

The Other IT: Getting the Big Picture

STARTING in the early 1990s, many countries—initially industrial and, later, emerging market countries—began to adopt inflation targeting (IT) as a way of achieving price stability. IT countries make an explicit commitment to meet an inflation target (or target range): they regularly announce their targets to the public, and they have institutional arrangements to ensure that the central bank is accountable for meeting the target. About twenty countries have adopted an IT regime, and the trend appears likely to continue.

Ted Truman, a former senior official at the U.S. Federal Reserve Board and the U.S. Treasury, applies his considerable experience to a big-picture assessment of the inflation targeting regime. He describes himself as “an inflation targeting sympathizer, not a proselytizer,” and he believes that IT should be employed flexibly. The book is well thought out, and we agree with most, but not all, of its assessments and recommendations.

Truman urges the IMF to take a “more benign and constructive attitude” toward IT, based on his perception that the IMF has discouraged its adoption in emerging market countries. While it may be true that the IMF was slow to warm to IT, it has become much more supportive, including by providing extensive technical assistance to countries that want to consider adopting such a regime. Still, the IMF’s advice has to be tailored to each country’s circumstances. A message that is largely missing in this book is that, although IT is flexible, it may not work well for countries that do not have the credibility to stick to a target or are extremely open and vulnerable to large exchange rate fluctuations.

Truman recommends that IMF conditionality—specifically, the conditions attached to the performance of monetary policy—be tailored to IT frameworks. This, in fact, is already the case. The so-called performance criterion in IMF programs for coun-

tries with an IT regime is based on deviations from the inflation target; thus, it dovetails with the country’s chosen monetary framework. At the same time, the condition that international reserves must not fall below an agreed level is maintained with a view to safeguarding IMF resources.

The book argues for the United States, Japan, and the euro area (the



Edwin M. Truman

Inflation Targeting in the World Economy

Institute for International Economics, Washington, D.C., 2003, 288 pp., \$25 (paper).

so-called G3) to adopt IT. However, Truman seems to overstate his case. Inflation in the United States and the euro area is already low and stable, and deflation is fading away as a policy issue. For Japan, a strong case can be made that financial reforms would improve monetary policy more than would the adoption of IT. Further, the specific measures that Truman recommends for the G3 represent a watered-down version of IT. Indeed, the impact of the adoption of IT on the international financial system presumed by Truman may be inflated.

An important theme in the book is that IT does not require a free float

of the exchange rate. Truman recommends, therefore, that IT not be ruled out even when a country’s policymakers have a “fear of floating”; that is, they are unwilling to let the exchange rate float completely freely. We agree that the exchange rate need not be ignored under IT, and, indeed, many IT countries intervene in exchange markets to support the inflation target. But meaningful IT does require subordination of the exchange rate to the inflation target, especially when exchange rate movements work against adherence to the inflation target. In short, policymakers in countries where the exchange rate is subject to wide fluctuations are in a somewhat more difficult operating environment under IT than Truman acknowledges.

The book also gives rather short shrift to the institutional and operational issues that must be addressed if IT is to work. For example, it is important for the government to assume “ownership” of the inflation target because a strong fiscal position is important for the success of IT. Financial market development is another key issue: countries that do not have sufficiently liquid money markets will find it more difficult to use the interest rate as an operating target to manage liquidity and signal policy intentions.

But despite these reservations about some aspects of the book, we feel it will become a widely used reference on inflation targeting. In some cases, its conclusions are a bit overstated. Still, its accessibility and broad scope make it important reading for academics and policymakers concerned with the practice of monetary and exchange rate policies.

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Theodore Friend

Indonesian Destinies

The Belknap Press of Harvard University Press, Cambridge, Massachusetts, and London, England, 2003, 628 pp., \$35 (cloth).

INDONESIA is the world's fourth most populous nation and its most populous Muslim nation. It is the world's largest archipelago and straddles important shipping lanes. But despite its size and strategic importance, the country's economic and political history has not received the attention it deserves from scholars. A handful of international academics, mainly Australian, have studied the country in depth, but some of them have shown a tendency to portray the country in an overly sympathetic light.

In a welcome departure, Theodore Friend, a renowned American scholar of Southeast Asian countries, has written a balanced, fascinating, and richly illustrated book about Indonesia. He records the views of presidents and generals, but he also dwells "on several individual Indonesians of no special prominence because they illustrate ordinary lives with grace under pressure, and because I like them." The result of this combination of personal anecdote and scholarly expertise is a kaleidoscopic view of the successes and failures of Indonesia: "sometimes rarified aromas; too often, bloody reek."

The book concentrates on the period following the Dutch departure

Still Living Dangerously?

from the country in 1949 and carries the narrative to the present. Friend says he gives the events of 1997 to 2002 "relatively strong weight" because they brought to a head "numerous crises that were suppressed in the long Suharto era." Friend first visited Indonesia in August 1967, in the early days of President Suharto's rule and in the aftermath of the mass killings of suspected communist sympathizers, a period described in the 1982 movie *The Year of Living Dangerously*. President Sukarno's rule had taken its toll on the economy. There was hyperinflation, food shortages were rampant, and a large segment of the population lived in abject poverty.

Incredibly enough, Suharto, an unschooled general who had maneuvered himself into power, would, for three decades, provide a steadying hand to guide the country out of its complex socioeconomic and political problems. Friend writes that Suharto's practical values after assuming power were simple and focused: "Suharto had a peasant's commonsense understanding that you must eat to live, that education helps you earn more money, and that those with more money eat better and live longer. He showed great appetite for the burdens of state, demonstrated early aptitude, hired good advisors, and listened to them, along with his military." These qualities enabled Suharto to deliver solid economic growth for three decades.

Why, then, was Indonesia hurt so much more than its Asian neighbors during the regional financial crisis of 1997–98? Because, Friend says, Suharto's record can also be described "in a less respectful way." In his thirty years in power, Suharto created a feudal system that drifted into corruption and excess: "Suharto, Inc., exceeded the Marcos regime in the Philippines as a kleptocracy." And though overborrowing and underregulation, often thought to be underlying causes of the Asian crisis, were common throughout the region, Friend says that Indonesia's behavior was dangerously lax.

He notes that the culture of the cold war era meant that the international community largely condoned corruption in anticommunist countries like Indonesia. The end of the cold war "blew away the hypocrisy that had induced donor nations to ignore political corruption in anticommunist countries. . . . After the mid-1990s, the World Bank and the IMF, for whom corruption had been a hushed topic, began to ventilate it." As the financial crisis hit, the World Bank appealed for help in combating "the cancer of corruption." But this was too little, too late: Friend writes that the crisis "had apparently so accelerated the cancer's growth as to make it inoperable." One example he cites is the "misuse" by commercial banks of the emergency liquidity support credits injected by the central bank at the onset of the crisis to stabilize the situation. Another attempt to siphon off money, this one unsuccessful, was one by Suharto's children to adopt a currency board at an exchange rate of 5,000 rupiah to the dollar. "It was," Friend writes, "too clearly a device for Suharto's family and cronies to buy dollars for 5,000 rupiah each, instead of being savaged at 10,000 by their own borrowings and speculations."

In sum, Friend traces Indonesia's collapse in 1997–98 to deep-rooted structural causes, and so it is not surprising that he is more sympathetic than most to the role of the IMF over this period. "Did the IMF's stress on structural reforms merely worsen the crisis? I don't think so," he writes. "The international business community largely played the local game, without pressing for reform. Most domestic voices for change had been forced into exile, jailed, intimidated, or ignored. In a critical situation, only a body of world standing like the IMF" could have made the case for the dismantling of a corrupt empire, Friend concludes.

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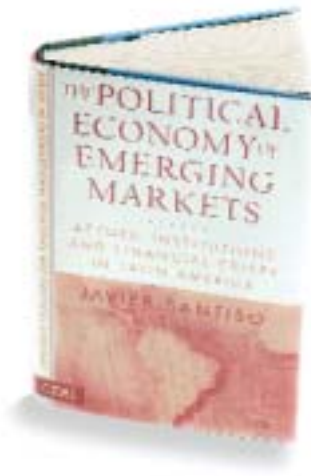
Markets versus the Masses

JAVIER SANTISO, chief economist for Latin America at Banco Bilbao Vizcaya Argentaria, does a superb job in this book of demystifying the world of emerging markets finance, unmasking it for what it often is: a confidence game. In the best possible way to research his subject, he frequently interviews market practitioners directly. As someone who spent nearly 10 years in these markets, I found that the Rolodex Santiso consults turns up familiar names—global finance is a small world.

Santiso captures well the inherent tension between the nature of the markets and the imperatives facing leaders of the emerging world, who are trying both to develop their economies and to get reelected. Occasionally, the interests of markets and politicians are mutually reinforcing, but for the most part their agendas are at cross-purposes. He notes, for example, that politicians sometimes try to win the confidence of markets by delivering on a few reform policies—generally common to all countries—that the markets deem important. But because markets may have focused on those policies in a capricious manner, politicians may not necessarily be acting in sync with their country's optimal development strategy.

This tension comes to the fore when the election cycle requires politicians to turn their attention to winning over the populace rather than just the markets. In short, there is often an incongruence between the political calendar of governments and the economic cal-

endar of markets. The warning that surfaces from Santiso's analysis is on target: by playing to the expectations of the markets rather than to fundamentals, policymakers are putting at risk, if not undermining, the economic well-being of the people they represent.



Javier Santiso

The Political Economy of Emerging Markets

Actors, Institutions and Crisis in Latin America

Palgrave Macmillan, New York, 2003, 268 pp., \$59.95 (cloth).

Nevertheless, Santiso overplays his hand by coming too close to suggesting that markets are mostly to blame for the ills that have befallen the developing world while the countries themselves are generally guiltless. He is particularly off the mark in portraying Argentina as the victim of its own blind commitment to the much-maligned Washington Consensus. Argentina may have been held up as

the star pupil, in great measure as a result of some self-promotion and the vested interest of the international financial community, but it was the Argentine government's own missteps that ultimately did the country in. Argentina broke an important commandment of the Washington Consensus in not living the life of fiscal rectitude that its convertibility regime required. Santiso may also be reaching when he suggests a direct correlation between the eruption of financial crises and the bonus calendars of investment banks.

All in all, Santiso succeeds in raising the right questions, which is what good books do. For this book, the questions include: How can we best harness the power of the markets to improve conditions in the developing world? In particular, can we reconcile the short-term bias of markets with the long-term nature of development planning?

The book gets us thinking about the right balance between the benefits that come from the accountability markets impose on policymakers and the risks presented by the markets' propensity to urge similar reforms—some of which may be no more than fads—on countries that are at very different stages of development. In short, as Santiso says at the end of the book, there is an “unfinished dialogue between states and markets.” This book provides a rich context in which to undertake this dialogue.

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