# Making Sense of Seattle
## Distributional Conflicts, Institutional Diversity and the End of the Cold War

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The stalemate at the World Trade Organization (WTO) Ministerial Conference at Seattle, Washington lent itself to multiple interpretations. Some see it as a turning point in the tug-of-war between profit on the one hand and people and Mother Earth on the other. We argue that Seattle has to be viewed through the lenses of 20th century history, especially the end of the Cold War. This epochal conjuncture unleashed previously suppressed distributional conflicts and institutional dogmatism combined with the growing affluence of some middle income countries, which will further reshape the global market economy. 'Procedural fairness', the guiding principle behind the WTO, must begin to share the spotlight with concern for a fairer distribution of gains and a global safety net. Finally, how deep into local institutions procedural fairness should be allowed to penetrate is a problem that is highlighted even as it begs for a solution.

THE FAILURE OF THE WORLD TRADE ORGANIZATION (WTO) Ministerial Conference held on November 1999 in Seattle, Washington to hammer out new agreements on very contentious issues was claimed by the demonstrating coalition of passionate naysayers as the defeat of globalization and its trojan horses: the WTO, World Bank and International Monetary Fund (IMF). These institutions are accused of being highly paid mercenaries of multinational corporations. Predictably, the global media was riveted on the antics and slogans outside the conference, as these were infinitely more tabloid-friendly than the arcane technical sparring over 'social standards' and 'intellectual property' in the conference itself. Novelty was on the

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naysayer's side: such a statistically improbable confluence of disparate worldviews outside of Hyde Park made for a rare conceptual free-for-all, where prepostery easily trumped coherence. 'People over profits' is Raeburn's (2000) sympathetic distillation of the constellation of motives arrayed against globalization. Some tried honestly to put context above coherence (e.g., Finnegan 2000); others (e.g., Engardio 2000) were downright dismissive of the demonstrators for their lapses into incoherence and recurrent *non sequiturs*. While many issues raised were compelling regardless of logical distance to globalization, one issue—the distribution of the gains from trade between rich and poor countries and between players in each country—resonated in various guises both in and out of the conference.

Would the WTO Ministerial Conference have performed better without the demonstrations? The fact that the working committees in Geneva failed to hammer out a framework for new agreements in the run-up to Seattle already portended a stalemate in the ministerial conference. Fairness and balance in the implementation of old agreements sorely needed improvement (Stiglitz 1999). The LDCs, having legitimate gripes on agriculture, anti-dumping measures etc, and foot-dragging on the issues raised by OECD (Organization for Economic Cooperation and Development) countries were, as a group, digging in. Labor and environmental standards oscillated between disguised neo-protectionism and paleo-humanism. Genetically modified foods added to the already many difficult cleavages between developed countries.

The truth of the matter is that the multilateral cooperative enterprise on trade that started as the General Agreement on Tariffs and Trade (GATT) after World War II and folded into the WTO in the 1990s has entered a new and more contentious territory—one where the welfare theorems of economics are more guarded and stretched. Global fair play standards have begun, for good or for ill, to impact on the way nation-states manage their affairs at a time when the age-old ogre of unfair distribution of gains is refusing to be ignored. This essay attempts to put Seattle in the longer term perspectives of these issues. But before we plunge into these perilous waters, it is wise to look back and be instructed by globalism's stormy career in the last 150 years.

GLOBALIZATION EPISODES

*Post-wwii Globalism.* Post-World War II globalization started in 1947 with the wrapping up of the General Agreement on Trade and Tariffs in Geneva. It was conceived as a venue for an orderly resolution of trade and tariff disputes and an international cooperative venture toward lower tariff barriers among member countries, then still limited to 'developed', if temporarily devastated, countries. It was partly prompted by the sad memory of the Great Depression that ravaged the capitalist economies in the 1930s. Although the Great Depression started with the Great Crash in 1929 of the New York stock market bubble and was aggravated by the patently wrong-headed, credit-tightening response of US monetary authorities (which promptly mowed down the banking sector), it was deepened and prolonged by the populist but senseless tariff escalations adopted to protect dwindling domestic jobs. This confluence of factors re-ignited the hegemonic competition for 'spheres of influence' that, a mere two decades before, had precipitated World War I. The consequent call to re-arm motivated a fiscal aggressiveness that partly stemmed the economic retreat, as JM Keynes predicted in his General Theory. But apart from FD Roosevelt's New Deal, the gains were dangerously etched on a jingoistic canvass. Italy hankered for Ethiopia (then Abyssinia); Germany for Lorraine and territories east; Japan for the 'Asian Co-Prosperity Sphere' and Russia for the Scandinavian and Baltic States. Sadly unhindered, the syllogism of armaments led to wwii.

While wwii was of multiple parentage, its genetic make-up included the contest for physical space which, it was claimed, conferred exclusive markets and cheap raw materials. When states cease competing for market shares through price and quality, they invariably compete for market exclusivity with 'Stukas' and 'Zeros'. Mercantilism, imperialism and militarism are of a strain.

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A coherent Marxist challenge from the Soviet Bloc made the avoidance of the 1930s debacle an even more compelling project. GATT and

the Bretton Woods System (designed partly by JM Keynes) and its offshoot institutions—the IBRD (International Bank for Reconstruction and Development, later the World Bank) and the IMF—were to spearhead post-war reconstruction in Europe and nurture development among LDC (less developed countries) allies. In effect, they would form the bulwark against the Red tide that fed on poverty. One obvious goal was to reverse the 'mercantilistic fit' that pervaded the inter-war period and allow the states arrayed against the Red menace to compete among themselves on the basis of price and quality. The idea was to showcase a development strategy based on comparative advantage and market.

The globalism that was nurtured by GATT and the Bretton Woods System celebrated trade and market share competition based on price and quality. The natural consequence of market competition is Schumpeterian 'creative destruction', which drives institutional evolution. Institutional experimentation in market economies is a natural market survival imperative. The corporate entity called the *keiretsu* system in Japan little resembled anything in US capitalism but it worked extremely well in the era of rapid catch-up. The 'dual tract' in Taiwan (export processing zones for direct foreign investments or DFIs were insulated from the domestic sector) was a momentous institutional innovation in the 1960s that became the LDC standard in the 1970s. The 'welfare state system' in Sweden worked well before citizens became rich and cross-border mobility became a matter of walking to the train station. West Germany's 'social market model' underpinned the West German miracle. These models were not just semantic twins of each other. Market share competition based on price and quality nurtured institutional diversity. One can almost say that the market economy was multi-species.

By the 1980s, the capitalism that Lenin fought in the 1930s was long gone. Unemployment insurance and old age pensions, offsprings all of the New Deal, were now taken for granted in OECD countries. Worker stock ownership, an institution that would have sent Henry Ford frothing in the mouth, was all but the standard in information technology corporations. Indeed, Standard Oil and AT&T have been broken up by anti-trust laws. And Microsoft is about to go the same way.

In contrast, 'institutional experimentation' was suppressed in the socialist bloc (the Hungarian Commune of 1956 and the Prague Spring of 1968 and their aftermath). Trade was based largely on 'political solidarity' while the system scoffed at creative destruction. Institutional purity had become more important than outcomes. It did not matter that people were poor, so long as they were equal. This explains why Deng Shiao Ping's famous quip, 'It doesn't matter that the cat is red or white as long as it catches the mouse', was the height of heresy. It stated with succinct precision the logic behind market economies.

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China, thanks to Deng, allowed some institutional experimentation in the 1970s and 1980s (the 'household responsibility system' and DFIS) and quickly forged ahead. The 1989 collapse of the Soviet bloc in the face of a thriving Mainland China was the final reminder that institutional diversity and flexibility beats institutional purity in a world of rapid technical change. Adam Smith, it appeared, had trounced Karl Marx.

The second half of the 20th century was politically dominated by the Cold War. This massive political and economic conflict between the market and socialist camps that led to the eventual downfall of central planning and command economics is magisterially essayed by Yergin and Stanislaw (1998) in 'The Commanding Heights' and requires little additional commentary. The competition for market share, celebrated within the capitalist camp, delivered overall a superior economic outcome, which clinched the day for the market economy. While this competition seemed no more than a minor intramural preoccupation under the threat of a nuclear holocaust, the Cold War played a critical role in the success of market economies.

The market economy, whether global or domestic, is a genius at unlocking productive forces. This was true of 19th century capitalism, of which Karl Marx would observe that 'during its rule of scarce one hundred years, [it] created more massive and more colossal productive forces than all preceding generations together'. The second half of the

20th century demonstrated this prowess with even more finality. Compared with the 20th century, the 19th century seems like a standstill (*The Economist* April 15, 2000). This time around, it was a social experiment ran, as it were, with a control group—the socialist camp. The verdict was the same.

But hold your horses. The theory of comparative advantage, which anchored GATT's mandate, is fairly unambiguous in the mutual benefit of freer trade for countries involved *if* the distribution of gains problem is solved. Comparative advantage inevitably involves 'creative destruction', which produces winners and losers. The losers can veto freer trade and have done so many times in democracies. But who said democracy was inherent in the market economy? This is where the Cold War weighed in.

The Cold War muted or defanged many distributional conflicts inherent in market economies. The modalities were interesting. First, it motivated a wide berth for political and institutional diversity. The Duvaliers, the Somozas and the Marcoses rubbed shoulders with liberal democracies in a club where the only hurdle was allegiance to private property and an anti-Communist posture. Second, distributional advocates were boxed into a corner and lumped together with saboteurs and fifth columns of the Red menace. Third, cross-country intramural disparities and imbalances were viewed with remarkable tolerance. Violations of intellectual property rights (IPR) received scant scrutiny. OECD countries viewed its growing trade deficit against East Asia with a 'better trade than aid' nonchalance. Violations of GATT's fair trade rules by LDCs were largely routinely passed over. The extramural threat sustained a sort of 'lifeboat principle' within the capitalist camp.

But now the Cold War is history. Distributional conflicts will no longer be bottled by extramural eminent threats. Stalemates would become the rule rather than the exception. Seattle was just the logical culmination of the many distributional skirmishes unleashed by the end of the Cold War.

The nature of the contest among nations has changed irrevocably in the post-Cold War era. Nations now compete on two fronts (Fabella 2000a)—goods and capital. Price and quality are still the main weapons of rivalry. But the rivalry promises to be more contentious as the 'prin-

ciple of procedural fairness' becomes pulled one way and then the other to serve distributional interests. As we will argue later, it is this renewed preoccupation with distributional gains and the consequent foisting of procedural fairness that leads naturally to institutional intolerance.

*19th Century Globalism.* World War II was, in some sense, the second half of the war-to-end-all-wars, not only because the rearming and belligerence of Germany was a reaction to the onerous impositions and conditionalities on the German people in the aftermath of WWI (which JM Keynes opposed) but also because WWII was the culmination of the same dynamics that nurtured WWI—the contest for exclusive markets and cheap raw materials as the primary engine of growth and power.

The 50-year period between 1860 and 1910 was remarkable for great strides in globalization (Williamson 1997). The first, if only, symbolic shot was fired by the 'Cobden-Chevalier Treaty' of 1860, which lowered border tariffs in Europe. The decisive motive force for globalization was not political but technological change, viz, the Watt steam engine powering ships and railways and its most precious emanation—electric power, as well as chemical discoveries in Europe. The precipitous drop in transport cost, paralleling the drop in information technology prices in the 1990s, pulled back natural trade barriers (transport cost) between countries. Trips that took months now took days and sometimes just hours. Goods and people began to move between borders and continents in unprecedented volumes in search of arbitrage. The consequence was massive creative destruction. Native textile weaving in post-Meiji Japan, forced by Western Powers to free trade, collapsed under the strain of cheaper textile imports from Manchester and Bombay. To pay for its imports, Japan found a niche in silk and tea exports. Wheat and cotton from the New World paid for locomotives and railcars from Europe. Even more telling, capital turned trans-oce-

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anic in even larger proportions. Bonds floated in London financed mineshafts and rail tracks in the Americas and Asia. It seemed that the globalist trend would run forever.

But the globalist surge had an insidious political undercurrent that the keen social observer K Marx recognized and denounced. This was imperialism. The Great Powers were at each other's throats for physical space (Wells 1971). Russia, Austro-Hungary and Turkey were sparring for hegemony in the Balkans. France had designs on Syria, Africa and Mexico. Germany and Belgium wanted to carve an empire in Africa. All wanted a piece of China. The Spanish-American War mediated the transfer of Cuba and the Philippines to the US sphere of influence. The Russo-Japanese War was a battle for Korea and Manchuria. Countries resisting colonization were pried open to trade by the threat of violence. Japan assented to the 'unequal treaties' to buy time against the Western 'black ships'. China was forced into free trade by superior firepower. The logic was as follows: Global ascendancy comes with access to cheap raw materials and exclusive markets. These were guaranteed either by colonies or 'spheres of influence'. Finally, armies and battleships secured colonies and favorable, if unequal, treaties. The underlying political principles were asymmetry (as between lord and vassal) and exclusivity (as between lord and lord).

Comparative advantage, though at first greatly enabled by technology, was beginning to be hobbled by political and military rivalry. Exclusive markets left little room for contests based on price and quality. Global market shares depended on the radius of military and political dominance. This sinister undercurrent ignited many isolated skirmishes and culminated in an assassin's bullet that felled Archduke Francis Ferdinand of the Austro-Hungarian Empire in Sarajevo in 1913. *Aprés Sarajevo, le deluge* characterized the subsequent state of affairs. World War I ensued and, among others, promptly reversed the course of 50 years of technologically-driven globalism. In its place was installed almost 50 years of jingoistic autarkism.

Along the way, Latin America picked up 'import substitution' and 'export pessimism' as dogma. This was Latin America's defiant response to asymmetry. Japan dangled the 'Asian Co-Prosperity Sphere' to challenge Western exclusivity. The malady would not be cured until after

WWII with GATT and Bretton Woods in 1947. For LDCs, it took a while longer.

### *DAS KAPITAL* UNBOUND

THE 1990s saw the globalist goalpost moved farther to embrace portfolio capital. The contest for foreign capital that started from the EPZs to ever more liberal foreign investment statutes heightened with the emergence in the late 1980s of foreign investment miracles in Thailand, Malaysia, Singapore and Indonesia. Doing one better meant, to many policy makers, a capital account ever more open to short term capital flows. This created profound policy mismatches in East Asia (see, for example, Fabella 1999). With its institutions tailored for catch-up—i.e., a banking sector as appendage of manufacturing and credit allocation dominated by state-directed rationing—a crisis was being seeded by an overflow of fly-by-night capital. The bubble it created exploded first in Mexico in 1994, and then in Asia in 1997.

The phenomenon of zillions of dollars zipping through cyberspace at warp speed has received the correspondingly voluminous commentaries it deserves (see, for example, Grieder 1997). It has also aggravated a 'syndrome of helplessness' in developing countries with regard to the control of their own destinies (e.g., The Copenhagen Seminar 1997). This tended to reflect rhetorical resignation in the West. When faced with the closure of a microchip factory in his own constituency, PM Tony Blair remarked: 'We can't as a government do much about the twists and turns of world markets in an increasingly globalized world.' (*The Economist*, May 6, 2000) We will deal with two global issues pertinent to this essay, namely, capital account liberalization with regard to short-term flows and the great danger posed by institutional convergence.

**But where is it written that capital should be freely mobile? Indeed, where is it written that the exchange rate must be either fully fixed or fully flexible?**

The 'helplessness syndrome' in the face of global capital is clearly exaggerated. The whole East Asian tigerdom developed with hardly a capital account open. Taiwan and Mainland China, which survived the capital flight-driven Asian crisis, both had some mechanisms to restrain

footloose capital. Economic models do not justify this sense of helplessness. The Mundell-Fleming framework says only that if capital is freely mobile, then an economy loses fiscal autonomy if its exchange rate is fully fixed; it loses monetary autonomy if its exchange rate is fully flexible. But where is it written that capital should be freely mobile? Indeed, where is it written that the exchange rate must be either fully fixed or fully flexible? Something in between can be efficient if the accompanying package of policies is consistent.

Early in the Asian crisis, the IMF's standard reaction was a ritual denigration of all forms of capital flow intervention; instead, it rammed down the prescription of high interest rates. Of late, thanks to incontrovertible facts, the IMF has softened its position: price-based interventions (for example, tax) are consistent with an open capital account; quantity-based interventions (for example, currency inconvertibility) are inconsistent (Eichengreen and Mussa 1998). The latter are understood nowadays to constitute the reflexively disparaged 'capital controls'. Price-based intervention can slow down footloose capital considerably. Chile's intervention is of this sort. Thus, it is obviously a false claim that the only options for an economy are either a completely open capital account or marginalization. Consistency of the policy package is, by far, more important than ritual purity.

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If contagion played a big part in the Asian crisis, it was precisely because most East Asian policy makers tried to outdo each other in the pursuit of the same capital account architecture—'opener than thou'. This architecture was eminently vulnerable to 'herd behavior' among fund managers. In contrast, the contagion foundered where countries shunned this architecture, viz, Taiwan and Mainland China. This is no different than the vulnerability of the world information network to virus assaults when it runs on only one engine, say Microsoft Windows. Institutional diversity is valuable for stability.

The Asian crisis confronted East Asia with a fork in the road: either slow down portfolio capital account opening, as did Taiwan and Mainland China, or plunge into more massive institutional reconfiguration to accommodate free portfolio flow, a path favored by multilateral banks that controlled the loan windows. Here was the window of opportunity for a new institutional dogmatism, a way to further leverage the post-1989 ideological high ground. The IMF and the World Bank appeared to spearhead this dogmatism.

## INSTITUTIONAL IMPERIALISM

THE end of the Cold War intensified the distributional conflicts among trade partners and quickened the frequently bogus recourse to 'fairness' as a basis for retaliation. Instruments such as the 'Super-301' of the US State Department, anti-dumping laws and the single-port-of-entry rule the French imposed on Japanese goods began to proliferate. Even the European integration had a 'Fortress Europe' flavor.

Now market share is won or lost on the basis of price and quality. The price of a good reflects its cost of production, which itself derives from the price of labor, the price of capital and the price of cooperating nontraded factors and services. In the interest of procedural fairness, all these are now subject to scrutiny. Labor standards may be too lax and unionism outlawed, which artificially lowers the price of labor. That is unfair. Capital may be subsidized and that is unfair. The entry of imports may be restricted by a biased retail system and that has to change. The quintessential example was the long-running US-Japan trade dispute that touched many previously overlooked concerns: city zoning laws (which allegedly restricted US-type supermarkets), Japanese procurement, the left-hand traffic drive system and the six-day work week.

The application of procedural fairness in trade disputes among countries entered the arena of the nontraded goods sector (services) and institutions (way of life). Services was becoming the dominant sector in developed countries in the West and the West's comparative advantage there could be better leveraged if services trade and investment became regularized. GATT had to evolve into something more compre-

hensive. Hence, the WTO. The new issues involved trade in services to be addressed by the General Agreement on Trade in Services (GATS), and foreign investment, especially in services, to be addressed by Multilateral Agreement on Investment (MAI), etc. The unfinished business trade in agricultural products was also folded in.

But procedural 'fairness' always involves rules and standards by which everyone plays, and there is the fundamental problem of defining the standards. Should the US employer-employee relation be the standard? Should OECD pollution laws be the standard? Should Western redress of grievance structures be the standard? If US motorcar export penetration of the Japanese market is four percent and Japanese penetration of the US market is 10 percent, is this indicative of unfair practices or of Japanese taste? Is Japanese *Katakana* script an unfair trade barrier? These are very disturbing issues because they intrude into how nations define themselves. These also encourage institutional convergence to conform to the fairness principle. Thus, the WTO can become the enforcer of uniform institutional architecture, which begets instability as we saw with the 'opener than thou' capital account.

From a slightly different angle, the World Bank and the IMF, prompted by the absence of progress in many LDCs despite trade opening and the realization that good institutions and governance played a big role in the East Asian miracles and in Latin American successes (largely Chile and Argentina), expanded their mandate from 'getting prices right' to 'getting institutions right'. LDCs have failed to seize the opportunity of freer trade because they are saddled with wrong institutions that do not complement the market. If the right institutions are in place, governance would improve and the component of the cost of production due to nontraded goods would retreat. These countries' goods would consequently become competitive even as they attract more direct foreign investments. The result is the 'Washington Consensus'.

## THE WASHINGTON CONSENSUS

THE various aspects of the new post-1989 orthodoxy coalesced into what became known as the Washington Consensus, a list of do's and don'ts allegedly distilled from success experiences in Latin America and East Asia. It is an amalgam of 'prices matter' and 'institutions matter' agenda.

**TABLE 1. The Washington Consensus**

I. Fiscal discipline
   1. Budget deficits should be measured to include those of local, state and national governments as well as the central bank.
   2. Budget deficits should be small enough to be financed without inflation tax.

II. Public expenditure priorities
   1. Resources are allocated based on economic, not political, merits.
   2. Typically, administration, defense and subsidy expenditures are reduced so that primary health, education and infrastructure expenditures can be increased.

III. Tax reform
   1. Broaden the tax base and cut marginal tax rates.
   2. Improve horizontal equity without lowering progressivity.

IV. Financial liberalization
   1. Market-determined interest rates.
   2. If this is not possible, then abolish special rates for preferential borrowers at *a modestly positive real interest rate.*

V. Exchange rates
   1. Create a unified exchange rate set at a level sufficiently competitive to induce growth in new export markets.
   2. Currency policy should be stable so as to assure exporters that competitiveness will be maintained in the near future.

VI. Trade liberalization
   1. Tariffs should replace quantitative trade restrictions.
   2. Tariffs should be gradually reduced to 10 percent over a period from 3 to 10 years depending on macroeconomic conditions.

VII. Foreign direct investment
   1. Barriers that prevent the entry of foreign firms should be removed.
   2. Local and foreign companies should be able to compete equally.

VIII. Privatization
   1. State enterprises should be privatized.

IX. Deregulation
   1. Governments should abolish regulations that impede the entry of new firms into markets or otherwise restrict competition.
   2. All regulations are justified by criteria like safety, environmental protection or prudential supervision of financial institutions.

X. Property rights
   1. The legal system should be able to secure property rights without excessive cost and make these available to the informal sector.

* Source: Williamson 1994.

Table 1 (Williamson 1994) gives the bill of particulars of the agenda, viewed from pre-Asian crisis lenses. It has four main parts: fiscal reform agenda (I, II, III), domestic liberalization agenda (IV, IX), foreign deregulation agenda (V, VI, VII) and institutional agenda (X). Its better-known summary—'globalization, liberalization and deregulation'—encapsulates, to many, the action program of the World Bank and the IMF.

As a proposed distillation of the underpinnings of successful economic catch-up of the last 40 years, the Washington Consensus is hard to fault. Fiscal discipline and more economic deployment of fiscal resources serve both efficiency and equity. Collecting tax due is progressive and helps finance high returns spending in health care and education. A competitive exchange rate protects domestic producers. The excessive tariff and non-tariff barriers that it wants pulled back are the classical breeding ground of corruption, even as they distort domestic prices. The right FDIs raise investment, exports and employment. Privatization improves service quality by insulating price and factor decisions from political influence, even as they unburden the state of a large fiscal drag. Deregulation raises the level of competition and forces market discipline. Finally, property rights protection is the core value of a market economy.

However, many people (e.g., Root 1999) think the Consensus is short on institutions and governance. Since 1994, with the Asian Crisis and the continuing Russian Big Bang experiment as additional laboratories, the set of accepted market-supportive institutional arrangements has expanded beyond property rights. A properly functioning market economy needs in addition (Rodrick 1999): (a) a regulatory capacity to complement privatization and deregulation; (b) institutions for social insurance and safety nets to mitigate the cost of Schumpeterian creative destruction; (c) institutions for enforcement of rules and redress of grievances; and (d) institutions for macroeconomic stabilization. The Washington Consensus has clearly moved from an emphasis on outcomes (less distortions in prices and more 'head-than-heart' in the use of fiscal resources) to an emphasis on modalities and institutions. But institutions are part of how nations see themselves. How the implementation of the Consensus will avoid a bias toward particular institutional set-ups (for example, liberal democratic) is a difficult maneuver.

'Market determined interest rates' are a case in point. The idea is that this will reflect the true scarcity value of capital and channel scarce capital to borrowers who can best use them. But the frequency of market failure (which is normal even in developed countries due to substantial private banking moral hazard) led to local experimentation to deal with this problem. In Post-War Japan the 'main bank system' was one such outcome and, together with 'tight money', worked very well and indeed was for a while a real challenge to the US banking system. It was able to funnel resources to manufacturing and away from bubble-prone and corruption-endemic real estate. The Stiglitz-Weiss moral hazard logic was working. When Japan, following the historic 1985 Plaza Accord, which forced the yen to appreciate with impunity, shifted to 'easy credit' to ease the pain, the implied credit rationing of the 'main bank system' became irrelevant and credit instead began to fuel the 'bubble economy'. The collapse of the 'bubble economy' has since discredited the main bank system and overshadowed the Japanese economic landscape. But the whole pre-bubble institutional package in Japan worked wonders in the catch-up stage. In contrast, the Washington Consensus looks with disfavor at such 'alien' institutional arrangements as anti-market and non-transparent and would have vetoed them from the start. But it is doubtful whether the Japanese economy would have performed as well as it did in the 1960s and '70s without the main bank system.

This issue is illuminated as well by the debate on Mainland China's groping toward some form of a market economy. To Sachs and Woo (2000), the success of Mainland China reflects its institutional proximity to the institutions usually found in market economies. The policy prescription is simple: Accelerate the convergence of Chinese institutions to the accepted blueprint. The blueprint is already there; it need not be reinvented. Abandon state corporations in the choppy sea of the market. Contrarily, for Lau, Qian and Roland (1997) and Qian, Roland and Xa (1999), the Chinese gradualist approach of allowing the private sector to capture an ever larger portion of the economy, thereby gradually chipping away at but not abruptly severing the umbilical cords of state corporations (the dual tract), is a superior compensated Pareto efficient strategy. It is a safety-net approach to transition that respects

history and social stability. As is well known, the Chinese authorities adapted the phrase 'market socialism' to describe the system and would prefer the economy to converge to some variant of the 'East Asian model', not to the 'Wall Street model', of capitalism. Had the IMF had its way, it would have been 'Big Bang' part two. Russia would have loved the company in its misery.

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The problem with institutional conditionalities is that the Multilateral Banks (MLBS) have to assume that they know more than they really do. The World Bank made the Philippine power restructuring program a condition for loan access. This restructuring program is comprehensive—inter-class, inter-franchise areas and inter-grid subsidy abolition, state power generation (genco) privatization, retail competition and electric power auction market. The original domestic private sector clamor was more modest: lower electricity prices to industry via the abolition of inter-class subsidy and retail direct wheeling. The World Bank raised the ante by dangling a loan and turned the limited and purely local debate into a multi-front and, even worse, a sovereignty issue. It does look like a bill in some form will be passed but the danger of mangling is high. While comprehensiveness has very distinct merits, a greatly mangled comprehensive plan, however well meaning, may be worse than a modest sequential one. There is great uncertainty here and ample room for debate.

The strength of the dynamic market economy is precisely its orientation toward outcomes and its capacity to coexist with diverse institutional arrangements. Institutional diversity is the mother lode of an ever-changing market economy. The MLBS could do more harm by forcibly eroding institutional diversity and preventing local experimentation.

### THE WASHINGTON CONSENSUS AND GOVERNANCE

GOVERNANCE is the capacity of the state to enforce its laws and promulgations at ground zero. This capacity depends partly on the nature of laws themselves. If laws are perceived as 'beneficial', they elicit from

the citizenry both compliance and cooperation in their enforcement; if laws are roguish and predatory, they elicit contempt and either indifference or active participation in their violation or subversion. In the case of rogue laws, moreover, enforcers become mere paid mercenaries and, as such, are open to the highest bid. The consequent 'truck and barter' of enforcement of rogue laws *infects* the enforcement of beneficial laws and the whole standard of enforcement is eroded. Since rogue or predatory rules heap rents upon a small sliver of the polity, the law-making authority can sell these rules to potential private beneficiaries who invest in rent seeking. When legislators are elected by the citizenry, citizens may first opt to sell their votes in order to partly offset the burden of rogue laws. But the more important instrument of citizen resistance to rogue laws is disobedience. This perverse spiral of marketization of votes, rules and enforcement is at the heart of the so-called 'soft states' (Myrdal 1970). The soft state is a market solution gone berserk.

One way to break the vicious circle is to slash and burn the forest of rogue laws. The 'globalization, liberalization and deregulation' thrust of the Washington Consensus has precisely this effect on the forest of corruption. Laws or rules that restrict voluntary trade, discriminate between market agents, and restrict entry and competition are generally rogue laws that provide rents for the elite and their cronies. These in turn can be, and are, bought and sold to the highest bidder. Cutting down these laws not only reduces pockets of corruption but also raises the enforcement standard for the remaining beneficial laws (Fabella 2000b). This governance outcome is easily more important than the reduction in price distortions and the direct rise in the market efficiency of specific sectors. Unwittingly, the Washington Consensus may be a most effective governance program.

Despite its many detractors who seem to co-extend with those of globalization itself, the Washington Consensus as a set of enabling outcomes is not a bad road map for LDCs on the way to the market economy. LDCs should, however, be allowed time to experiment with institutional arrangements that best reconcile these outcomes with their own socio-cultural heritage. They should choose their version of the market economy. The imposition by multilateral banks of specific in-

stitutional structures or a specific market regime (most likely evolved some place else over long periods of trial and error) either court failure or threaten institutional diversity if successful.

If a country is unable to pay the price of institutional adaptation and decides to chuck part of the Washington Consensus, it should be free to do so. Its market economy will be more truncated but slower growth is just another price it pays for the privilege to define itself. If it overreaches economically, given its preferred institutions, it will go into a tailspin and inherit a payment crisis, which opens the door to the World Bank and the IMF. Economic viability and sustainability is the best defense against outside intervention and the best guarantee of institutional independence. Institutional independence is the privilege of the prudent.

## CONCLUSION

MARKET competition, both within and without political borders (globalization), is without any known peer at unlocking productive forces over the long term. However, it has a number of dark and sinister sides. First, at the heart of market competition is ample room for individual self-interest combined with a (some will say, quixotic) reliance on the 'Invisible Hand' to promote social welfare. No doubt, there are many instances when this backfires because the heretofore unstated third fundamental theorem of welfare economics states: 'The Invisible Hand is not omnipresent.' For best results, market competition is consequently usually circumscribed by an appropriate regulatory framework, which sees to it that the rules of the game are adhered to fairly. For it to be efficient, market competition requires a modicum of governance that will maintain procedural fairness (Kuttner 1997).

Second, central to and synonymous with market competition is 'Schumpeterian creative destruction'. The testimony of history is that this creative destruction, like simple voluntary exchange, is a positive sum game. But a positive sum game, even if procedurally fair, need not be (ex-post) outcome-fair. There are always winners and losers. Within political borders, governance and institutions have evolved to provide 'safety nets': unemployment insurance, solidarity groups such as the Iglesia ni Cristo, the welfare state, and even mom-and-pop stores in

Japan. These are financed by some tax on the winners (for example, zoning laws in Japan impose an implicit tax on consumers who support mom-and-pops). These are mechanisms to render the presumably procedurally fair market economy less outcome-unfair. But there is great danger here. Outcome fairness can be pushed to the point of negating the private incentives to self-seeking in the market economy and the engine simply stops.

Unlike market governance within political borders, there are no mechanisms to mitigate unfair distributional outcomes in the global economy. The WTO is, in theory, a mechanism to safeguard procedural fairness in global market competition. We have argued that even at this limited task, the WTO (and the World Bank and IMF) has become too invasive because procedural fairness is subtle. J Rawls (1971) had to resort to the fiction of the 'veil of ignorance' to safeguard procedural fairness in the Rawlsian game. The mitigation of unfair outcomes is not and, many conservative thinkers will say, should not be the WTO's or anybody's concern.

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Within political borders, outcome fairness is usually paid tribute to because losers have a 'voice'. Under democratic governance, losers can and sometimes do veto a procedurally fair game if the likely outcome is unfair. Voice and fair outcomes are natural partners. In the pie division game with reversion, two players must agree on a division of a pie or the pie reverts back to the donor. That each player has a veto over an allocation serves to ensure a fairer allocation. 'Voice' in the governance of global competition is not directly served. The EU Parliament in Brussels is a nascent attempt to serve 'voice'.

The absence of this voice, or its distant cousin, underlies a good part of the frustration in Seattle. This heroic attempt at securing a hearing may already be starting to bear fruit, even if couched on procedural grounds. The WTO in late May ruled that the EU has discriminated (procedurally) against Ecuadorian bananas in favor of Lomé Convention bananas and has awarded Ecuador $200M worth of countervailing duties against EU goods. That's a step in the right di-

rection. However, the question of whether more of this will be enough remains.

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