Stephen Grenville
Good advice gets a bad name in South-East Asia
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One legacy of the 1997 Asian crisis is regional suspicion of the International Monetary Fund and, to a lesser extent, the World Bank.

In Jakarta now, the IMF label on any policy is virtually a kiss of death. The consequences go beyond the composition of Indonesia's cabinet, where one well qualified candidate for finance minister was recently vetoed because she had spent time at the Fund. Such attitudes leave economic policymaking open to influence from the self-interested and the ignorant.

While the Fund's performance during Indonesia's economic crisis was inadequate, the criticisms made, including by this writer, were not of the Fund's basic model but of its rather naive implementation. Many Indonesians, however, largely blame the severity of the crisis on the IMF. It is irrelevant that this reflects excessive paranoia and misallocates responsibility between the Fund and the domestic authorities. The damage is done: it has given good policies a bad name.

Beginning in 1967, Indonesia experienced three decades of 6-7 per cent annual growth that took it into the same league as Thailand, the Philippines and even Malaysia. The basis of policy was a soft version of the Washington Consensus, the kind of sensible, conservative, academically founded advice dispensed by Washington-based institutions for the past few decades. The central elements of this policy, though eroded over time, focused on reliance on markets (including market-based exchange and interest rates), openness in international trade, reduction of regulations and subsidies, and diminution of the role of state-owned enterprises.

Indonesia's 1997 crisis revealed the missing dimensions: inadequate banking supervision, excessive offshore borrowing by the private sector and an inadequate legal and administrative infrastructure. It also revealed weaknesses in areas where tenets of the Washington Consensus did not hold, including wasteful expenditure on state-sponsored industrialisation and resource allocation by non-market methods, not to mention straight corruption. The lesson of the crisis was to strengthen those elements which failed and to build the longer-term governance and institutional infrastructure needed for successful market-based policies.

With Indonesia's political parties sensitised to these issues, it will be hard to bring a rational framework to tackling challenges such as attracting foreign investment, making sense of new decentralisation efforts, reviving the privatisation of state enterprises and, most urgently, whittling away budget-sapping petroleum subsidies.

Thailand mirrors this anti-IMF view, although less vehemently. It repaid its IMF borrowings early and asked the Fund's Bangkok representative to leave. It is experimenting with a "third way" of low interest rates and off-budget stimulus. But will this push things too far? Could a rise in household debt, prompted by low interest rates, cause problems? So far so good, and Bangkok's comparatively strong bureaucracy is likely to keep policymaking closer to the conventional model.

Indonesia's best hope may be to follow a similar middle way, with less genuflection to some of the purest forms of the Washington Consensus (leading industrialised countries, after all, are hardly in a position to lecture others on budget deficits), while retaining central elements such as free trade principles and market-based pricing for interest rates. There can be enough heresy in such policy to satisfy the IMF's detractors, while retaining core elements.

On the larger stage, the legacy of the crisis is that South-East Asia now looks to its own region for its international institutional framework, mainly through variations of regional agreements such as the Chiang Mai Initiative covering bilateral swap arrangements. There is nothing wrong with stronger regional arrangements, but if they come at the expense of links with the multilateral institutional framework, everyone will lose. The wider framework provides leavening to the region's penchant for interventionist policies. The task of institution building can also be assisted by links to countries outside the region which have already done the job.

While South-East Asia is groping towards a new policy framework, the IMF should continue its own adaptation so that it has helpful answers for the more rational among its critics.

The writer, a visiting fellow at the Lowy Institute for International Policy, is a former deputy governor of the Reserve Bank of Australia