Reform first requires recognition of a wrong
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The former managing director of the International Monetary Fund, Michel Camdessus, was back in Jakarta last month for the first time since his infamous arms-crossed triumphalist photo standing over former president Soeharto in 1998.

Now he makes the surprising claim that Indonesia's progress since the 1997-98 crisis is evidence that the fund's prescriptions were right all along.

Camdessus' self-satisfied comments on his return to the scene of the crime only demonstrate that he still doesn't get it.

Indonesia, having experienced three decades of rapid growth before the crisis, has only recently clawed its way back to the pre-crisis level of per-capita income.

No one wants to attribute this tardy economic recovery entirely to the IMF's ministrations, but to talk as if it has all turned out for the best demonstrates just how far Camdessus is out of touch.

One problem was that the IMF misdiagnosed the problem from the start.

The central economic issues were severe foreign capital flight, combined with a fragile and immature financial system.

With ironical mistiming, at the very moment the Asian region was struggling to cope with an overwhelming volume of volatile international capital flows, the IMF was advocating a rewrite of its own rules to make unrestricted capital flows mandatory for its members.

Driven by a doctrinal belief that free markets would sort out these problems, the IMF was slow to recognise the need for some co-ordinated arrangement for foreign debt rescheduling.

The efficacy of debt standstills and renegotiations was demonstrated a few months later in Korea, but this learning on the job came too late to help Indonesia.

The fund's macro-policy response was based on the irrelevant experience from Latin America 15 years earlier: "When in trouble, tighten policy."

It began by pushing the fiscal lever the wrong way. The IMF thought falling exchange rates could be propped up with higher interest rates (despite the failure of such policies in the UK and Sweden five years earlier).

The rapid expansion of base money was seen as a sign of weak monetary policy, whereas it was the symptom of a banking system in the process of collapse.

If institutional weakness was a central element of the problem, how much better is it now, after nearly 10 years of IMF tutelage?

In the financial sector, where the IMF claims special expertise, the outcome of all this has been mediocre at best.

It was only last year that Indonesian policymakers gained the confidence to break free of the IMF strictures and adopt the monetary policy regime that is best practice around the world - using interest rates as instrument rather than the textbook base money multiplier.

The IMF's plan for privatising the state-owned banks was always going to be politically unacceptable. Today, nearly 10 years after the crisis, these banks remain majority-owned by the state, with all the governance and efficiency problems implied by this.

Efforts to make the financial sector more crisis-proof - through financial safety net procedures and a proposed universal supervisor - would require complex new institutions in a country that has trouble even maintaining the existing ones. Anyone doubting that the IMF is still out of touch with reality in Jakarta should look at the IMF Article IV consultation documents for Indonesia released last month, which include an esoteric study of banking stability based on options pricing models.

This might be of interest in the antiseptic laboratory environment of academia but the two largest banks are state-owned, with only a tiny fraction of their shares traded in the market, making options pricing meaningless.

Nor has the key issue of central bank independence been assured. The IMF was slow in responding to the blatant attack on central bank independence in 2001, when a former governor was given the choice: take an ambassadorship or go to jail.

Thanks to advice from IMF "experts", the central bank's balance sheet has been lumbered with a load of zero-interest bonds, leaving its profit and loss intrinsically underwater.

As a result, a theoretically independent bank distorts monetary settings in its bid to avoid going cap-in-hand to the government for recapitalisation.

Camdessus wonders why the East Asian countries have spent so much effort trying to build regional alternatives to the IMF. Any business person knows the answer to this: when your customers want to shift their business elsewhere, you must be doing something wrong.

Emerging countries such as Indonesia need an IMF that is trusted in its judgements and relevant in its policy prescriptions.

The first ingredient of the reform that is needed is a recognition that something went wrong.

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