power and new modes of government. In addition to being a political doctrine against mercantilism, liberalism was itself *a governmental rationality*.

Two phenomena that are not easily reconcilable with the 'conventional' understanding of liberalism stand out. First, although liberalism carries with it a perception of freedom and government as opposites, it seems that freedom and government go hand in hand and that a wide range of governmental technologies are intended to enable, regulate and orchestrate freedom. The ongoing efforts at global economic standardization, surveillance and corrective reform constitute a powerful manifestation of this with regard to 'global financial integration'. Second, although liberalism perceives itself as the guardian of freedom, always suspecting that we may be governing too much, it seems nevertheless to be blind to its own governmental nature, and thus fails to problematize the governmental programmes launched by liberalism itself. In problematizing government,

libertarians thus focus on the size of the public sector and overall levels of taxation—i.e, the 'deductive' manifestations of government—but not on the vast regime of imposing a particular mode of organizing and regulating economies on a global scale.

What underlies these two 'paradoxes' is, I argue, the widespread tendency—perhaps particularly among economists—to embrace freedom, the ideal of liberalism, and yet stick with state reason when it comes to conceptualising what counts as 'government', namely law. Government, however, assumes many other forms than law or decree. Government in its distinctly liberal form—disciplining and self-disciplining through normalization and surveillance—has become invisible, it seems, and thus little remains of what was arguably the ultimate objective of liberalism as a governmental rationality: a continuous problematization of government.

As compared with liberalism, neo-liberalism has committed itself to a particular *form* of capitalism, namely the Anglo-American one, rather than, for instance, the German, Scandinavian or Asian ones. And it has done so to the extent that the promotion of this model of capitalism is seen as more important than the freedom of nations, firms and banks to choose and regulate their economic activities. What are we to call a liberalism that has not only reduced its problematization of government to a concern with the size of the public sector and the overall level of taxation, but also committed itself to the global enforcement of a particular form of capitalism at the expense of the freedom of nations, banks and firms? What is a modality of liberalism that does not entail a problematization of the modes through which it governs? What is a liberalism that does not ask that crucial question, *are we governing too much?* Neo-liberalism, in its current configuration, is a crypto-liberalism, ignorant of its still more totalitarian character.

If the drive towards the formation of 'docile' economies reveals an inherent tendency in liberalism, a tendency towards disciplining, towards government through norms, surveillance and corrective reform, towards bureaucracy and totalization, then this tendency should be met with the *ethos* of early liberalism: continuous problematization in favour of a regulatory framework that *widens and ensures* a space for free, institutional competition.

If classical liberals were concerned with whether there were too many laws, perhaps today one should be concerned with whether there are too many standards and codes. Might one imagine, for instance, a system of normalization that consisted of more than *one*, universal set of norms, reflecting that different historical, cultural and institutional contexts might well call for different modes of organizing and regulating economies? Further, could one imagine that quantitative modes of regulation—such as, for example, taxes on capital flows—might in fact entail more freedom, allowing for more "institutional competition" than does the current regime of enforcing globally one particular mode of organizing and regulating economies?

It is as if liberalism, in its current form, lacks an articulation of itself as governmental rationality; it is as if it lacks a critical reflection of its own key

categories, including, particularly, that of freedom. It is indeed paradoxical that a governmental technology that would *not* encroach upon the organization and regulation of economies, firms and banks—such as a tax on currency transactions—is considered inappropriate in the name of freedom, when compared to the comprehensive system of economic standardization, surveillance and corrective reform that has been developed over the last decade. Whereas liberalism was originally a critique, it has become a dogma based upon ideas about what government is that belong to the era of *raison d'état* and mercantilism. In the continued absence of such articulation and reflection, liberalism is likely to become still more homogenizing, still more totalitarian.

THE DYNAMICS OF LIBERALISM

The conception of liberty as 'freedom from government intervention' has immediate appeal but leaves crucial questions unanswered. When Friedman, in his 1980 television series *Free to Choose*, was confronted with the fact that he drew no distinction between "the Big Government of Red China and the Big Government of the United States", he had nothing to reply (Galbraith 2008:1). At the root of this predicament is the fact that the predominant attitude to freedom is constituted by a curious combination of two opposing conceptions of liberty. Indeed, Galbraith's question to Friedman, in *Free to Choose*, has a long history, although a history now to large extent forgotten. In the late seven-teenth century Hobbes and Harrington debated where a man would enjoy most freedom; in the democratic city of Lucca or in the despotic city of Constantinoble. Hobbes ridiculed the idea that one would be 'more free' in a republican, democratic city. In Hobbes' view, freedom began where the law ended, and thus the question of freedom was not a matter of who was making the laws, but a matter of their number and scope. Two conceptions of liberty were opposed at the time; liberty understood as freedom *ensured* by law, which was the 'republican' understanding, and liberty understood as freedom *from* the law, which was the 'liberal' conception. The 'liberal' conception of freedom was mobilised by the British in the late eighteenth century to argue that America need not be independent; for what mattered to the freedom of Americans was indeed not the *source* of laws, but only their scope and number. Today, both these conceptions of liberty are at play, in a somewhat unstable configuration. Unfortunately, little attention is given to the tensions this duality creates and to the unfortunate silences that result.

One might argue that the shift from the Washington to the Post-Washington consensus marks a shift from a 'naturalist' to a 'constructivist' conception of the market, a shift, in other words, from a conception of 'the market' as a natural mechanism of regulation, which in order to function needs only non-interference from government 'interventions', to a conception of 'the market' as being *constituted* by a set of governmental institutions. This characterization of the shift mobilises a dichotomy closely resembling the one identified by Pettit and Skinner: freedom *from* the law versus freedom *by* the law. From

this perspective, one may say that the IFA marks a reverse shift to the one that took place two centuries ago, when the liberal conception of liberty replaced the republican one, a shift, at the level of economies, from conceiving of freedom as freedom *from* intervention to conceiving of freedom as freedom *by* intervention. In this logic, the shift from the Washington to the Post-Washington consensus is a shift from a liberal to a republican conception of what constitutes freedom, of what constitutes a 'free market economy'.

Another way of depicting the shift, drawing upon Foucault's analysis of liberalism, is to see in the Post-Washington consensus a neoliberal appropriation of 'the economy'. In classical liberalism, the focus was on preventing government from constraining the 'natural liberty' of individuals, Foucault argued. With the neo-liberalism of the Chicago school, however, the individual came to be perceived instead as a "behaviouristically manipulable being" (Lemke 2001:200). Governmental action was to play strategically on the rational cost-benefit calculations of individuals in order to achieve its objectives. The individual was no longer an "inviolable core", no longer an "external limit" to governmental action (ibid.). It is tempting to see in the move from the Washington to the Post-Washington consensus a similar move, from 'natural liberty' to the 'behaviouristically manipulable'; this shift has now occurred at the level of 'the economy'. The status of 'the economy' is no longer that of "external limit" and "inviolable core", but rather an entity to be created, shaped and trained through governmental standardization—that is, designed, implemented, and enforced through international organizations such as the IMF and the World Bank.

The shift from from 'naturalism' to 'constructivism' has been argued in the governmentality literature to be a key characteristic of the shift from liberalism to neo-liberalism:

Neo-liberalism replaces the naturalism of liberalism with a certain kind of constructivism … [Neo-liberalism] differs from earlier forms of liberalism in that [it does] not regard the market as an existing quasi-natural reality situated in a kind of economic nature reserve space marked off, secured and supervised by the State. Rather, the market exists, and can only exist, under certain political, legal and institutional conditions that must be actively constructed by government (Barry et al. 1996:10; Burchell 1991:23).

In this logic, the shift from the Washington to the Post-Washington consensus is a manifestation of a general shift from liberalism to neo-liberalism. The construal of the shift from liberalism to neoliberalism as a shift from 'naturalism' to 'constructivism' is a misconstrual, however. 'Naturalism' and 'constructivism' are not a series in the history of liberal governmental rationalities, one replacing the other: they are the two constituent elements of liberal governmental rationality, as noted in Chapter 15. Interpreting the post-Washington consensus as a shift from non-interventionist 'naturalism' to interventionist 'constructivism' trivialises the issues at stake, in other words.

In truth, the Washington consensus never agreed with liberalism, just as the Post-Washington consensus does not accord with neoliberalism. The Washington consensus was 'abstentionism without activism', naturalism without constructivism, just as the Post-Washington consensus appears to be 'activism without abstentionism'. The Washington consensus and the Post-Washington consensus each represent their extreme on a bipolar opposition of interventionism vs non-interventionism, in other words. Neither of them has much to do with liberalism, for liberalism consists in intervening without intervening too much, in striking a balance. It is as if liberalism is inherently 'suicidal', carrying within it the seeds of its own destruction. It is as if liberalism has an inherent tendency to mutate to one side or the other, to become either 'abstentionism without activism' (as in the Washington consensus) or 'activism without abstentionism' (as in the Post-Washington consensus). Perhaps this is why the *ethos* of liberalism is so important. Perhaps the ethos of liberalism, the ethos of avoding the twin dangers of governing too much and governing too little, is a *sine qua non* for liberalism. Without this ethos there is nothing to keep liberalism from self-destruction; nothing to counter its self-annihilating, centrigugal force, driving it towards one of its extremes, undermining itself.

AN AFTERTHOUGHT

If the welfare liberalism that preceded neoliberalism consisted of 'two axes'—one inclusive and solidaristic, the other individualizing and responsibilizing, as Nikolas Rose argued—one might say that neoliberalism abandons the former and refines the latter. Or, that the former is subordinated to the latter: there is no inclusion other than inclusion in the economy, and no 'solidarity' other than encouraging individuals to make themselves useful and valuable in the terms of the economy. In neo-liberalism, politics is concerned not with society, but with the economy. The notion that a good society is a society in which individuals make choices based on personal cost-benefit calculations of consequences for themselves, with little regard for wider societal objectives such as peace, justice and global solidarity is, I should argue, indeed an ethically problematic, if not 'false' individualism. The opposition of individualism and solidarity is perhaps the single most troubling aspect of neoliberalism. Why should the responsibilization of the individual involve only responsibility for oneself and one's family, and not for society as such? Why is a type of individualism devoted not only to the happiness and prosperity of oneself, but also to the happiness and prosperity of fellow human beings, seen as a crooked form of individualism? How may hope for justice and peace in the future be upheld in a world which sees in solidarity beyond one's kin a threat to 'true individualism'?

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18

A New Regulation of International Finance

INTRODUCTION

In this last chapter, I set out a new approach to the regulation of international finance. In this endeavour, it is of paramount importance that the twin dangers of governing too much and governing too little are avoided. This, I believe, is a key lesson to be drawn from reviewing the IFA in light of the Foucauldean literature on liberal and neoliberal governmental rationalities. The IFA in a sense governs both too much and too little: too much because it involves a regime of global homogenization and disciplining, and too little because it is ineffective (if not counter-productive) in terms of enhancing the stability and resilience of the international financial system.

Earlier this year, Liu Mingkang, chairman of the China Banking Regulatory Commission, gave a lecture at the British Museum in London. Discussing the US subprime mortgage crisis, he accused US regulators of "ignoring their duty for prudential supervision and their job of preventing misbehaviour".1 Liao Min, Director General of the Regulatory Commission, explained to the Financial Times that Chinese regulators found that the "Western consensus on the relation between the market and the government" needed to be reviewed (ibid.). This Western consensus, argued Liao, "tend to overestimate the power of the market and overlook the regulatory role of the government, and this warped conception is at the root of the subprime crisis" (ibid.). This chapter explores the conceptual origins of what seems indeed to be an 'exaggerated' belief in the self-regulatory power of markets. "The difficulty lies not in the new ideas", said Keynes, "but in escaping from the old ones, which ramify ... into every corner of our minds". Therefore, before starting to think about a new approach to the regulation of international finance, an effort should be made to destabilize the conceptual underpinnings of the current one. More specifically, the chapter endeavours to track the origins of the widespread conviction that the proper role of regulation is to 'enable' and 'facilitate' markets, rather than 'taming' or 'tempering' market forces.

This journey starts at the policy level, deploying the analysis offered by Michael Pettis (2001, 2003). The model that underlies the thinking of

regulators, argues Pettis, is the 'investment model' which is fundamentally different from the model that guides the behaviour of financial market practitioners, the 'liquidity model'. The next step taken in this chapter is to consider the theoretical 'roots' of these two models. The investment model is closely related, I argue, to neoclassical economics and the liquidity model to Keynesian and Post-Keynesian economics. The exploration of the dubious conceptual roots of the 'investment model'—and its 'heroic' belief in unhampered market forces—involves excavating a history unknown to most economists, brilliantly unearthed by Philip Mirowski (1989).

Destabilizing the belief in unhindered market forces theoretically or conceptually may not be enough, however. Thus, the chapter proceeds to briefly examine the historical record of 'free capital' in terms of generating economic growth and development. All this leads, in the final sections of the chapter, to an outline of a new approach to the regulation of international finance.

THE INVESTMENT MODEL VERSUS THE LIQUIDITY MODEL

"There are, broadly speaking, two main types of models used to explain the flow of capital from rich countries to poor countries", argues Michael Pettis (2001:36). They differ in what they see as the prime determinant of these flows and in the modes of financial regulation they advocate. One model posits the *destination* of the capital flow, the other the *source* of the flow, as being the prime determinant. The former model—which Pettis denotes the 'investment model'—is the dominant one. According to this model, "rich-country investors continuously evaluate profit opportunities at home and abroad" and invest in less developed countries (LDCs) when growth prospects seem more favourable there (ibid.). In this model, international capital flows derive from the analysis of "local economic fundamentals", the contention being that "money will flow and stay in LDCs if domestic authorities eliminate distortions that reduce a country's economic prospects" and "engage in policies that prepare the country for rapid growth" (ibid.). In the liquidity model, however, international capital flows are seen to depend "less on local economic conditions and more on changes in the liquidity of rich-country markets", contending capital flows from rich countries to poorer countries, in situations of "excess liquidity" (ibid.). Such excess liquidity leads to a 'boom' in capital outflows, whereby a liquidity cycle with substantial self-reinforcing features in set in motion. Pettis describes the typical 'liquidity cycle' as a process consisting of twelve steps. It is beyond the scope of this work to set out this whole process in detail, but the essence is as follows (Pettis 2001:43–45).

A liquidity expansion in rich countries causes volatility on risky assets to decline and investors to systematically underestimate risk in 'nontraditional' sectors. Funds now flow to high-risk, non-traditional sectors,

including asset markets in developing countries, which, as a consequence, experience a strengthening of their currencies and an increase in economic growth. This reinforces capital inflows, and markets in these developing countries boom. The local banking system now expands, and credit becomes widely available. Inevitably, part of this expansion of credit in developing countries leads to local asset speculation. Sooner or later, however, excess liquidity in rich countries reverses, causing capital flows to developing countries to reverse too and commodity prices to decline. This, in turn, causes economic growth and asset markets in developing countries to weaken and volatility to increase. Eventually, "capital outflows become self-reinforcing and local markets crumble" (Pettis 2001:44).

Despite the fact that such liquidity cycles are a recurrent pattern of the last two centuries of international capital flows, most of the debate on "the causes of market booms and financial crises" is predicated upon the investment model, Pettis argues (2001:39). The main reason why the investment model continues to dominate debates as well as policy-making is, Pettis contends, that it has a particular appeal. In brief, it suggests that "the good … are getting rewarded" by financial markets (Pettis 2001:47).2 By contrast, the liquidity model "deemphasizes the link between domestic policies and the investment decision of foreign creditors". While "often *justified* by *perceived* changes in economic policy" investment decisions and capital flows tend "to follow [their] own exogenous pattern" (Pettis 2001:47, emphasis added). In terms of policy, Pettis stresses two main implications of the liquidity model:

First, preventing externally induced financial shocks is extremely difficult since the investment decision is exogenous and what may seem like small shifts in rich-country capital flows can easily overwhelm less developed markets. Second, if shocks are inevitable, domestic economic policies will have little impact on preventing crises (Pettis 2001:50).

Avinash Persaud makes a similar argument. Policy-makers and international financial institutions tend to conceptualise contagion mainly in terms of so-called 'fundamental' factors such as trade links and exogeneous shocks, rather than in its 'pure' form, which is "unrelated to fundamentals" and remains poorly understood (Kumar and Persaud 2002:403). Contagion in this pure form often "mystifies" financial market analysts "because the markets that are hit are fundamentally unrelated":

The stepping stone of the Asian financial crisis from Thailand to Indonesia and Malaysia, then to Korea and on to Russia and then finally to Brazil, were not laid out along the path of trade flows, but *along the path of shared creditors and bankers* (Persaud 2001:97, emphasis added).

This failure to appreciate the dynamics of financial market behaviour and the resulting mechanisms of contagion is to Persaud what explains the

paradoxical "discrepancy between the large degree to which financial crises are external and systemic and relate to the herd behaviour of creditors in developed countries, and the focus of policymakers on the need for domestic reforms in crisis countries" (Persaud 2004:95). Against this background, there is little point in pressing for the (costly) domestic policy reforms that compliance with standards entails. In the words of Michael Pettis:

[P]roposals to prevent future crises by deepening domestic economic reforms, eliminating crony capitalism, improving bank lending procedures ... are irrelevant ... [T]hey do not address the way shocks are transmitted into the economy and they cannot reduce the occurrence of these shocks (Pettis 2001:50, 93, emphasis added).

THEORIES OF FINANCIAL INSTABILITY

These two views on international capital flows are not unrelated to economic theory, of course. Michael Pettis attributes the 'liquidity model' to the work of Charles Kindleberger and Hyman Minsky (Pettis 2001:38). In recent months, as the credit crisis has proved to be more than a parenthesis, interest in the work of Kindleberger (1978) and Minsky (1986) is increasing, as witnessed by frequent references in the financial press.3 In the following however, I wish to highlight the work of Veblen and Keynes as important precursors of that of Kindleberger and Minsky. Pointing to these precursors brings forth particularly well the fundamental differences vis-à-vis neoclassical economics. In brief, I present the 'liquidity model' as closely related to Keynesian and Post-Keynesian theory, and the 'investment model' as closely related to neoclassical economics. The following thus briefly explains how financial instability is conceptualised in these two schools of economic thought.

Competing Conceptualisations of Financial Instability

Mainstream economists construed the Asian crisis as a crisis of *Asian* capitalism. The implicated 'localist' pattern of explanation was by no means exclusive to the Asian crisis. As noted by Ilene Grabel (1999), mainstream economists construed each of the financial crises of the 1990s—from Mexico to Asia, Russia and Brazil —as rooted in local polity failures. The tendency to see macroeconomic instability as caused by forces external to the economic system dates back to Jevons and the offspring of neo-classical economics. The notion of a "naturally stable market structure subject to random shocks" has been a persistent theme of more than a hundred years of economic thought, Philip Mirowski argues (1988a: 53). Mirowski's observation that mainstream economists tend to explain financial crises by reference to 'exo-economic' phenomena relate to a general observation made by Stephen Resnick and Richard Wolff on the neoclassical mode of explanation:

[All] neo-classical explanations for deviations [from optima] … can be expressed in terms of and ultimately reduced to either human or physical nature … [T]hese are the essences to which neo-classical theory reduces all its arguments … [D]eviations are not endogenous to the capitalist system itself, for their cause is found outside of that system (Resnick and Wolff 1987:103).

Early institutionalist economists Thorstein Veblen and his student Wesley Clair Mitchell were among the first to argue that "orthodox neoclassical theory was useless for the discussion of macroeconomic fluctuations" (Mirowski 1989:306). In conceptualising the macroeconomic, Veblen and Mitchell emphasized the divergence of financial from material expansion, an approach later pursued by John Maynard Keynes. To Keynes, these differences in conceptualising macroeconomic instability were crucial, although most often ignored:

[I]t is my belief that the far-reaching and in some respects fundamental differences between the conclusions of a monetary economy and those of the more simplified [neoclassical] real-exchange economy have been greatly underestimated by the exponents of the traditional economics (Keynes 1973:410).

On the basis of his theory of a 'monetary economy', formulated in explicit opposition to the neoclassical 'real-exchange economy', Keynes warned strongly against the internationalisation of finance. He stressed in particular the paramount importance to macroeconomic stability of constraining and controlling international flows of capital:

Ideas, knowledge, art, hospitality, travel—these are things which should of their nature be international. But let goods be homespun where it is reasonably and conveniently possible; and above all, let finance be primarily national (Keynes 1982 [1933]: 237).

Keynes' warning with regard to the potentially destabilizing effects of international capital flows was not taken seriously in the mainstream reception of his work, and his project of a monetary theory of production never "got a firm footing in the economic literature", Paul Davidson notes (1991:16). Post-Keynesian theory stresses that Keynes, in the mainstream reception, was altered beyond recognition. The 'neoclassical synthesis', epitomized by Hicks in the so-called ISLM model, reduced Keynes to a short-run qualification of the existing equilibrium apparatus.4

Since the logic of this [neoclassical] synthesis was based on axioms which presumed a long-run non-inflationary full employment outcome for a free market economic system, these 'Keynesians' reduced Keynes's analysis to that of merely providing a 'quick fix' for the short-run disruptions that shocked the economic system. In the long run, despite Keynes' dictum to

the contrary, these self-styled Neoclassical Synthesis Keynesians believed that the market would right itself (Davidson 1991:15–16).

Joan Robinson argued that the overall objective of Keynes's work was "to break out of the cocoon of equilibrium", and observes that this "was too great a shock". "Orthodox theory managed to wind up into a cocoon again", whereby "the whole of Keynes' argument [was] put to sleep" (Joan Robinson, quoted in Davidson 1991:22). Keynes was "smothered", she argues, and orthodox equilibrium theory was "enthroned once more" (ibid.).

The Post-Keynesian school of economic thought claims that the neoclassical theory that "has guided monetary policy in most of the capitalist countries for the past several decades, is flawed", and that "the adopted policies have had disastrous consequences" (Wray 1996:125). Randall Wray argues further that these misfortunes ultimately result from the way money is conceptualised in neoclassical theory:

Orthodox [neoclassical] monetary theory misunderstands the nature of money, the role money plays in the process of accumulation, the importance of accumulation for capitalist economies, and the role that monetary authorities should play in capitalist economies (Wray 1996:125).

Whereas in neoclassical economics an economy is conceptualised *as a system of exchange* in which money is only a medium of exchange and thus neutral with regard to the allocation of resources, in post-Keynesian theory it is emphasized that in capitalist economies, economic agents do not produce in order to exchange products, but to obtain money. Post-Keynesian theory thus insists that "production for the market is always *monetary production*" (Wray 1996:129). This critique of neoclassical conceptualisation was emphasized In the work of John Maynard Keynes also:

An entrepreneur is interested, not in the amount of product, but in the sums of money which will fall to his share … [and the firm] has no object in the world except to end up with more money than it started with (Keynes 1979:82–89).

The profit motive, Keynes argued, eventually undermines the reproduction and growth of the producing apparatus and leads to low levels of employment, output and investment. In fact, the very core of Keynes' theory was, in the words of David Levine, that "the presence of a financial alternative leads wealth holders away from the work of building society's producing structure" (Levine 1986:23). In Post-Keynesian perspectives, economic expectations are crucial:

If financial assets are expected to generate greater money-denominated returns than are expected to be realized from widget [real] production,

then capitalist 'money' will be directed toward financial assets rather than toward real capital assets (Wray 1996:136).

If expectations for the returns of real capital assets are high relative to financial asset returns, investment in capital assets will be high, whereas when expectations to returns on capital assets are declining relative to financial asset returns, investment in capital assets will decline too. This pattern constitutes a boom-and-bust cycle. On the downturn of the cycle, the behaviour of economic agents reinforces the downward trend; the lower the expectations, the lower investments in real capital assets, the lower the production output and employment level, the lower the expectations—and so forth. The supply of money plays a central role in these cycles:

[T]here is a systematic and interdependent pattern to the demand for and supply of money over the cycle. The endogeneity of money supply can be seen to be accommodating in the upturn, but frustrating in the downturn. Further, the more accommodating it is in the upturn, the greater the danger of an irreversible financial crisis … The pattern and level of production and employment over the cycle is interdependent with this cycle in liquidity preference and availability of liquidity (Dow 1996:178).

In this perspective, government has a crucial role to play in countering these cycles, in countering the inherent drive to macroeconomic instability. Such cyclical analysis does not, however, apply in the neoclassical conceptualisation of the economy. Here, the economy is naturally stable, subject only to short-term volatility caused by exogenous shocks, soon neutralized by the natural, equilibrating mechanisms of 'the market'. The money supply is exogenous in the neoclassical conception of the economy, and thus the pattern depicted by the Post-Keynesians, of cycles driven by preferences with regard to the degree of liquidity of portfolios of financial and capital assets,5 is conceptually incompatible with neoclassical economics. Money is conceived as neutral in the sense that it is thought not to have an impact on the allocation of resources in the economy. Any divergence in the growth rate of the money supply from the real growth rate is fully reflected in price adjustments—not in the behaviour of economic agents and thus not in the allocation of resources.6

The main differences between neoclassical and Post-Keynesian theory may be schematically depicted as follows:

Keynes's concern with the danger in modern, capitalist economies of a crowding out of productive interests by financial interests is central to contemporary, heterodox perspectives on the world economy and its modes of regulation. Despite what Altvater and Mahnkopf (1997:461) have registered as a 'decoupling' of monetary from real accumulation, the dominant

school of economic thought, neoclassical economics, makes no theoretical distinction between investment and speculation, and continues to consider money as neutral, that is, as having no impact on the allocation of resources. From the perspective of Post-Keynesian theory, it is surprising that the neoclassical school of economic thought—with its 'exo-economic' conceptualisation of financial crises and 'exceptionalist' explanations of a phenomenon so recurrent in the contemporary world economy—continue to dominate both economic theory and economic policy-making. Hence, it

Table 18.1 Neoclassical Versus Post-Keynesian Theory

	Neoclassical theory	*Post-Keynesian theory*
The economy	Stable (by 'nature') - subject to exogenous shocks	Unstable (inherently) - 'stabilizable' by policy
Phenomena in focus	Exchange: 'real exchange economy'	Accumulation: 'monetary economy'
Equilibrium	Unifying and structuring concept	Marginal concept 7
Future	Known	Uncertain
Time	Mechanical	Historical
Expectations	Rational—individuals make optimal use of available information	Modelled differently for entrepreneurs and speculators8
Money	Neutral with regard to the 'real economy'	Decisive in macroeconomic processes
Money supply	Exogenous	Endogenous
Wage and interest rates	Market-clearing prices, assure adjustment to equilibrium	Do not assure adjustment to equilibrium 9
Purpose of theory	To demonstrate social optimality if the real world were to resemble the model	To explain the real world as observed empirically
Analytical focus	Mathematical 'solutions' rather than causal statements about economic processes	Causal forces, and the process of gravitation
Policy	Deregulation	Counter-cyclical
Methodology	Axiomatic/Deductivist	Critical realist
World view	Atomistic/Cartesian	Organic

Source: Dow (1996) and Eichner and Kregel (1998).

may be worth considering briefly how financial instability came to be conceptualised in this particular 'exo-economic' way. What are the concepts and categories that produce this mode of conceptualising and explaining financial crises?

Economics as Mechanics

Neoclassical economics is not an assemblage of concepts and categories, each picked out independently for its relevance and expediency to the phenomena in question. Rather, it is a conceptual *system*, constituted by a set of mathematical formalisms. The first applications of these mathematical formalisms are historically dated. Neo-classical economics "grew out of attempts to appropriate and apply the metaphors, practices, and methods of physics, … and to bend them to the discussion of economic phenomena", Mirowski explains—and as a result the core of neo-classical economic theory became, and continue sto be, "a bowdlerized version of nineteenth-century physics" (Mirowski 1986:4–5). Neoclassical economics is predicated, in other words, upon the appropriation in the 1870s of the mathematical formalisms of energy physics, and thus upon the translation of the concepts of energy physics into economic concepts. All of the "progenitors of neoclassical theory" had some training in the natural sciences, Mirowski notes, and the "impact of this training upon their economic writings was not at all subtle, or difficult to detect" (Mirowski 1989:217). "The notion of value is to our science", proclaimed Jevons, "what that of energy is to mechanics" (Mirowski 1989:219). To the concept of energy corresponded the concept of value, or utility, to the concept of a particle, the economic agent, and so forth. Indeed, it was an explicit objective of these economists to create a mathematical science of the social, a 'physics of the social', appropriating the mathematical formalisms of energy physics. Hence, these new economic theories did "not differ in general character from those which are really treated in many branches of physical science", Jevons explained (Mirowski 1989:218).

The use of the energy physics metaphor was deeply problematic, however. Indeed, the analogy was met with heavy criticism from contemporary physicists. Jospeh Bertrand, a professor at the College de France, and a specialist in the mathematics of rational mechanics, reviewed and criticized the work of Cournot and Walras in 1883 for not making sense mathematically and for being, in effect, "a poor analogy for market activity" (Mirowski 1989:241–242).10 In general, such criticisms by physicists were met, Mirowski notes, with "defensiveness, incomprehension, and farrago" (Mirowski 1989:250). Although neoclassical economists have, "time and again in the twentieth century", been chastised by "prominent physicists", neoclassical economics "has remained wedded to a … physical metaphor of vintage 1860" (Mirowski 1989:374).

A key effect of patterning neoclassical economic thought upon the energy physics analogy was the idea of a *mechanical* economic equilibrium.

Energy physics is a static, mechanical system, as is the neoclassical conceptualisation of 'general equilibrium'. With this static, mechanical system—which by construction accommodates no endogenous dynamics—cycles and fluctuations in economic processes come to be conceptualized as deriving from exogenous 'shocks' (on the part of nature, government or technology) temporarily destabilizing the equilibrium, which, however, is soon restored through the natural mechanisms of 'the market'. In other words, the connection between the 'exo-economic' mode of conceptualising macroeconomic crises and the conceptualization of the economy adopted with the appropriation of the mathematical formalisms of energy physics is an intimate one. The notion that "economic crises must be caused by … fluctuations exogenous to the social operation of the economy", in the words of Mirowski, is a "direct extrapolation from the energetics movement of the later nineteenth century" (Mirowski 1989:258–59). The main difference between economists of the marginal revolution, such as Walras and Jevons, and contemporary mainstream economists, Mirowski notes, is that "it is no longer the vogue to insist that the shocks are of *natural* origins"—instead contemporary neoclassical economists "prefer to blame meddlesome *governments* for generating the disturbances" (ibid., emphasis added). The story now as then is, in Mirowski's phrase, that "macroeconomic fluctuations are generated external to market structures; macroeconomic instability is in no sense endemic nor endogenous" (Mirowski 1988a: 53).

Along with these mathematical formalisms and the corresponding conceptual framework came a particular conceptualization of the human being as an economic agent, as well as a particular conceptualization of what an economy is. In and through this conceptual framework, neoclassical economics adopted "the Cartesian world view", Mirowski argues, including a rational economic man, endowed with "exclusively Cartesian powers and abilities":

> [T]ransparent individual self-knowledge, mechanical algorithms of decision making, independence from all historical determination, and all social action ultimately explained by rational individual assent (Mirowski 1988b: 120).

The conception of 'man' at the core of neoclassical economic theory is a recapitulation of Cartesian epistemology. In the words of Charles Taylor, Cartesian epistemology is characterised by a set of 'anthropological beliefs'. These may be summarized as consisting of the following three main elements: *individualism*, the notion of a free and rational subject; *instrumentalism*, the notion of the individual self as instrumentally oriented toward its own well-being; and *atomism*, by which is understood the conception of society as being constituted by, and explained in terms of, individual goals (Browne & Quinn 1999:140; Taylor 1993:471–472). The latter is key to understanding how economies are conceptualised in neoclassical

economics. The global economcy is conceived in similar atomistic terms; as constituted and explained in terms of 'individual economies'. Economies are not conceived as components of a *system*; the global economy is merely an aggregation of individual economies.

One can note at this point a key feature of what Ha-Joon Chang has termed the 'unholy alliance' between neoclassical economics and Hayek's neo-liberalism (Chang 2003:47). Although these two strands of economic thought are predicated upon diametrically opposed conceptions of human agency, as mentioned previously, they share the political dream of a 'pure society'. A mechanical economy is a *pure* economy, just as a 'spontaneous society', based on a minimum of 'abstract principles', is a *pure* society. Though the premises couldn't possibly be more different, their utopia is the same: a world without friction, without intervention—spontaneous, smoothly self-adjusting.

THE SIAMESE TWIN OF 'EXO-ECONOMICS': FREE CAPITAL

There is an intimate relationship between the continued predominance of neoclassical conceptualisations of financial instability and the firm belief that international financial regulation should abstain from 'tampering' with financial markets. 'Exo-economics' and 'free capital' are like Siamese twins: destabilizing one without considering the other is a work half done.

Examples of the belief in free capital abound; just a few will be given here. First, consider the debate on the Asian crisis. Mainstream narratives construed the Asian crisis as a crisis of '*over*-borrowing' and '*over*-investment'. Yet this same narrative contended that, in dealing politically with the crisis, it was of paramount importance that inflows of foreign capital should not be restricted. To the extent that countries adopted any type of capital controls, these had to be only short-term 'emergency' measures. Restrictions on capital flows are, in brief, seen as fundamentally detrimental to economic growth and prosperity. It seems beyond question, for mainstream economists, that the relationship between 'free capital' and economic growth is unambiguously positive. Barry Eichengreen thus started his book on a 'new international financial architecture', simply assuming—with neither caution nor qualification nor discussion—that "liberalized financial markets have compelling benefits":

The recommendations of this book follow from six assumptions that I make about the operation of the international financial system. First, liberalized financial markets have compelling benefits … They encourage savings mobilisation and efficient investment allocation … Compared to the earlier era, when developing countries repressed private financial transactions and governments employed policies of directed

credit to dictate resource allocation, there are clear efficiency gains from relying on the market (Eichengreen 1999:2).

Eichengreen's approach to the question of a 'new international financial architecture', starting the whole exercise merely by assuming this positive relationship, is telling of what is best described as a key 'article of faith' of mainstream economics: the universal beneficence of free capital is beyond questioning. At a point in history where an economic and social order based on the principle of 'free capital' is being universalized, it might be appropriate to investigate this 'assumption' at least briefly. A brief history of 'free capital' is warranted, in other words.

One may distinguish two overall periods in the post-WW2 world economy financial system; the Bretton Woods period, and the 'free capital' period. Much can be said about these two periods and their financial regimes. It is beyond the scope of the present research, however, to provide more than a crude overview.11 Here, suffice it to note that while in the Bretton Woods period, from 1950 to the early 1970s, the international financial regime was based on pegged exchange rates and capital controls, this was replaced from the mid-1970s onwards by an international financial regime based on floating exchange rates and the increasingly free flow of capital. In the former period, average GDP growth in the OECD countries was 4.8 percent, as compared to 2.8 percent in the latter period. Growth in the 'free capital' period fell, in other words, to almost half of what it had been in the 'Bretton Woods' period. This has not dismissed the idea, however, that a positive relationship between free capital and GDP growth may exist. David Felix explains, on the contrary, that most attempts to explain this "growth slowdown" "have taken as axiomatic that the relation between financial liberalization and allocative efficiency is monotonically positive" (1998:173–74). Instead, economists have sought, he explains, "for market 'distortions', exogenous technology and supply shocks, and factor supply rigidities that in tandem must have more than offset the efficiency gains from liberalizing and globalizing the financial markets" (ibid.). Be that as it may, the fact remains that generating empirical evidence for a positive relationship between 'free capital' and GDP growth is no easy task. Perhaps this is why Eichengreen—and others with him—merely assume them.

Interestingly, data further show that the high rates of growth of *investment* in OECD countries in the Bretton Woods period were replaced by much lower ones in the free capital period. For instance, whereas the growth rate of investment was 6.1 percent in the 1960s, it fell to an average of 2.1 in the 1970s.12 Not all things have declined in the 'free capital' regime, though—financial sector activities have accelerated rapidly—but this has had unfortunate effects, Felix argues. "Until the early 1970s", the growth of finance, insurance and real estate "was paralleled by rising

real growth of goods and non-financial services" (Felix 1998:175–181). In the free capital period, however, growth of the non-financial sectors decreased even more than overall GDP growth, "implying that the increasing absorption of resources" in financial activities had "become counterproductive" (ibid.). Matthew Watson refers to this trend as 'the crowding out' of productive interests by financial interest. Though in theory financial markets should serve the purpose of reconciling the monetary and investment subsystems of the economy, the increasing sophistication and globalization of financial markets during the 'free capital' period seem actually to have run counter to this ideal or supposed trend, Watson argues:

At the same time as there has been a surge in activity in international financial markets, this activity has become increasingly disembedded from the real economy. The circuit of capital has become progressively more dislocated, consequently impeding productive investments … Capital holdings have been switched from productive to financial assets. Consequently, an ever smaller proportion of money assets has been prepared for non-financial, or GDP, purposes. Productive interests have been crowded out by financial interest (Watson 1999:60–61).

There is, in brief, reason at least to hesitate with regard to the alleged universal benefits of 'free capital'. Growth in Western economies was, in the 'free capital' period, markedly lower than in the previous period—and the growth of the East Asian economies was markedly higher than the growth of Western economies in both periods. Low and declining growth, low and declining levels of investment, and a financial system the growth of which seems to be increasingly at the expense of the real economy, should, I believe, compel one to hesitation.

BEYOND 'EXO-ECONOMICS'?

Does the shift from the Washington to the Post-Washington consensus, and the related shift in international policy-making from a mechanical to an organic conceptualization of economies constitute a break with mechanical 'exo-economics'? Are we, finally, breaking out of the cocoon of equilibrium, to paraphrase Joan Robinson? So far, the evidence is inconclusive, unfortunately. Consider again the debate that followed in the wake of the Asian crisis:

Financial crises are "inevitable", said Bijan Aghevli, former deputy director of the IMF's Asia and Pacific Department (Aghevli 1999:6). This contention that financial crises are unavoidable was a key component of the new conventional wisdom of mainstream economists. "[W]hile the benefits of a market-led financial system are compelling", it must be acknowledged,

argued Barry Eichengreen, that “crisis will still occur” (Eichengreen 1999:6). Whether a country would be afflicted by a financial crisis or not was considered to large extent beyond the control of its government authorities. This was reflected in the increasing recognition that even countries pursuing the full set of recommended ‘sound’ policies and ‘best practices’ could nevertheless easily fall victim to so-called ‘contagion’. This recognition gave rise, for instance, to the launching of the Contingent Credit Lines (CCL) initiative, which was specifically targeted at countries that could be considered the ‘innocent victims’ of contagion.

At first, one might think that a break with exo-economics was involved. If financial crises are indeed ‘inevitable’, would not ‘localist’ explanatory narratives blaming ‘meddlesome governments’ be abandoned by implication? One would think so, but in fact explanatory ‘exceptionalism’, blaming governments, was maintained, as illustrated for instance by Barry Eichengreen’s (1999) influential contribution to the debate on the construction of a new international financial architecture.

“Proposals for reforming the international financial architecture”, said Eichengreen, “make sense only if they address the fundamental causes of financial crises” (Eichengreen 1999:133). Eichengreen therefore lays out the “different ways in which crises are conceptualized” in order to provide a “theoretical justicfication for the approach” he proposes (ibid.). This leads him to conclude that “theorists are prone to exaggerate their differences; in reality, “differences are less than meets the eye” (Eichengreen 1999:140):

What emerges from competing models and interpretations is a single synthetic understanding of why crises occur. Crises do not occur randomly. Rather, they afflict countries whose governments set themselves up for the fall (Eichengreen 1999:140).

Although financial crises after the Asian crisis were seen less as ‘exceptional’, ‘isolated’ occurrences, and more as an ‘inevitable’ phenomenon in the global economy, governments remained the main culprits, in other words.

A key novelty needs to be stressed, however. Whereas before governments were blamed for causing financial crises by intervening *too much*, now the logic suggests that they should be blamed for not having intervened enough. In mainstream narratives on the Asian crisis, it was not a set of specific government interventions in the economy that were identified as ‘root causes’ of the crisis, but Asian *economies as such*. In a sense, one could say that this implied an abandonment of the usual ‘exo-economics’. The Asian crisis was caused not simply by ‘meddlesome governments’ making too many interventions in the economy; entire economies were wrong, or ‘improper’, not just a certain set of interventions in them. A shift occurred, in other words. Before, the contention was that nothing was wrong with economies; causes were always to be found elsewhere, notably in political

interventions in economies. Now, suddenly, the contention is that *everything* is wrong with economies, everywhere and always, and that politicians must never cease assessing, intervening, reshaping them. The IFA did not mark a break with exo-economics, but rather a somewhat paradoxical *recasting* of it, with financial crises being now at the same time inevitable and beyond the influence of individual countries, yet nevertheless afflicting governments which 'set themselves up for the fall'.

The financial crises of the 1990s in general, and the debate that followed in the wake of the Asian crisis in particular, led to the IFA initiative which reinforced the procyclicality of financial systems. Instead of a revival of business cycle theory and the notion of counter-cyclication regulation—which would have represented a genuine break with exo-economics—what we got was a rather lame story about the 'inevitability' of financial crises and the importance of complying with 'proper' economy standards.

A recent evaluation by the IMF's independent evaluation office stressed that the IMF had "not been at the forefront of the debate about what … can be done to reduce the cyclicality of capital movements through regulatory measures targeted at institutional investors in the source countries" and recommended that the "IMF's analysis and surveillance should give greater attention to the supply-side factors of international capital flows and what can be done to minimize the volatility of capital movements" (IEO, 2005:4, 7). Perhaps this was a first sign that a new approach to international financial regulation was underway. With the occurrence of the US subprime mortgage crisis and the global 'credit crunch', the emphasis on financial systems as procyclical and the potential role of international financial regulation in countering these cyles has increased considerably.13 The recently released annual report of the Bank for International Settlements (BIS 2008) thus gave prominence to the notion of pro-cyclicality. "Financial innovations have heightened", the report argued, "what seems to be an inherent tendency to 'procyclicality' in liberalized financial systems":

[A]s credit expansion fuels cyclical economic growth, asset prices and optimism rise while perceptions of risk recede. This further supports credit expansion, not least through the provision of more collateral to allow more borrowing, leading to spending patterns that could eventually prove unsustainable. Initial rational exuberance might in this way become irrational, setting the stage for a possible subsequent collapse (BIS 2008:137).

It is too early, of course, to judge whether a new approach to international financial regulation focusing on counter-cyclical measures will result from such increased awareness of procyclicality. For one thing, as the BIS report notes, "not everyone accepts the hypothesis" that procyclicality and excessive credit growth are at "the root of the problem" (BIS 2008:149).

Add to this, the BIS report continues, the practical problem of mobilising political support "to take away the punch bowl at the party", as counter-cyclical regulation will imply (ibid.).

In brief, the extent to which the new attention being paid to counter-cyclical regulatory measures in organizations such as the IEO and the BIS will have an impact on future approaches to the regulation of international finance remains to be seen. In the short term, it is probably unlikely that much will be changed with regard to two of the key procyclical features of the current approach: fair value accounting and quantified, marketsensitive risk management. It will be interesting to follow in the coming months which types of counter-cyclical regulation will be considered and which not.

A NEW APPROACH TO FINANCIAL REGULATION

There is something all too familiar about the regulatory responses currently advocated by regulators and the majority of the financial press. "This is the seventh international financial crisis I have lived through", notes Avinash Persaud (2008). "At the end of each the focus on avoiding the next one has always been the same trinity: more transparency, more disclosure and more risk management" (ibid.). More of the same won't do, however. It is "bad news" indeed that it is "largely the same consensus we reach after every crisis" (Gooddhart and Persaud 2008). Future international financial regulation needs to move beyond "the new Basel consensus of regulation—greater transparency, more disclosure and more market-sensitive risk management at the company level—and instead develop practical *systemic* proposals" (Eatwell and Persaud 2008, emphasis added). The following discusses briefly the essential elements of a new regulation of international finance that would be decisively systemic and counter-cyclical. It is beyond the scope of this book to go in great detail with this. A brief outline of the essential elements will have to suffice.14

Addressing Systemic Risk

The approach to financial regulation epitomized by the IFA initiative and the Financial Sector Assessment Program (FSAP) is disappointingly 'nonsystemic', in a whole range of ways (see details in Chapter 12). Although it is in theory "generally accepted that the core purpose of financial regulation is to mitigate systemic risks, such as a global credit crunch", in practice "the regulatory rules are focused entirely on risk-taking by individual firms" (Eatwell and Persaud 2008). What appears safe and solid risk management at the level of the individual financial institution may not be so at a systemic level. Future financial regulation *must* abandon the assumption that if financial institutions are individually safe, one by one, then so is

the financial system as a whole. Unfortunately, however, proposals made in recent months by regulators as well as by the banking sector continue to suffer from this inconsistency between overall objectives and the concrete governmental measures mobilized to meet them. Genuinely shifting the focus of financial regulation from the individual financial institution to the financial system as such is a *sine qua non* of a more stable and resilient international financial system in the future. Once ths conceptual shift has been followed through, a rethinking and refocusing of stress-testing as well as of the multilateral surveillance activities of the IMF more generally should be undertaken.

Counter-cyclical Capital Requirements

Raising capital adequacy ratios will reduce the degree of leverage of banks but it does not affect the liquidity available to a financial institution to cover losses in the face of adverse eventualities such as a global credit crunch (see details in Chapter 12). In the words of John Eatwell and Avinash Persaud, "minimum capital requirement is a charge, not a buffer" (Eatwell and Persaud 2008). "If resources are to be available in the downturn, then they must be freely released as necessarily as they have been compulsorily accumulated" (ibid.). In response to the fact that the single most important source of systemic risk is the economic cycle itself, Charles Goodhart and Avinash Persaud suggest that "capital charges should be raised in a boom and relaxed in a slump" (ibid.). Goodhart and Persaud's proposal has the merit of being evolutionary in the sense that it builds upon the Basle II framework (although departing from some of its key assumptions). This is likely a wise strategy, since it took more than nine years to negotiate the Basle II framework in the first place (Wade 2008:10). What Goodhart and Persaud propose is to "switch the basis of capital adequacy ratios from levels of risk-weighted assets to their rates of growth" (Goodhart 2008:14). More specifically, the proposal is to raise capital adequacy requirements "by a ratio linked to the growth of the value of bank assets, bank by bank", in a manner that would "moderate excessive lending" as well as "build up reserves during booms" (Goodhart and Persaud 2008). "Each bank would have a basic allowance of asset growth, which would be linked to the inflation target, the long-run economic growth rate and some margin for structural changes in the bank lending/GDP ratio", they explain (ibid.). The key regulatory mechanism would be to raise the capital adequacy requirements "by 0.33 per cent for each 1 per cent excess growth in bank asset values" (ibid.). Hence, "if a bank grew its assets at a rate of 21 per cent above its allowance, its minimum capital requirement would rise from, say, 8 per cent to 15 per cent" (Goodhart and Persaud 2008).15 This revision of capital adequacy requirements would have the great advantage that it would make it possible for regulators to better "link micro to macro stability" (ibid.).

Regulation of Non-bank Financial Institutions
It is important that attention is shifted from an "institutionally defined approach to a functionally defined approach", so that highly leveraged institutions are targeted by regulators regardless of their legal status (Eatwell and Persaud 2008). The key objective of financial regulation should be to prevent excessive leverage. The extent of deleveraging in a crisis has a lot to say about the severity of the crisis, and the degree of damage done to the non-financial sectors of the economy. Hence, regulation should target not only banks but also non-bank financial institutions which in recent years have often carried much higher levels of leverage than commercial banks. Saying that all financial institutions—rather than only banks—should be subject to regulation does not imply, however, that all financial institutions should be regulated in the same manner. On the contrary, it is of paramount importance to realize that liquidity is a complex phenomenon and that diversity in investment behaviour is absolutely crucial for systemic liquidity.16 Hence, the expansion of financial regulation to encompass all financial institutions *must* be accompanied by a diversification of regulation.
Diversified Regulation
At present, regulation tends to impede diversity rather than promote it. The current tendency to advocate the same market-sensitive risk management systems for all financial institutions—whether banks, insurance companies or pension funds—is dangerous. The focus of regulation should be shifted "away from sensitivity to the market price of risk and notions of equal treatment for all institutions, to a greater sensitivity to risk capacity and a better appreciation that diversity is the key to liquidity" (Persaud 2008):
Systemic resilience requires different risks being held in places where there is a natural capacity for that type of risk. In the name or risk-sensitivity and equal treatment we ended up with institutions who had no liquidity, holding liquidity risk and those with little capacity to hedge or diversify it, owning credit risk" (Persaud 2008).
Financial regulation itself should be diversified, in other words, so as to encourage more diversity in the behaviour of financial institutions "by giving their considered stamp of approval" to a set of "varied risk-management approaches" (Persaud, 2004a: 101). In such diversified financial regulation lies, Persaud argues, a "potential for a virtuous cycle" (Persaud 2004a: 102). "The more short-run and long-term investors behave differently", he argues, "the shorter market disruptions will be and the more this different behaviour would be profitable for long-run investors" (ibid.).17
Hence, with regard to banks, the main task will be to place much less reliance on market-based approaches. With regard to long-term investors—

such as pension funds, insurance companies and mortgage companies—the regulatory ambition should be to encourage adoption of "contra-cyclical risk management systems", rather than the current short-term risk-management systems (Persaud 2004a: 85–86, emphasis added). In brief, a more effective regulation of international finance will have to promote diversity and segmentation of risk, as opposed to the current homogenizing and uniform approach.

MODERATED FAIR-VALUE ACCOUNTING

Since August last year, Fair Value Accounting (FVA) has increasingly become subject to criticism from banks and insurance companies, which argue that applying FVA to financial instruments in the current financial turmoil "risks undermining the financial system" (Hughes 2008). Earlier this year, Martin Sullivan, Chief Executive of the US Insurance company, American International Group (AIG), urged a rethinking of fair value accounting (Guerrara and Hughes 2008). Sullivan argued that FVA "forced companies to recognise losses even when they had not intention of selling assets at the current prices", and said that this practice created a "vicious circle whereby companies recorded huge losses, lost investors' confidence and were then forced to raise funds at unfavourable prices" (ibid.). Instead, the AIG proposed that companies were to "estimate the maximum losses they were likely to incur over time and only recognise these" in their accounts (ibid.). Accounting regulators have so far rejected such proposals, with the widespread support of the financial press. A key argument has been that it is not the role of accounting to ensure financial stability. But surely it's not the role of financial accounting to exacerbate financial instability either. What is needed here is a pragmatic approach. Once one abandons the naïve notion that FVA somehow unveils the undistorted, 'pure truth' about the value of banks and companies, there is little reason not to engage in devising a pragmatic rethinking of FVA. Just as there is a need to rethink Basle 2 capital adequacy ratios in order for them to become counter-cyclical rather than pro-cyclical, the FVA must be moderated so as to reduce its pro-cyclical effects. This is all the more important given that once a general valuation crisis unfolds, as in recent months, the distinction between liquidity problems and solvency problems becomes "a highly theoretical one" (James 2008).

Enhancing Incentives for Diligent Counter-cyclical Regulation

The financial sector is not exactly enthusiastic about counter-cyclical regulation. During a boom, the financial sector is a highly profitable place to be—and as we've seen, when the bubble burst, losses are 'socialized'; transferred that is, to the public balance sheet, at the expense of taxpayers. William McChesney Martin, former chairman of the US Federal Reserve, is reported

to have said that authorities should "re move the punch bowl before the party gets going" (Goodhart and Persaud 2008). But as Charles Goodhart and Avinash Persaud notes, "parties are fun", and "underpaid supervisors cannot easily squeeze past" powerful groups such as "rich lenders, borrowers with seemingly worthy projects and politicians taking credit for the good times, to take away the bowl of punch" (ibid.). There is a need, in other words, to send a very clear signal to markets as well as regulators that counter-cyclical regulation is the name of the game now. An important element in this would be to introduce annual bonuses for financial sector supervisors. Creating incentives for regulators to pursue counter-cyclical regulation and prudential supervision as diligently as possible, in the form of bonuses conditional on successful supervision, might enhance financial stability considerably (Goodhart and Persaud 2008). "We have seen the deleterious but powerful effects of banking bonuses", notes Goodhart and Persaud; "Why not use financial incentives for more socially useful behaviour?" (ibid.).

Abandon Narrow Inflation-targeting

A new approach to monetary policy that abandons narrow inflation-targeting is needed. Efforts at reducing volatility are important because volatility comes with large costs, even in the absence of full-scale financial crisis. Though many types of financial risk can be hedged or otherwise insured, such financial services "can be expensive, both in terms of direct costs and in terms of the collateral that often must be pledged to support forward contracts":

For large companies this may all be routine, but for small companies—the majority of our employers—the costs of avoiding financial volatility can be prohibitive. As for consumers, they are, quite simply, naked to most forms of financial volatility (Poloz 2006:3426)

In light of the significant social and economic costs of volatility, Stephen Poloz advocates that central banks be encouraged to target not just inflation, as is widespread practice, but rather to "condition its pursuit of inflation targets on short-run financial outcomes", i.e., smoothing short-term financial fluctuations "while maintaining the inflation target in the medium term" (Poloz 2006:3427). The case for requiring central banks to combine inflation targets with the objective of reducing short-term financial volatility is compelling, Poloz stresses, particularly for those that contend that "financial volatility can take on a life of its own, as in the endogenous bubbles literature" (ibid.).

Financing Bail-outs

Interdependence in the international financial system is today so profound that the previous 'too big to fail' doctrine has in effect been replaced with

a 'too interdependent to fail' doctrine. The past decade has witnessed a *de facto* institutionalization of government bail-outs of financial institutions. If a more counter-cyclical mode of international financial regulation is introduced in the near future, it may reduce large-scale financial institution collapses, but it will hardly eliminate any and all needs for future government bail-outs. The regressive taxation, or 'socialism-for-the-rich', implied by government bail-outs is deeply problematic. Some mechanism ensuring that, in the medium to long-term, the financial sector is *not* subsidised by taxpayers is indispensable. A tax on capital flows could serve the purpose of generating funds so as to ensure that the financial sector pay for previous bail-outs and save funds for any future bail-outs. Unfortunately, it is a widespread notion that such a *quantitative* measure would be an 'inappropriate' form of international financial regulation, on the grounds that they are detrimental to economic freedom and to economic efficiency and growth. Is it not, however, a curious and indeed untenable idea that quantitative measures should somehow be more 'distortive' and more detrimental to economic freedom than qualitative measures such as the comprehensive system of global disciplining launched in and through the IFA? I believe there is a rather strong case for reconsidering a tax on capital flows, whether in the name of financial stability, economic growth, or freedom. In practical terms, the Continuous Linked Settlement-Bank, owned by central banks and regulators, could provide a means by which governments could "levy a tax on foreign exchange transactions in their currencies" (Wade 2006:127). 18

National Liability Management

Michael Pettis advocates that sovereign states should engage in liability management of their national 'equity' accounts, inspired by corporate finance theory. He notes that at present sovereign states tend not to be concerned with the *dynamics* of the value of their assets and liabilities. The 'investment model' encourages optimistic risk-taking on the receiving end of capital flows. If foreign investors do in fact "invest because growth prospects are promising and the government's policies are 'working'", then it is only "logical that borrowers would take advantage by structuring their funding in a way that allows them continuously to lower their borrowing costs as conditions improve" (Pettis 2001:113). Such 'optimistic' structuring of borrowing will, however, be the Achilles heel when the business cycle turns. As the value of their assets declines, the costs of servicing their debts will increase. Instead, sovereign states should adopt the basic principle of liability management in corporate finance theory, namely that funding should be structured in a counter-cyclical way so that liabilities become less costly when the value of assets is declining. This funding strategy would automatically reverse or dissipate "the damage caused by unpredictable external shocks", Pettis argues (2001:50). Liability management

of national 'equity' accounts along these lines should be an essential part of a new approach to financial regulation.19

A Revised Financial Sector Assessment Program (FSAP)

Despite awareness of key limitations of the FSAP, especially following the evaluation of the FSAP by the Independent Evaluation Office, and the acknowledgement that "significant modifications" were needed (IEO 2006a: 6), little if any reform of the FSAP has taken place. On IMF's FSAP website one finds no entries for 'policy papers' nor for 'other related FSAP material', dated later than the IEO-evaluation. This does not reflect that the FSAP in the past two-three years has *overcome* its problems. On the contrary, the credit crunch of the past year has left the FSAP in an even deeper crisis. In the period from August 2007 to July 2008, as little as four new FSAP assessments and three FSAP Updates were made.20 Hence, for at least a couple of years now, the FSAP has found itself in a sort of paralysis: despite increasing acknowledgement of many rather severe limitations of the FSAP, no rethinking of it has been undertaken by the IMF, the World Bank or any of the other involved international organizations. A fundamental rethinking of the FSAP, which take into account the problems identified in Chapter 12, must be undertaken. In the process of rethinking and reforming the FSAP it will be of paramount importance that a new mode of financial stability analysis is devised which enables early detection of asset price booms and system-wide stress-testing. Moreover, a new FSAP should replace the previous compliance-to-standards agenda with a national-liability-management agenda along the lines indicated above.

AN AFTERTHOUGHT

Whether the shift from the Washington consensus to the Post-Washington consensus, and the corresponding shift from a 'mechanical economy' to an 'organic economy', will help economics 'break out of the cocoon of equilibrium' remains to be seen. However, having become the target of new mechanisms of power, the economy is being 'offered up to new forms of knowledge', in Foucault's phrasing. One could hope that the opening of economies to a new analytical gaze could cause various types of institutional economics to gain new momentum, in relation to the still dominant mechanical tradition of neoclassical economics. In extension, one could hope that this would, eventually, lead to a recognition on the part of the 'international community' and its policy-formulating organizations that there are multiple paths to economic growth and development. The IFA implies an attempt to enforce a particular form of capitalism worldwide, which demonstrates little acknowledgement of the existence of different paths to economic growth and development, and may be perceived

as arrogant or disrespectful. In addition to such concerns, global homogenization of economies is likely, as we have seen, to exacerbate processes of self-feeding volatility and contagion. It would be desirable if the 'international community' were to charge the IMF and other international organizations with an effort to *govern the interaction* between different types of capitalist economies, instead of their current efforts at *homogenizing* them.21

Dani Rodrik commented on the Post-Washington consensus and its "new focus on institutions" that it had "led to an overly ambitious agenda of 'governance' reforms" (Rodrik 2002:2). In relation to this new policy agenda, Rodrik felt compelled to stress that "our ability to disentangle the web of causality between prosperity and institutions is seriously limited" (ibid.). In addition to the limits of our knowledge about the relationship between institutions and prosperity, Rodrik pointed out that there is strong evidence suggesting that countries do *not* need "an extensive set of institutional reforms" to spur economic growth (Rodrik 2002:9). Instead, the "best we can do", he argued, "is to come up with … institutional prescriptions that are contingent on the prevailing characteristics of the local economy" (ibid.) and "identify the binding constraint on economic growth at the relevant moment in time" for that particular economy (Rodrik 2002:11).

With regard to the approach taken by the IMF and the World Bank to individual member countries, one wonders whether the reinvented universalism might *in practice* be discarded in favour of country-specific diagnoses and differential policy prescription as advocated by Rodrik and colleagues (Buira 2003b; Hausman et al. 2005). This would not only contribute crucially to reversing the troubling trend towards increasing homogenization in the world economy. It would also increase the legitimacy of the IMF and the World Bank and help countries focus on growth and development issues rather than on the compliance agenda. The notion that one set of policy prescriptions exists which constitute the best development strategy for all economies remains a dream, 'a fantasy perhaps', which has not served developing countries well in the past, and is unlikely to do so in the future. Such a shift may hinge, however, on the question of whether or not emerging market economies, in the not too distant future, achieve a representation in the governing boards of the IMF and the World Bank that reflects more adequately their increasing size and importance in the global economy.

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Notes

NOTES TO THE DEDICATION

1. From Kierkegaard, S., (1844), *Against cowardliness, four upholding discourses* (translation by Hong & Hong). Original Danish version: "Selv naar Feighed forvexles med Klogskab, med en i Menneskenes θine priselig Forstandighed, hvis Hemmelighed er Selvkjaerlighed, selv da er den foerst bleven forvexlet med Stolthed, saaledes nemlig, at det at vaere saaledes klog paa Verden og sin egen Fordeel er noget Stort".

NOTES TO CHAPTER 1

1. Japan in 1989–1991; Finland, Italy, UK, Sweden in 1992; Mexico in 1994–1995; East Asia in 1997; Russia in 1998; and Brazil in 1999, not to mention the near-collapse of the LTCM hedge fund, avoided only by a large US Treasury-led bail-out.
2. The International Institute of Economics, a Washington-based independent research institute, today operates under a new name; the Peterson Institute of International Economics.
3. Wolfensohn, cited from Singh (2003:377). For more on this; see Chapter 11.
4. For more on the theoretical framework, see below, pp. 14-16.
5. The term 'Ordo-liberals' refer to the German branch of neoliberalism. For more on this, see chapter 16 and 17.
6. When Weber notes, for instance, that "military discipline is the ideal model for the modern capitalist factory" (Weber 1968 [1921]: II 56), one sees indeed a close affinity with the later work of Foucault.
7. For discussions of Foucault's work, see Breuer (1989), Dreyfus & Rabinow (1983), Gutting (1989, 1994), Kusch (1991), O'Neill (1986), Philp (1985), Smart (1985).
8. Besides the work of Donald MacKenzie (2003a, 2003b, 2004, 2006), key contributions to this field have been made by Karin Knorr-Cetina and colleagues; Knorr-Cetina & Brugger (2000); Knorr-Cetina & Preda (2001, 2005). See also Abolafia (1996) and Beunza & Stark (2004).
9. It was the philosopher J.L Austin who first coined the term 'performativity', MacKenzie notes, to "distinguish utterances that *do* something from those that report on an already-existing state of affairs": if I say "I apologize", or "I name this ship the *Queen Elisabeth*", or "I bet you sixpence it will rain tomorrow", then "in saying what I do, I actually perform the action" (Austin, cited in MacKenzie 2006:16).

10. This third level of performativity involves also the possibility of "counter-performativity", where the practical use of economics alters "economic processes so that they conform less well to the theory or model" (MacKenzie 2006:19).
11. MacKenzie's recent book (2006) includes an analysis of the 1998 crisis "surrounding the hedge fund Long-Term Capital Management (LTCM)" (MacKenzie 2006:34). The crisis of the LTCM, which was run by a fund including "the finance-theory Noble Laureates Robert C. Merton and Myron Scholes", is of key interest, MacKenzie argues, because studying it enables one to understand better the relationship between financial models and financial markets. In MacKenzie's analysis, it was the social process of "imitation" that was "at the heart of the LTCM crisis" (ibid.). The LTCM and its predecessor had been extremely successful, and this success inspired others to attempt to pursue "similar trading", resulting in the creation of a "superportfolio"—a "large, unstable structure of partially overlapping arbitrage positions"—that began "to unravel" in 1998, ultimately bringing LTCM itself to the verge of a financial collapse that was only avoided through a recapitalization by a host of the largest Western banks (MacKenzie 2006:34–35).
12. On this, see also the discussion in Tribe (1978).
13. The work of Michel Callon and Donald MacKenzie, with their focus on the performativity of economics, to some extent at least implies a sort of "scientific rationalism" in a Bachelardian sense. Thus, in the difference between the approach pursued in this book and that of Callon and MacKenzie, one may see something reminiscent of the difference between the work of Gaston Bachelard and Michel Foucault.
14. Another perspective absent in the present work is a historical perspective on finance. See de Goede (2005) for genealogy of finance, which considers "foreclosed possibilities and decisive moments in financial history" and thereby endeavours to contribute "imagining alternative economic futures" (de Goede 2005: xxvi). See Seabrooke (2005) for historical study of financial practices, focusing on the concept of 'market civilization' and its relationship creditors and borrowers in both the public and private sectors.
15. For another recent contribution along these lines, see Rowe & Lipschutz (2005).
16. Michel Foucault should not be conceived a 'postmodernist'. If any such labeling applies—and Foucault strongly resisted it—he is best thought of as a 'poststructuralist'.
17. With the exception of Vestergaard (2004).
18. See Vint (1986), Amariglio (1988), Mirowski (1989, particularly pages 4, 5 and 116).
19. This means that only a modest selection of Foucault's many books, articles and interviews have found their way into this book. The parts of Foucault's work that I employ in this book are his books *Discipline and Punish* (1991b), and *The Will to Knowledge* (1998 [1976]), along with a lecture series on the genealogy of the modern state, held in 1978–1979 at the College de France. With regard to the latter, the focus is on those of the lectures tthat have been published in English (1991a, 1997a, 1997b), and on secondary material based on transcriptions of tape recordings, notably Lemke (2001).
20. Overall, governmentality studies have not yet had much impact in the field of economics, despite the existence of a few studies of economic discourse; cf. Hindess (1998); Miller & Rose (1990). See also Foucauldian studies of accounting, particularly work by Anthony Hopwood, Peter Miller and

Ted O'Leary; e.g. Hopwood (1987); Hopwood & Miller (1994), Miller & O'Leary (1987, 1990, 1993, 1994, 2006).

21. On the Malaysia assignment, the World Bank consultancy team consisted of a Thai, a Malaysian, an Australian, an American, a Moroccan, and myself, a Dane. Thus, the team comprised not only of a varity of ethnicities, but also a variety of professional experiences. By using the term 'knowledge sharing', I do not intend to deny that such assignments constitute a power relationship. Power is not in and of itself a 'bad thing'; as Foucault would say, power is, power produces. There is no point in 'being against' power, as such; the point is to examine and problematize different modalities of power, to always remain open to the possibility of other forms and modalities of power.

NOTES TO CHAPTER 2

1. See, for instance, Philp (1985:67) and Sarup (1993:72).
2. This series of lectures, given at College de France in the late 1970s, was first published in English in 1979 (Foucault 1979), but only after being republishing in 1991 (Foucault 1991a) did a vast literature inspired by this work emerge. For key contributions and overviews of the literature, see Barry, Osborne & Rose (1996), Burchell, Gordon & Miller (1991), Dean (1999), Miller & Rose (1990, 2007), Rose & Miller (1992), Rose (1999).
3. In addition to the work of Michel Foucault, the methodology of Peter Miller and Nicolas Rose is inspired by Ian Hacking's (1983) work on the philosophy of natural science, arguing that the study of theory (representation) should be combined with the study of experiments and instruments (intervention). For a recent explanation of this link, see Miller & O'Leary (2006).
4. Notably, the 'French historical epistemologists'.
5. Including an analysis of typologies requires, of course, that a certain 'gestation time' has passed; typologies of the debate, by their very nature, begin to appear only after some time has passed.

NOTES TO CHAPTER 4

1. Moral hazard: "The situation in which a person has no incentive to act honestly or with due prudence in the absence of penalties" (*Oxford Dictionary of Finance and Banking*, 2005:270).
2. Krugman assumes what he terms "a very stark form of moral hazard", in which the investor "is not required to put up any capital of his own, and that he can walk away from the institution at no personal cost" (Krugman 1998:4–5).
3. The $20m is the government bail-out covering the loss of failed investment.
4. For details of this two-period model, see Krugman (1998:7–8).

NOTES TO CHAPTER 6

1. By starting the summary of Wade's paper from his section on 'the history of the Asian crisis', I skip the introductory sections, where he refers and criticizes other interpretations of the crisis; cf. Wade (1998a: 1555–58).
2. "Excluding Japan and partially, Korea" (Wade 1998a: 1539).

3. Again, apart from Japan, and partially, Korea (Wade 1998a: 1541).

NOTES TO CHAPTER 7

1. In this chapter, page references to the four narratives are excluded; please refer to chapters 3 to 7 for page references.

2. This categorisation and depiction of four main lines of problematization is supported, *inter alia*, by a reading of the following contributions to the debate: Aghevil (1999); Baer, Miles & Moran (1999); Bello (1998); Bird & Milne (1999); Burkett & Hart-Landsberg (1998); Chang et al. (1998); Corbett & Vines (1998, 1999), Eichengreen (1999); Felix (1998); Goldstein (1998); Grabel (1999); Haggard (1999); Haggard & McIntyre (1998), Johnson (1998); Kregel (1998a, 1998b); Krugman (1999); Lane (1999); Lauridsen (1998); Palma (1998); Richter (2000); Singh (1999); Stiglitz (1999, 2002); Taylor (1998); Wade (1998a, 1998b, 1998c); Wade & Veneroso (1998).

3. Robert Wade may be considered a partial exception to this pattern in the sense that he did not mask his moral judgment in a reference to 'ultimate causation' or the like, but presented it as what it was, a moral judgment (Wade 1998a: 1545).

4. For the full list and quote see Introduction, section on 'the Asian crisis'.

5. The Meltzer Commission, formally known as the 'International Financial Institution Advisory Commission', was established by US Congress in November 1998. The Commission consisted of five experts nominated by the Republican Party (including Charles Calomiris, Cato Institute) and five experts nominated by the Democratic Party (including Harvard Professor Jeffrey Sachs, and Fred Bergsten, Director of the International Institute of Economics).

6. Mainly with regard to fiscal policy targets.

7. I.e, slide from bullet point 2 to bullet point 3 in the conflation overview.

8. The term 'Orientalism' denotes hostile and denigrating views of the East by the West, associated with the attitudes of European imperialism in the eighteenth and nineteenth centuries. See Said (1978).

9. For an exception to this overall pattern, see Lance Taylor (1998), who emphasizes a pragamatic and non-reductionist approach to the issue of policy response to the Asian crisis: "A number of policy issues are posed by these episodes. It is convenient to discuss them under three headings: steps which can be taken at the country level to reduce the likelihood of future conflagrations; actions both an afflicted country and the international community can take to cope with a future crisis, when and if it happens; and how the international regulatory system might be modified to enhance global economic comity and stability" (Taylor 1998:670).

NOTES TO CHAPTER 8

1. The IMF displayed a construction site to illustrate graphically the need to build a more solid international financial system; cf. the IMF's Quarterly Magazine, *Finance & Development*, 1999, 39 (2): cover page.

2. The literature on the 'international financial architecture' is extensive. For key contributions, see Acharya (2001); Best (2003a, 2003b); Cartapanis & Herland (2002); Eatwell (2004); Eichengreen (1999); Griffith-Jones and Bhattacharaya (2001); Kaiser et al. (2000); Kenen (2001); Rodrik (1999); Singh (2003); Soederberg (2005); Wade (2007b).

3. Tietmeyer's report was formally known as the report on 'International co-operation and coordination in the area of financial market supervision and surveillance'. See Tietmeyer (1999).
4. Nomenclature for the three different areas varies. The FSAP Handbook uses the categories transparency standards; financial sector and financial integrity standards; and financial infrastructure standards. In other IMF reports, the following three categories are used: policy transparency; financial sector regulation and supervision; and market integrity. In the section above, I have combined these two nomenclatures to arrive at a simpler yet more informative version.
5. To complement these two, FSAPs deploy two further methodologies; macrofinancial linkage analysis; and surveillance of macroeconomic conditions. For more on this, see IMF (2005a :36, 47–50).
6. EWS models are usually constructed on the basis of the 'indicators approach', the 'limited dependent variable probit-logit' approach, or some combination of the two.
7. Another distinction in the EWS literature is between three "generations" of crisis models, with each generation focusing on a different set of determinants. Thus, whereas first-generation models focused on macro-economic imbalances, the focus of second-generation models was on speculation, contagion, and weakness in domestic financial markets, while in third-generation models emphasis is on moral hazard as a cause of excessive borrowing, suggesting that asset prices can be a key indicator of crises.
8. Sometimes, the term 'microprudential indicators' is used instead of 'financial soundness indicators'.

NOTES TO CHAPTER 9

1. Foucault's work is sometimes presented as if this was the case. See, for instance, Sarup's introduction to Foucault (Sarup 1993:67).
2. In his account of this 'discovery' of the body as a governmental object, Foucault refers to La Mettrie's *L'homme-machine*; "the great book of Man-the-Machine".
3. See also Polanyi's comments on Bentham and the Panopticon (Polanyi 2001:111–113, 122–126).

NOTES TO CHAPTER 10

1. Note also that the FSAP Handbook (2005a) devotes an appendix to 'sequencing' issues.
2. For examples of other uses of the metaphor of the Panopticon in analyses of the global economic order, see Gills (1995) and de Angelis (2001, 2002).
3. For more on the Washington consensus, see Chapter 13.

NOTES TO CHAPTER 11

1. A significant body of literature on 'transparency' and 'standards and codes' as a means of international financial regulation has emerged. For key contributions, see Best (2005, 2006); Hansson (2003); Mosley (2001); Price (2003); Seabrooke (2005); Singh and Zammit (2006); Vestergaard (2004); von Furstenberg (2000).

2. These 39 countries are: Bangladesh, Bosnia & Herzegovina, Botswana, Bulgaria, Chile, Colombia, Croatia, Czech Republic, Dominican Republic, Ecuador, Egypt, Estonia, Hungary, India, Jamaica, Jordan, Kenya, Korea, Latvia, Lithuania, Lebanon, Macedonia, Mauritius, Mexico, Moldova, Morocco, Nigeria, Pakistan, Peru, Phillippines, Poland, Romania, Senegal, Slovakia, Slovenia, South Africa, Sri Lanka, Tanzania, Uganda, Ukraine.
3. Cited in *Financial Times*, November 10, 2004.
4. This case study draws upon the work of Andreas Nölke and James Perry (2006, 2007).
5. The literature on competing models of capitalism is extensive. For key contributions and overviews of the literature, see Amable (2003); Boyer (2005); and Crouch (2005). See also Whitley's discussion of six types of business systems (Whitley 1999:31–64).
6. In Scandinavian countries, political economists tend to see the 'Nordic' model of capitalism as an 'ideal' model of capitalism. In France, the tendency is to praise 'the French model', and so forth.
7. This by no means implies the end of the binary tradition, nor that binary studies cease to be insightful and relevant. See, for instance, work by Pontusson (2005) juxtaposing 'social Europe' and 'liberal America'.
8. Another 'trichotomy' takes the same two starting categories of market capitalism and managed capitalism, but then adds 'Latin capitalism'—that is, Spain, Italy and France—as the third, separate group (Rhodes and van Appeldorn, 1997). Other work differentiated European economies along a North-South dimension, arguing that the differences between Southern Europe, Central Europe and Northern Europe are so large, that a typology of four or more different models of capitalism is warranted to grasp them (Ebbinghaus, 1999).
9. The comparative capitalism literature is a predominantly 'Eurocentric' literature, in the sense that except for Asian economies one finds very few references to non-Western economies (Latin America, Africa, Middle East), and in the case of Asian economies these are usually lumped together as one category. This lumping together of Asian capitalist economies stands in stark contrast to the almost endless differentiation of European models of capitalism that is characteristic of many contributions to this literature. Orrù, Biggart and Hamilton (1997) represent a remarkable exception to this tendency. Orrù and colleagues proposes three ideal types of capitalism—alliance capitalism, *dirigiste* capitalism, and familial capitalism—and identifies examples of each ideal-type in both East Asia and Europe. On the differentiation of Latin American economies, see Boyer (2005:524).
10. *The Journal of Development Studies* and *The Journal of the Asia Pacific Economy* have both devoted special volumes to the study of institutional reforms in the wake of the Asian crisis; see Robison & Hewison (2005) and Beeson (2003) for overviews of these. See also Beeson & Islam (2005), Chang et al (2004), Haley & Richter (2002), Jeong (2004:219–224), Jayasuriya & Rosser (2001), and Robison et al (2000). For a more recent study of compliance to standards in East Asian countries; see Walter (2007).

NOTES TO CHAPTER 12

1. Less than a year after the launching of the FSAP pilot, in March 2000, a first review of progress and lessons was conducted. This was followed by a new review later that year, in December 2000, which resulted in upgrading the

FSAP to regular programme status. Since then, two full-scale programme reviews have been made, first in March-April 2003 and then again two years later, in February-March 2005. More recently, a review of the FSAP was conducted by the IMF's Independent Evaluation Office and published in January 2006 (IEO 2006).

2. The World Bank and the IMF charged the joint Bank-Fund Financial Liaison Committee (FSLC) with the operation of the FSAP.

3. See Wade (2001) for an illustrative example of how the IMF may exert its 'discretion' in judging whether a country has sufficiently lived up to conditionality and thus qualifies for the next phase of the loan or not.

4. In the course of IMF's history, both the number of conditionalities typically made and their content have changed significantly. On the history of IMF conditionality, see Gould (2006). The expansion, or explosion, of conditionality was among the key targets when the IMF was increasingly criticised towards the end of the 1990s. Responding to these criticisms, the IMF developed new conditionality guidelines emphasizing 'parsimony' and 'tailoring' to the specific country in question, which were approved by the Executive Board in September 2002.

5. The continued emphasis on macroeconomic policy issues reflected, the report argued, where the knowledge and expertise of the majority of Executive Board members continues to lie, irrespective of attempts by the IMF to reinvent itself (IEO 2006:11).

6. The three other criteria were: (i) no expected need for IMF resources, i.e., 'sound policies'); (ii) constructive relations with private creditors and progress towards limiting external vulnerability; and (iii) a satisfactory macroeconomic and financial program and a commitment to adjust policies (IMF 2004).

7. For more info on the CCL, see the official IMF review of it (IMF 2003b). See also IMF (2004).

8. This was a repetition of the Mexican case; Mexico had also for years been the 'star pupil' of the IMF, when the financial crisis in Mexico in 1994–1995 occurred.

9. For interesting work on how the Argentine crisis marked a new practice in sovereign debt rescheduling, which eventually led to change in international bond issuing so that 'collective action clauses' are now a standard element of these, see Helleiner (2005).

10. And, further, that "within this generally limited impact … failure to participate or to publish a FSSA is regarded as perhaps the most significant signal".

11. For other studies of this nature, see Chortareas et al. (2001), Gelos & Wei (2002), IMF (2003a) and Schneider (2003, 2005).

12. This could be taken as a vindication of the assertion made recently by Thirkell-White: the notion that "mere market discipline" can "secure widespread implementation" of the standards "seems misplaced", he noted (Thirkell-White 2007:34).

13. Sonakul made these remarks in a speech to the Asia Society Southern California Centre in 2000.

14. Cited in the *Internatioal Herald Tribune*, 2008, June 17.

15. For a study of indirect and direct linkages between capital inflows and capital flight in Southeast Asia, see Beja (2006:26–28).

16. While liquidity is not an easily defined concept, the Bank for International Settlements recently suggested a definition it thought would be acceptable to most. A liquid market, in this definition, is a market where participants 'can rapidly execute large volume transactions with a small impact on prices' (cited in Spratt, 2004:106). Most literature perceives

liquidity as consisting of three main components: tightness, depth and resilience. Whereas tightness refers to the cost of turning round a position over a short period, depth refers to the volume of trade needed to significantly affect prices, and resilience to the speed by which prices return to equilibrium (ibid.).

17. Bankers and investors herd partly because, in a world of uncertainty, 'the best way of exploiting the information of others is by copying what they are doing' and partly because they are 'more likely to be sacked for being wrong and alone, than for being wrong and in company' (Persaud 2001:59).

18. There are interesting parallels to the LTCM debacle. Prior to its near-collapse, many financial market participants imitated the investment strategy of the LTCM, which was perceived to be highly successful. With large numbers of financial market investors replicating the investment strategy of the LTCM, a radical reduction in the diversity of investment portfolios resulted, ultimately, made an otherwise highly successful investment strategy fail spectacularly (MacKenzie, 2005, 2006).

19. See Metcalfe and Persaud (2003) for a discussion of the role of the daily disclosure of reserves data in the financial crisis in Argentina.

20. Compare these observations with similar points made in recent research by Boris Holzer and Yuval Millo: "[T]he application of models-based risk management may result in the creation of second-order dangers" which "raises questions about the recent move of financial regulators worldwide toward an integration of mathematical risk assessment tools in the regulatory framework" (Holzer & Millo 2004:17).

21. FSAP staff expressed concern in interviews with the IEO that "they lacked the necessary training and experience to interpret FSIs and integrate the analysis into ongoing surveillance work" (IEO 2006b: 31).

22. The formulation in full: "We do not evaluate the technical merits of particular codes and standards . . . Nor do we attempt to assess whether the entire international architecture of standards and codes is better than other possible approaches, since such questions go well beyond the role of the IMF" (IEO 2006:17).

23. Persaud cites a reduction in the value of pensions by 50 pct over just two years as a key example of the substantial, but largely ignored costs to pensioners of the current regulation of international financial markets.

NOTES TO CHAPTER 13

1. Cf. the title of Rodrik's paper: 'Goodbye Washington consensus, hello Washington confusion?'. For another example of interpreting the co-existence of different intellectual perspectives on development policy as signalling a Washington 'confusion', see Santiso (2004).

2. The World Bank report draws extensively on the work of Rodrik and colleagues. On this, Rodrik comments: 'It is gratifying to see one's ideas being taken seriously, particularly by an institution that has frequently served as a target of one's criticisms . . . But I would like to think that the laudatory note I have struck above has to do not just with an ego being stroked' (Rodrik 2006:986).

3. See, for instance, contributions by Gore (2000) and Krogstad (2007). The literature on the Post-Washington consensus is extensive. In addition to already mentioned contributions, see Fine (2002), Flynn (2007), Hayami (2003), Jayasuriya & Rosser (2001), Pincus (2002), Stiglitz (2004), Wade (2007), and Williamson (2005).

4. Williamson distinguishes between three versions of the Washington consensus: the market-fundamentalist version, the version of the Bretton Woods institutions, and his own. For more on this, see Williamson (2005:5–11).

5. In Ben Fine's characterization, the Washington consensus was 'the counter-part for developing countries to the Reaganism and Thatcherism that had been prescribed for developed economies—an ideology of reliance upon market forces and the reduction of state intervention and expenditure to a minimum' (Fine 2002:2).

6. The reference to 'Washington' refers to the contention that this city is the world's 'de facto capital'—the city where an international 'network of opinion leaders'—'the IMF, think tanks, politically sophisticated investment bankers, worldly finance ministers'—meet each other and 'collectively define the conventional wisdom of the moment' (Krugman, cited in Raghavan 1996:14).

7. Further, 'it is probably worth noting', Michael Pettis argues, 'that the free market policy advice that rich countries generally provide to LDCs was, perhaps mercifully, never followed too closely by the best documented cases of LDCs that became rich—England and France in the eighteenth century, the United States and Germany in the nineteenth century, and Japan, Taiwan and Korea in the twentieth century (Pettis 2001:49).

8. This, ultimately, led to the birth of the 'good governance' agenda, which called for reforms in a range of areas, from civil service and primary education to finance and microcredit (Wade 2007a: 4).

9. See, for instance, a late 1990s book by two World Bank economists, Burki & Perry (1998), titled *Beyond the Washington consensus: institutions matter*. See also World Bank (2002).

10. For more on this, see IEO (2006). The effectiveness of the IMF's multilateral surveillance is disputed. There seems to be a problem of under-utilization of the IMF's multilateral surveillance data, and also an insufficient emphasis on these activities.

11. In 2001, the year the new set of guidelines were prepared and approved, a loan was made to Turkey following its financial crisis, listing a comprehensive set of 42 conditionalities, not exactly bearing testimony to a move towards parsimony in lending practices (Buira 2003b: 67–69). The IMF's evaluation unit (IEOs) is currently working on three major projects, one of which is a comprehensive evaluation of 'structural conditionality'.

12. It is not without irony that it is professionals of the social science most committed to being an 'objective' science, as opposed to a normative one, that are so committed to a dogmatic as opposed to a pragmatic approach to the governing of economies.

13. Ben Fine notes that, unlike the Washington consensus, the Post-Washington consensus seeks 'not only to set the agenda but also to incorporate dissidence' (Fine 2002:14).

NOTES TO CHAPTER 14

1. Writing the history of the past in the terms of the present is a pervasive problem in the history of economic thought. See Tribe (1978:5–23).

2. The three main bodies of work planned were *complementary* in the sense that they described three different institutions of social order: moral, market, justice—different dimensions of social order, to be understood in conjunction.

3. According to Douglas Long, Bentham explicitly argued that a sovereign could "enhance the value of subjects' liberties by his acts of regulation" (Long 1977:43).

NOTES TO CHAPTER 15

1. Foucault's 'governmentality lectures' were published in English in 1991 (Foucault 1991a). This chapter further draws upon Foucault's *The will to knowledge (1998)*, a few short articles (1997a, 1997b), as well as on secondary material.
2. The root of the word 'oeconomy' is the Greek word *oikos*, meaning *household*, cf. Aristotle.

NOTES TO CHAPTER 16

1. The following relies on Lemke (2001)—which is based on transcriptions from tape-recordings of Foucault's lectures on these topics at the Collége de France, in the late 1970s—and two brief papers by Foucault himself (1997a, 1997b).
2. Founding statement of the Mont Pelerin Society, cited in Harvey (2005:20)
3. Hayek mentions Josiah Tucker, Adam Smith, Adam Ferguson, Edmund Burke, Lord Acton and Alexis de Toqueville as representatives of 'true individualism'—and refers to "the Encyclopedists, Rousseau and the physiocrats" to delineate the 'false' one (Hayek 1980:4).
4. This name derives from the journal *Ordo*, in which most of the work of these scholars was published. Key figures among the *Ordo-liberals* were Wilhelm Röpke, Walter Eucken, Franz Böhm, Alexander Rüstow and Alfred MüllerArmack. For an important account of German *Ordo-liberalism*, see Tribe (2006).

NOTES TO CHAPTER 17

1. Harvey locates the fiscal crisis of the New York City government in the mid-1970s as the first instance of this new neo-liberal practice of blaming borrowers: "The management of the New York fiscal crisis pioneered the way for neo-liberal practices both domestically under Reagan and internationally through the IMF in the 1980s. It established the principle that in the event of a conflict between the integrity of financial institutions and bondholders' returns, on the one hand, and the well-being of the citizens on the other, the former was to be privileged" (Harvey 2005:48).
2. Though this may have been a relevant distinction when discussing liberal social order as opposed to communism or fascism, was it relevant also—as Hayek argues—when discussing (early) British versus Continental liberalism?
3. For a contemporary exposition of the inconsistencies and myths of 'free market' thinking, see Ha-Joon Chang (2002, 2003).

NOTES TO CHAPTER 18

1. This and the following two quotes are taken from the *International Herald Tribune* (2008, June 17).
2. And hence, one might add, it comforts us in terms of our desire for 'justice'.
3. See, for instance, Martin Wolf's references to the work of Hyman Minsky in *Financial Times* (14 August 2008 and 22 January 2008, to name two examples). See also an article on the work of Hyman Minsky by John Cassidy in *The New Yorker* (4 February 2008).

4. Hicks later acknowledged that Keynes' theories were not and could not be absorbed into the equilibrium system of the ISLM model: "The ISLM diagram, which is widely, but not universally accepted as a convenient synopsis of Keynesian theory, is a thing for which I cannot deny that I have some responsibility ... [T]he time came when I felt that I had done with it. I could see that it was nonsense. It does deliberate violence to the *order* in which the real world (in *any* real world) events occur" (Hicks 1977, quoted in Davidson 1991:28, emphasis in original).

5. In this terminology, cash is the most liquid asset, real capital assets the least liquid, with financial assets of different degrees of liquidity in between.

6. Keynes's theory of the monetary economy has later been further developed, by Hyman Minsky, into a theory of the interdependence of financial and production cycles. It is, unfortunately, beyond the scope of this research to discuss Minsky's contribution. For a brief overview, see Peterson (1996:161–162); Rousseas (1998:133–136); Papadimitrou and Wray (1999). For a Minskyan interpretation of the Asian crisis, see Arestis & Glickman (2002).

7. Dow describes two uses of equilibrium analysis in Post-Keynesian theory: one is partial equilibrium analysis, the other is analysis where equilibirum is conceived as a centre of gravitation in historical time.

8. I.e. the distinction between the long-term expectations of entrepreneurs and the short-term expectations of speculators in financial markets.

9. It is beyond the scope of this work to account for Post-Keynesian theory on this matter. See Dow (1996:63, 105).

10. For a range of other examples of criticism of the economists of the Marginal Revolution by contemporary physicists, see Mirowski (1989:241–275). See also the chapter on the 'The ironies of physics envy' in that same book (Mirowski 1989:354–395).

11. For an in-depth study, see Tabb (2004). See also Isard (2005).

12. OECD average annual change of gross fixed investment at constant prices; cf. Felix (1998:176).

13. The Economist, for instance, as early as in May this year devoted a 24-page 'special report' to international banking and issues of procyclicality, titled 'Paradise lost' (Economist, 2008, May 17th). See also Martin Wolf on "Seven habits finance regulators must acquire" (Wolf 2008).

14. Before proceeding, I should mention that several of these proposals draw upon the work of John Eatwell, Charles Goodhart, Avinash Persaud and Michael Pettis (Eatwell and Persaud 2008; Goodhart 2008; Goodhart and Persaud 2008; Persaud 2004a, 2004b, 2004c; Persaud and Nugée 2007; Pettis 2001, 2003). Persaud and Pettis are both 'financial-market-practitioners-turned-academic' which adds to the credibility to their proposals.

15. Goodhart and Persaud recommends that growth in the value of bank assets "would be measured as a weighted average of annual growth" using exponential weights "to emphasise more recent activity" (Goodhart and Persaud 2008). For instance, "growth above the basic allowance over the past 12 months" could have "a 50 per cent weight", growth over the preceding year "a 25 per cent weight", "and so forth until 100 per cent is approximated" (ibid.).

16. On this crucial issue of liquidity, see key contributions by Goodhart (2008), Nesvetailova (2007, 2009) and Persaud (2004).

17. "[G]iving a stamp of approval to a variety of risk-management systems designed for different types of investors would solve a coordination problem; it would become easier for fund managers to go to their trustees and say that they are not following a short-term, market-sensitive risk-management system,

but another, along the lines proposed by the regulators specifically for long-term investors" (Persaud 2004a: 102).

18. On the potential of launching a Tobin tax; see Raffer (1998) and Haq et al. (1996).

19. Pettis argues that there is no need to change the current architecture of the international financial system: the current problem "is not that global financial markets are too volatile or free capital flows too dangerous but that sovereign capital structures are not usually designed with this volatility in mind" (Pettis 2001:199). It is difficult to see, however, why the promotion of counter-cyclical liability management by sovereign states should not be supplemented with counter-cyclical regulatory measures at the international level. Why not endeavour to make international business cycles—and thereby the volatility shocks that economies are subject to—less pronounced? Surely, the results will be far better if the agenda of volatility-reduction and countercyclical regulation is pursued both nationally and internationally.

20. New FSAP assessments made for Montenegro, Sri Lanka, Turkey, and United Arab Emirates, and FSAP Updates made for Austria, Canada and Croatia. With respect to ROSCs, the vast majority of assessments made in this same period have been of policy transparency standards, with almost no assessments made in the areas of financial sector integrity and market integrity. More specifically, in this period, nine ROSCs were made in the area of Data dissemination (Chad, Chile, Dominican Republic, Grenada, Kazakhstan, Mongolia, Netherlands, St. Kitts and Nevis, St. Vincent and the Grenadines), five for fiscal transparency (Costa Rica, Kenya, Kyrgyz, Mozambique, Pakistan), two for Anti-money laundering (Sri Lanka, Switzerland) and two for banking supervision (Haiti, Sri Lanka).

21. Wade (2008) makes a similar point, using a metaphor from the IT sector. Regulation should perform a function akin to that of 'middleware', he argues: "Middleware provides a large organization an alternative to a single large software program spanning the whole organization . . . [I]t allows more scope for decentralized choice of program. Global economic regimes need to be rethought in terms of being more like 'middleware', to allow more diversity of rules and standards while keeping transactions cost down, instead of trying to get ever more uniformity" (Wade 2008:21).

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