

09/09/2000

Krugman: Political instability will hold up the economic recovery process

PAUL Krugman rose to prominence in the early 1990s and became a world-renowned figure in 1997 at the dawn of the Asian economic crisis. He went against the tide of economists all blissfully admiring the success of the new industrial nations of East and Southeast Asia.

He strongly supported Malaysian Prime Minister Datuk Seri Dr Mahathir Mohamad's controversial decision to apply temporary foreign exchange controls in order to prevent further depreciation of their beleaguered currency; a decision that has proven highly successful.

Indonesia's Tempo magazine reporter I.G.G. MAHA ADI interviewed Krugman by telephone recently. Here are the excerpts:

Most economists of the pre-1997 era forecast Asian economic growth averaging more than seven per cent based on strong fundamentals. Why were they so optimistic?

It's hard to dispute the success this region has achieved. At the time Southeast Asia was growing at a spectacular rate and was considered the fastest growing region in the world. Although I personally considered the region's fundamentals similar to depression-era nations of the 30s, I didn't think the crisis would transpire so quickly and that the recovery process would take so long.

You previously suggested implementing foreign exchange control in Asia. Would you consider this a viable alternative for Indonesia?

I don't consider foreign exchange control appropriate for Indonesia right now. Foreign exchange control is only viable when there is balance and correlation between economic recovery and the depth of the economic crisis facing a nation.

In addition, implementation of foreign exchange control requires strong governmental authority and political commitment. Unfortunately, Indonesia does not fit these criteria. In Malaysia, foreign exchange control policies were established on a short-term basis... It's highly doubtful the Indonesian Government has the administrative ability and political cohesion to apply foreign exchange controls.

The system might have worked had the country implemented foreign exchange controls at the start of the crisis in 1997. However, the Suharto regime had lost a lot of credibility at home as opposed to Dr Mahathir who had strong grassroots support.

Without credibility, any government would be ill positioned to implement such drastic measures. Although I personally dislike Dr Mahathir, I believe he has shown excellent managerial capabilities and has been highly effective in helping Malaysia come out of the crisis.

Compared to other countries, why is Indonesia the slowest to recover? ... The answer lies in the political instability in Indonesia and the future of separatist movements in Papua, Aceh and Maluku...

The IMF has proven incapable of helping Indonesia and other countries come out of the crisis. In contrast, countries such as Malaysia, which went against IMF advice, have recovered. What are your thoughts on that?

The IMF has made a number of fundamental mistakes in handling the Asian economic crisis. Harvard economist Jeffrey Sachs has criticised the IMF for pressuring central banks to increase interest rates, which resulted in prolonged recession and financial pressure to industries all over Asia....

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