

## **IMF: Its Role in the Asia Pacific Region**

### **Response to William Holder, Deputy Chief of Counsel, IMF**

**Tim Lindsey**

BA(Hons); BLitt(Hons); LLB; PhD

Associate Professor of Law  
Director, Asian Law Centre,  
University of Melbourne

I can't completely agree with the rosy picture of IMF reforms in East Asia presented by Mr Holder. I see the post-crisis reforms as mixed bag, at best. Clearly some IMF-assisted states have fared better than others. South Korea sits at one end of the spectrum as a patient that has responded reasonably well to the IMF's bitter pill while Indonesia languishes at the other end, still the sick man of East Asia, despite more than 3 years, massive institutional reform and one of history's largest financial bail-outs. And then there is the troubling anomaly of Malaysia, which has rejected IMF intervention, run its financial policy in direct contradiction to IMF-Washington orthodoxy and seems surprisingly well, or at least in remission.

On paper, since 1997 the IMF, in partnership with the World Bank, has succeeded in pushing East Asian governments to pass an enormous swathe of statutes, well over 200 in the case of Indonesia alone. Many of these reflect what might be called 'World best practice'. They have also succeeded in supporting a huge range of new institutions, from new courts, to competition commissions to anti-corruption agencies.

On the ground, however, it is not clear whether these reforms have achieved much. The traditional problems of institutional weakness and widespread failure to enforce new laws means that much of this new framework is rhetoric – window dressing. Even that has some value, of course. In some cases, it setting a stage for further reform and establishing what one IMF official described to me as the 'thin end of the wedge' but it doesn't amount to much more. In other cases, the recipient countries would have been better off without failed reforms like the Commercial Court in Indonesia which, set up in spectacular haste to attract investors, actually drove them away because its avoidable failure was seen as demonstrating that the judiciary was 'beyond redemption'. The problem here is that many of the IMF's failures, like the Commercial Court debacle could have been avoided with better-planned strategies of assistance.

I would now like to look at what went wrong with IMF post-crisis assistance. In doing so, I face two limitations: the first is the 10 minutes allocated, which puts me in the dangerous position of standing between you and dinner; and secondly, my own limited knowledge, which leads me to restrict my comments to Indonesia.

The over-arching source of problems for the IMF in Indonesia and elsewhere has been the strategy of '**conditionality**', that is, the practice of making financial assistance in the form of loans contingent on implementation by the recipient government of certain policies, more specifically, the introduction of legislation and new institutions. Conditionality creates problems for the IMF in its dealings with East Asian countries for a series of reasons.

First, the issue of **sovereignty**. Whether intended or not, conditionality in severely economically-affected countries such as Indonesia results in an effective transfer of sovereignty

(in the sense of popular and democratically-accountable control over government policy) to a foreign body that stands outside the political process of the recipient countries. The extent to which conditionality results in a transfer of sovereignty can be understated. Since the IMF intervention in Indonesia, almost every major legislative reform that has gone through the Indonesian DPR or Parliament has been determined by letters of Intent agreed by Indonesia and the IMF. I should indicate here that I simply don't accept that the LOIs are the product of equal negotiations between the Indonesian government and the IMF, whatever formulaic assertions are made that this is the case: the relative bargaining positions are just too far apart for that to be possible. This means that these huge programs are in essence largely imposed and that means their local political support is always wanting, at best. This makes them likely to fail and perhaps they should.

In a 'rats in the ranks' moment The World Bank's former chief economist and now chief heretic, Joseph Stiglitz has said that:

...[c]onditionality is at least widely perceived to have undermined transparency and participation [and] there is little evidence that it has achieved much in terms of better policies. The result should perhaps not be that surprising, given that policies imposed through conditionality are seldom politically sustainable

Despite these problems, however, extent of the control the LOIs have over domestic policy is vast, right down to basic commodity prices for petroleum, plywood, kerosene, etc., as well as macro-economic policy. Leaving aside the question of whether democratically elected governments, such as Indonesia, should surrender control over government to foreign bodies not elected by their constituencies, it remains the case that conditionality creates significant local resentment through a strong perception – whether or not justified - of foreign intervention and neo-colonialism. This sometimes manifests in the form of outright opposition to IMF programmes but, more commonly, and perhaps more damaging, to bad faith and covert sabotage on the part of those whose job it is to implement conditionality programmes.

The next issue is that of **capacity**. The IMF, began its operations in the 1940s essentially as a body to peg currencies. Following abandonment of the Bretton Woods agreement, it found itself a new role as a financier of last resort for developing countries, beginning with Mexico in the 1970s. It has now found itself forced by the scale of the economic crisis of the late 1990s and its own practice of conditionality to become de facto government for many developing states. The IMF's core capability is in lending. It would be unrealistic to expect it to have skills across the board in every aspect of government in a range of radically different countries. These problems are only magnified when the IMF is heavily involved in a series of countries simultaneously, from East Asia, Central Europe to Latin America and now Turkey and yet that is what conditionality requires of it. Dare I suggest it has over-reached itself?

The next problem is that of **transplanting laws**. One of the usual solutions of a major multilateral organisation to the complexity of the task of law reform in East Asia they impose on themselves through conditionality is 'blueprinting', that is, importing 'World best practice' legislative schemes or institutional models to recipient countries. Naturally this seems a reasonable response given that the past experience of many developing countries is also that of developed countries and it would seem pointless to 'reinvent the wheel'.

However the problem with blueprinting as a form of legal transplantation is that 'World best practice' isn't necessarily local best practice. The complexity of the tasks faced by multilateral organisations creates a certain degree of laziness - or perhaps a tendency to generalise - about

the problems of developing countries, particularly in the legal sphere. The German legal theorist Teubner argues that most transplants are 'legal irritants' and the result of that irritation may not be the desired pearl of reform but something quite different. So the World Bank's huge judicial independence reform program in Fujimori's Peru had to be cancelled in its early stages because Fujimori was using to undermine and weaken the judiciary!

The practice of blueprinting, importing models from other countries with little amendment, also leads to programmes of law reform that are rushed through. The fact is that most law reform is an extremely time consuming process. The Australian Trade Practices Act took between twenty and thirty years to develop and introduce and is still undergoing change. Likewise, the fiasco of our attempts to create a national Corporations scheme took the best part of half a century. Yet countries like Indonesia are forced to introduce substantially new areas of law in which they lack experience and jurisprudence - for example bankruptcy - in a matter of months or a year or two at best. This is perhaps the key cause of problems with IMF-backed law reform in Indonesia - an over-simplistic approach to the introduction of new legal frameworks and a rushing of major changes in an extremely complex and volatile political context of radical change; arguably the most sudden and severe economic collapse of any country in the last century; and widespread ethnic, religious and political fragmentation..

The final issue that I would identify is that of **dealing with the past**. The fact is that most of the multilaterals, in particular the World Bank, were heavily involved in lending in Soeharto's Indonesia. As was noted at the time, although not widely advertised - and certainly not considered politically palatable for public discussion - around thirty per cent of most transactions were creamed off in corrupt payments, much of it ending up in Soeharto family foundations. Naturally there was little choice for aid organisations that wished to be active in Indonesia, however the fact remains that the economic crisis was to a large extent caused by the corrupt practices of the former ruling elite with whom aid agencies cooperated.

Under Soeharto, the current leaders of reform in government and newly emerged civil society constituted a sort of opposition in Indonesia. They therefore react with hostility to conditionality demands from the multilaterals. They say, in summary, "you collaborated with a former dictator who destroyed the legal system and attempted to silence us. You put money into his system, however some of it was going into his pockets. Now you criticise *us* for economic failure, demand rectitude, insist on major reforms and threaten to economically punish us if we do not comply."

This is, of course, another aspect of the issues already raised: the question of the **moral authority** of the multilaterals to impose reforms on a new Indonesia. I don't accept that the multilaterals or the IMF are acting bad faith. I believe that they are motivated by a genuine wish to improve conditions in these countries. However, the sense of rigidity and inflexible adherence to US-driven regulatory orthodoxy is inappropriate in dealing with the new dispensation in Indonesia. We can put Michael Camdessus' folded arms behind us, but the fact remains that the IMF, the World Bank, the Asian Development Bank and the UNDP must take steps to present themselves in a less 'neo-colonial' and inflexible fashion if it is to win the hearts and minds of Indonesian reformers rather than just their grudging compliance masking covert sabotage of the programs of conditionality.

Perhaps I will leave you with an **image** from a century and a half earlier that still resonates in contemporary Asia. That is the arrival off Japan of the American Commodore Mathew Perry and his 'black ships'. Perry used gunboat diplomacy to secure for the United States what no other major trading power had been able to achieve through negotiation. The final agreement

was formalised between the US and Japan as the Treaty of Kanagawa in 1854, with similar treaties between Great Britain, France, Russia and Holland following shortly afterwards. Not surprisingly, these treaties became known as the 'unequal treaties'.

The shock and shame of having to acquiesce to Perry and the foreign powers fuelled a relentless commitment to improving Japan's legal infrastructure. The Japanese understood that national sovereignty was at stake. They opened their borders and made political and legal reform a top priority. The reforms were made in bad faith and were widely sabotaged in their implementation,

But despite the 'bad faith' of the treaty-driven reforms, changes such as the creation of legal profession and the education of Japan's lawyers had a momentum of its own, one ultimately more significant than the short-term consequences of Japan's formal obeisance to Perry. That momentum may have begun with a shock but it ended as a wave. It ultimately took the best part of a century to transform society: not an easy one for a multilateral consultant to tick off an 'outcomes' list at the end of a 3-month 'Green beret' tour of law-reform duty in Jakarta.

The Perry case reminds us of the long-term transformative potential of foreign involvement in law reform, although the 21<sup>st</sup> Century rider is that must be done with care and patience. This is because although legal transplants are inevitable in developing countries simply because they can be so effective, they are at the same time an inevitable source of tension. As in Japan, most significant law reform anywhere proceeds on the basis of studying other peoples' experience. Naturally, this is often mediated through foreign legal experts and the presence of foreigners to 'instruct' locals becomes problematic in itself, in many cases simply because of images of bad faith implicit in Western foreignness in Asia, rightly or wrongly: neo-colonialism, exploitation and arrogance. The most ominous words in the history of comparative law are surely 'we are here to help you' and foreign legal advisors are an easy target for the charge that they are engaged in neo-colonialism - taking control covertly by recommending changes that favour themselves or their own national interests.

The IMF does not come like Perry with guns at the ready: but conditionality is a potent weapon in its own right and both Perry and the IMF share the common motivation of the politics of international trade. Whatever the rhetoric, the IMF is committed to deregulation and the Post-Washington Consensus with all its attendant problems and is supported by US ambitions of creating a prosperous East Asia that opens markets to its businesses and capital. Most foreign donor and lenders are driven by the needs of the creditor/investor nations they represent. In its new role as global financial fireman it is still subject to control by the European Union, Japan and, most of all, the US Treasury, simply because they are its biggest contributors and votes on the board match contributions. Any decision the IMF takes about the affairs of a donee country must therefore be acceptable to the US government and will be coloured by the Fund's political need to satisfy its 'owners', as Stanley Fischer has admitted.

It would be nice to think the West had moved beyond anchoring a gunboat off the coast of Asia and demanding a treaty and a new court but there can be little doubt that broader political context of how the IMF operates means that some Asian decision-makers view 'conditionality' law reform as not that far removed. This means that foreign advisers acting in good faith have a double burden - to deliver options for reform and ensure that it is understood that the final decision really does lie with their hosts.

**Let us hope that the more moderate approach to change apparent in the latest, far more modest, LOI signed with Indonesia continues and that with a more realistic appraisal of**

**the need to base East Asian law reform on gradualism, tailored projects and negotiation that conditionality reforms become an irritant that produces a reform pearl without killing the national oyster in the process.**