

The Political Economy of Policy Reform in Southeast Asia

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'[P]olitical scientists ... are preoccupied with the distributional effects of policy: cui bono? Who are the beneficiaries? Whereas economists, in their innocence, worry about the best ways of improving social welfare, raising the living standards of the whole community, political scientists are fascinated by the struggle for shares.' (Arndt, 1994)

The literature on the political economy of trade liberalization emphasizes the interplay of 'ideas, interests, and institutions'. (Bhagwati, 2002)

'Countries cannot be transformed without the generous and farsighted involvement of the international community.' (Sachs, 1994)

'The leadership of Viet Nam did not decide to 'go market' because of any kind of ideological conversion from Marxism-Leninism to capitalism; instead it discovered the hard way that the alternative to a market economy does not work.' (Riedel and Comer, 1997)

'Turning points ... are invariably associated with macroeconomic crises.' (Lal and Myint, 1996)

'The real tragedy [of the IFI's] policy conditionality in Africa was not that the demanded policy changes were wrong, but that attempts to impose policy change from outside hardened resistance to them.' (Collier, 2007)

'Thus far, the most successful economic reform efforts have been merely those that remove restrictions on competition; far more complicated are initiatives requiring sustained administrative capacity.' (De Dios and Hutchcroft (2003) on the Philippines.)

(1) Introduction

Economists (think they) know what to do; much less clear how to get there. Why and how to reform successfully one of the keys to econ devt. Southeast Asia - great diversity, fertile territory.

(2) Issues and Context

Reform: significant, durable policy reform that advances aggregate socio-economic welfare. Outcomes and processes. Objectives?

'Big bang' v/s incremental reforms; 'turning points'; 'zig zag reform'. SE Asian examples of each.

Nature of reforms varies a lot: stroke-of-the-pen deregulation, to complex admin/implementation. Eg, removing QR's to tax reform.

Drivers. Why reform?

a) Crisis hypothesis, Olsonian hypothesis. Works sometimes.

'Twin crises' difficult to navigate.

b) Ideas are crucial. A clear reform agenda. Often outside govts. Unity crucial (Boediono).

c) Political leadership; combined with technocrats. Different roles and modes of operation; authoritarian regimes v/s democracies.

Coping with short time horizons: Bates, embedding institutions which enable politicians to adopt collectively rational strategies.

d) Bureaucracy: Diversity; reluctant reformers?

e) External actors and factors:

Exogenous shocks (crises).

Ideas; analytical training. ('Berkeley Mafia', 'Chicago Boys')

Competitive liberalizations (Pangestu).

Donors & IFI's: mixed evidence; like aid in general, works when countries are predisposed to reform.

f) Reforms need to be comprehensive.

Eg, trade reform requires macro stabilization;

need to win over constituencies;

different reforms different timetables.

Higher potential for policy change for regimes with a low dispersal of power? (MacIntyre)

(3) Southeast Asian Case Studies

Concentrated mainly in Indonesia, Philippines, Vietnam.

Less (major) policy change in Singapore, Malaysia, Thailand; largely open with consistently good macro.

(3.1) Major Reforms: Vietnam's Doi Moi

Important: success in very difficult circumstances - decades of war, international hostility, weak technocracy, cessation of Soviet aid. Ingredients: 'Learnt the hard way' (Riedel); observing China; loss of aid; gradual but produced results; good fortune (oil); strong (hard?) state.

(3.2) Significant Advances: Indonesia in 1980s

Comprehensive; averted a debt crisis; started with macro, then micro. Why? Trigger was looming crisis (oil price collapse). Technocrats united, had a coherent plan. Persuaded Soeharto then 'in supreme control'. Style important: Hadi's low politics. Donors helpful; neighbours reforming. Effectively implemented; produced results quickly.

See Table 1 for special case of trade liberalization; arguably the most important once had macro stabilization and realigned exchange rates.

Table 1: Indonesian Trade Policy, 1966-95: Major Contending Groups and Policy Outcomes

Year	1) Technocrats: Role in policy making	2) Economic nationalists: Role in policy making	3) Rent Seekers: Role in policy making	4) Foreign Institutions: Role in policy making	5) Trade policy outcomes				
1966-72	Pro market	Strong	Protectionist	Moderate	Protectionist	Strong	Pro market	Strong	Relatively liberal
1973-82	Adopted ISI, although still relatively pro-market	Declining	Protectionist	Strong	Protectionist	Strong	Pro market	Declining	Increasing protection
1982-85	Began to support economic liberalisation	Increasing	Protectionist	Declining, although still quite strong	Protectionist	Strong	Pro market	Moderate	Ambivalence
1985-90	Pro market and support for trade reform	Strong	Protectionist	Declining	Tended to be in favour of protectionist policy	Strong	Pro market	Increasing	Relatively liberal
1990-95	Pro market and support for trade reform	Declining	Protectionist	Increasing	Tended to be in favour of protectionist policy	Strong	Pro market	Relative strong ¹⁰	Relatively liberal

Notes: ISI: import substitution strategy.

⁸ Scattered around military, Soeharto and bureaucracy in the 1970s, and concentrated around Soeharto from the 1980s.

¹⁰ Increasing due to the important role of trade agreements such as APEC and AFTA.

(3.2) Significant Advances: Trade Liberalization in the Philippines

Eventually as effective and durable as Indonesia. But much slower, 15 years, deep crisis, three administrations, from authoritarian to democratic rule. Key driver was the econ profession, UP/PIDS. Gradually spread through gov. Then adopted by a vigorous reformer (Ramos). Comprehensive reforms with a growth dividend.

Also: sense that falling behind neighbours; IFI's, and retreat from US military alliance useful at the margins.

Though paradox (in post-Soeharto also) that, while won the battle for manufacturing (and increasingly services), agriculture now a problem.

(3.2) Significant Advances: Central Bank Independence

In both RI & RP, after crises. Learned lessons from crises.

Both part of IMF packages; but primarily domestic origins.

Key point that all major policy players have a stake in the outcome.

Similarly for 2003 RI Fiscal Law. Here exit from the IMF program used to persuade the president (Megawati).

(3.3) Creating New Institutions & Structures: Phils Decentralization

Major program, one of first in Asia. Triggered by political crisis. Clear rationale; well formulated. But marginal (positive) impacts. Why? Frustrated by CG's (a) unwillingness to let go; (b) inability to enforce clear rules of the game; (c) fiscal near crises; (d) weak implementing agency.

(3.3) Creating ... : Indonesia's Competition Commission

KPPU: unpromising beginnings - part of IMF LOI; interpretation of 'monopoly' in Indonesia; gov and bureaucracy greatly weakened; no tradition of independent authorities.

Imposed on Indonesia, but domesticated. Worked effectively. Operated in low key manner; avoided political vendettas. 'Monopoly' a topical issue. Suited both gov and parliament to have arms-length agency.

(3.3) Creating ... : Timor's Currency Board

An example of effective IMF input. Helped persuade/educate the interim leadership. Lessons of international experience. Petroleum Fund also. Both so far survived political turbulence.

(3.4) Incomplete Reforms, Mixed Outcomes, Setbacks: Privatization in Indonesia and Malaysia

Strong case for reform: inefficient, vehicles of patronage, etc. Indonesia: very little privatization, even during 1980s; political c/b analysis. Malaysia: major privatizations since 1983; but hijacked by Bumi interests. Why so difficult? (a) bureaucratic resistance; patronage; (b) local-level resistance (Cemex); (c) ethnic politics, especially when much else liberalized. Reformers: if can't have clean sales, best not to sell? A case where reformers forced to adopt second best solutions: Ensure competition; impose hard budget constraint; open subsidies.

(3.4) Incomplete ... : The Waning Influence of Technocrats

Evident in Indonesia, Thailand in pre-crisis 1990s, Philippines from late 1970s. Indonesia: technocrats less needed; 'accidents'? rise of Habibie, kids. Thailand (Ammar): BoT, MoF gradually weakened; less needed in time of abundant finance; erosion of civil service conditions. Philippines: rise of cronies, private (& IFI) funds from mid 1970s. 'Sadli's Law'.

(3.4) Incomplete ... : Labour Policy after Crises in RI & RP

Both, especially Indonesia, swung from regimes of limited intervention, repression, but growth in productivity & wages; to populist, restrictive policies, pushing up minimum wages, etc. Predictable effects on employment growth, etc. Why? Part of swing from authoritarian to democratic regimes. Intrusive IMF policy conditionality elsewhere. Labour portfolio often given to activists. Technocrats elsewhere occupied. General intellectual ambivalence on labour at a time of crisis.

(3.4) Incomplete ... : Making Policy after 'Twin Crises'

Special problems when have combined economic and political/institutional crisis. Creates policy vacuum and weakened states. Former USSR. Indonesia in 1998, Philippines in 1986; Economic contraction 13-15%; weakened executive; less cabinet unity; assertive, unpredictable legislature; noisy civil society; bureaucratic adjustment plus fiscal crisis; legal system underdeveloped; decentralization. Results: increased institutional uncertainty; technocrats limited role; policy processes long and uncertain. See Table 2: number of policy players with incentives to push for 'poor policy'.

Table 2: Major Post-Crisis Economic Policy Actors in Indonesia

Actor	Analytical Expertise	Rents from Poor Policies	Authority/Influence
Economics Ministries	High	Low	Limited outside macroeconomics
Line/technical Ministries	Weak, apart from sector-specific knowledge	High	Generally high
Local Govts	Generally weak	Potentially high	High
Parliament	Generally weak	High	High
Academics, Think Tanks	Variable; some high	Low	Moderate
Vested Interests	Weak, apart from sector-specific knowledge	High	Moderate, variable
Media, Civil Society	Generally weak	Variable	High

(3.4) Incomplete ... :

(to come)

Indonesian Financial Reforms

Industry Policy in Indonesia and Malaysia

Tax Reform in Indonesia and the Philippines

Legal Reform in Indonesia

(4) Tentative Generalizations

No one-size-fits-all. But recurring, interactive themes:

- a) Ideas that drive an intellectual agenda. Plus a group of individuals, united, able to sell the message. Need to be patient (Phils, India). Often (generally?) outside govt initially.
- b) Political leadership essential. Comes in different guises.
- c) External factors mixed, but at least some generally present - demonstration effects of successful reformers; exogenous shocks.
- d) Need to be comprehensive, deliver results; though at different speeds. Macro stabilization the bedrock; increasing openness central.

The bureaucracy?

Generally not a formulator, but crucial for implementation.

General presumption is a reluctant reformer; loss of rents, etc. But depends on:

- a) Relative strengths of executive and bureaucracy - presidential v/s parliamentary, etc
- b) Relative strength of reform-minded sections - finance, central banks, etc.
- c) Nature of reforms - scope for by-pass; but needed for some measures.

Note also:

- Not necessary to have high quality institutions to embark on reform (Rodrik).
- Corrupt regimes can reform effectively. Though type of reform varies; may be thresholds.
- Desirable to institutionalize reforms wherever possible - macro, public scrutiny, etc.
- Growth-oriented reforms easier than redistribution measures; positive v/s zero sum games.

(4) Tentative Generalizations (cont)

Foreign aid & IFI's? Mixed evidence: effective when have reform-oriented regime.

Can donors influence the reform agenda? Conditions-based lending uncertain.

Perhaps more effective to work discreetly with agents of change; training.

Is aid an obstacle to reform? (Easterly, Hughes) Generally not; though its absence often pushes reform.

Big bang v/s incremental? Difficult to generalize. Macro stabilization a pre-requisite, generally have to move quickly. Trade reform requires some adjustment. Tax reform often medium term.

Authoritarian, centralized regimes can move more quickly; though reforms may be less durable.

Also depends on political circumstances; eg, Indonesia in 1980s, not sure how long had Soeharto's support.

Backtracking? On big picture, rarely - Sachs-Warner (1995) on trade regimes; Hill (2007) on FDI regimes. So why are growth rates volatile? Reform fatigue can set in; macro can undermine good micro (eg, Phils). Plus exogenous shocks.

Are countries path dependent? No - Vietnam in 1986, Indonesia in 1966. But some countries seem to find it difficult to reform.