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The IMF and the policy of low inflation: A review of Article IV consultations for selected Asian developing countries

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Abstract

Spearheaded by the International Monetary Fund (IMF), there has been a rethinking of macroeconomic policies, in particular with regard to targeting inflation at a very low level in the wake of 2008–2009 global economic crisis. We provide a content analysis of the IMF Staff Reports on Article IV consultation of 12 Asian developing countries during the period 2009–2010 in order to see whether that rethinking has been reflected in the IMF's advice. The findings of this study reveal that the IMF continues with its prescription of achieving low inflationary environment irrespective of country-specific circumstances.

JEL Codes: E31, E52, O11, O23, O53

Keywords

Article IV consultation, developing Asia, growth–inflation relationship, IMF, monetary and fiscal policy

Introduction

Since the experience of *stagflation* in the 1970s, the dominant paradigm of macroeconomic policy that emerged in the 1980s is to target stabilisation by keeping inflation at a

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very low single-digit level. The Reserve Bank of New Zealand was first to adopt inflation targeting (IT) monetary policy in 1989 with a Consumer Price Index (CPI) inflation target band of 1%–3% on average over the medium term. In two decades (1990–2010), 26 countries adopted IT, about half of them emerging market or low-income economies.

Inflation targets constitute an important aspect of the IMF monitoring ('surveillance') of member countries. On joining the IMF, a country agrees, under Article IV of the IMF's Articles of Agreement, to pursue policies seen as conducive to growth and 'reasonable' price stability, to avoid exchange rate manipulation, and to provide the IMF with data about its economy. The IMF's regular monitoring of economies and associated policy advice occurs during Article IV consultations, whereby an IMF team of economists visits a country and discusses its economic and financial policies with government, central bank officials, and often representatives of business, unions, and civil society. The team reports its findings to IMF management and the Executive Board, and advice is transmitted to the country's government. Country reports are posted on the IMF's website.

Thus, Article IV consultations place strong pressure on countries to adhere to received wisdom on inflation rate policy. The IMF (2013) believes that 'when (annual) inflation passes the 5% mark investment and economic activity … suffer' (p. 4). Moreover, inflation might accelerate, thus leading to a crisis, when it crosses this benchmark, and the stabilisation programme that follows to bring it down might be very costly. Therefore, the fund's policy guideline, explicitly or implicitly, tends to suggest an inflation target of 5% or below, irrespective of country-specific circumstances.

Against the backdrop of the Great Recession of 2008–2009, however, revisiting the policy of low inflation, and most other traditional macroeconomic tenets, has come to the forefront. Palley et al. (2012) comment that the 'economic crisis that these events have generated, combined with the failure of the mainstream economics profession, has again put the question of change on the table'. Even the heads of the IMF have recognised the need for a change. For instance, Dominique Strauss-Kahn (2011), a former Managing Director of the IMF, felt the need for a 'wholesale re-examination of macroeconomic policy principles' in the face of the crisis. The Chief Economist of the IMF Olivier Blanchard (2012) also criticised the *one policy one instrument* consensus of the mainstream economists (p. 13). Raising doubt about the conventional view of a low inflation strategy, Blanchard et al. (2010) made an important observation that higher average inflation and higher nominal interest rates to start with would have helped to lower interest rates more, thereby most likely reducing the decline in output and deterioration of fiscal positions in the aftermath of global crisis.[1] This reservation against the low inflation strategy is not just shared within the IMF. A blog by RA (2010) in *The Economist* observed that 'Economists of highly divergent stripes … [such as] Kenneth Rogoff, Greg Mankiw, Scott Sumner, Paul Krugman, Brad DeLong – all have indicated that higher inflation would be a boon to the economy'.[2]

Nevertheless, the 'rethinking macroeconomic policy' thesis has been advanced from the perspective of developed economies. The discussion has no reference to the fact that for developing countries, the 1980s and 1990s marked the 'lost decades' (see Easterly, 2001). The median developing country experienced stagnation relative to the 1960s and early 1970s. Most of these countries were under the IMF's structural adjustment programmes with macroeconomic stabilisation as their centrepiece. Nevertheless, a number of observers (e.g. Chowdhury, 2006; Epstein and Yeldan, 2006; Pollin and Zhu, 2006), including the World Bank's (2005) Growth Commission and the IMF's Independent Evaluation Office (IEO, 2007), critiqued the IMF's rigid prescription of low single-digit inflation usually at less than 5%.

This study investigates whether the recent shift in the thinking process by leading economists, both inside and outside the IMF, has been reflected in any way in the IMF policy advice to Asian developing countries on inflation in practice. To examine the nature of policy advice by the IMF staff, we provide a content analysis of the IMF staff reports on Article IV consultations with 12 Asian developing countries (Bangladesh, Bhutan, Cambodia, China, India, Indonesia, Lao PDR, Malaysia, Maldives, Nepal, Pakistan and the Philippines). We also look at the country-specific historical evidence on growth and inflation to find the rationale behind the IMF's advice. To the best of our knowledge, an in-depth examination of the post-crisis policy advice of the IMF on inflation to Asian developing countries has hitherto been absent. We attempt to fill this gap. Our interest in Asian developing economies is due to their good performance in terms of both growth and macroeconomic stability. The findings of this study reveal that despite the rethinking by the leading economists, the IMF's policy advice remains unchanged. Moreover, the advice, irrespective of country-specific circumstances, seems to focus on achieving an inflation target of 5% or below. This notion of *one policy fits all* does not find support from the historical evidence on growth and inflation in the countries in question.

IMF and the policy of low inflation

The IMF's Article of Agreement states that 'each member shall endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances' (IMF, 2008 [1944]: Article IV, I(i)). Therefore, the IMF's advice to restrict inflation at 5%, irrespective of country-specific circumstances stands against its own mandate. Moreover, there is little empirical evidence that inflation above 5% becomes detrimental to economic growth.

Figure 1 presents a scatter plot of inflation and growth during 1961–2011 in all 150 emerging and developing countries, as listed by the IMF. We notice two important stylised facts. First, the relationship between inflation and growth is nonlinear as evident by the inverted-U shaped curve. Therefore, inflation has both positive and negative effects on growth. Second, within the range between 5% and 15% of inflation, there does not seem to be any relationship between the two variables. Growth does not appear to decline within this range of inflation. This means that the upper part of the inverted-U is flat, displaying a plateau in the relationship rather than a sharp cliff-edge. Therefore, the fear of accelerating inflation and sliding down of growth beyond 5% inflation is not grounded in evidence. The important implication of this is that policy makers can have a good deal of flexibility in dealing with inflation while pursuing strategies for sustained growth.

Recent empirical literature also provides strong evidence that the *threshold* beyond which inflation becomes detrimental to growth is well above 5% for developing

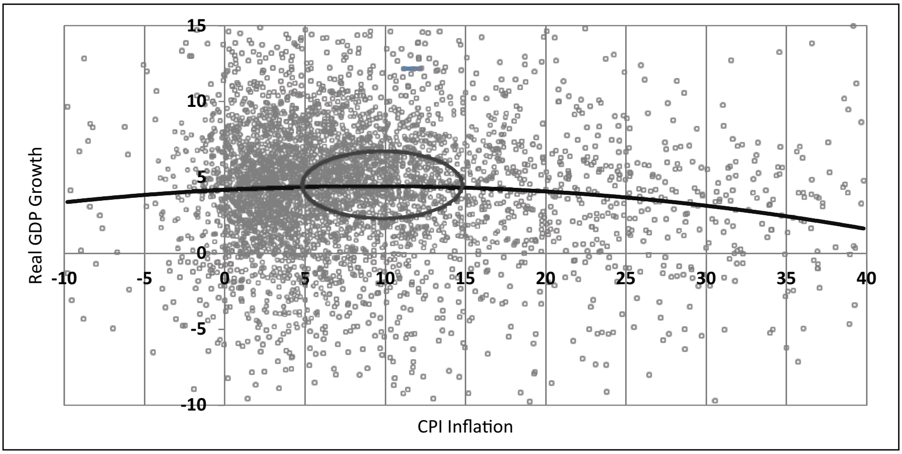

Figure 1. Scatter plot of inflation and growth in 150 emerging and developing countries, 1961–2011.
Source: Authors' calculations based on the data from World Bank, *World Development Indicators*. Note that to avoid outlier effects and unusual circumstances, growth is considered between greater than −10% and less than 15%, while inflation is less than 40%. The estimated equation for the fitted values is $y = -0.003x^2 + 0.05x + 4.18$ with $R^2 = 0.0078$.

countries (see Table 1). A study by Muzaffar and Junankar (2014) of 14 Asia-Pacific countries finds the inflation threshold around 13% and suggests that it may vary between 7% and 14% depending on the level of development. Furthermore, some cross-country studies (e.g. Bruno and Easterly, 1998; Dornbusch and Fischer, 1993) have found that inflation tend to accelerate only when it exceeds 35%–40%. These findings imply that the developing countries should not be alarmed when inflation crosses the 5% benchmark set by the IMF.

Several influential IMF studies such as Khan and Senhadji (2001) and Espinoza et al. (2011) reveal that for developing countries, the inflation threshold is around a double-digit figure, and it is higher than that of developed economies. Broadly, the threshold level determined by these studies varies between 7% and 19%. Yet, the authors recommend a low single-digit inflation target. For example, Selassie et al. (2006), in a study carried out at the IMF, conclude that a target of less than 5% should be pursued with caution as it may entail a loss of output (p. 24).

Goldsbrough et al. (2007) note that an inflation target of 5% or less was suggested by the IMF to 22 out of 32 programme countries between 1995 and early 2007. According to the IMF's IEO (2007), this figure was also used for 29 Sub-Saharan African countries during the 2000s. Chowdhury (2006) reviews post 1997–1998 Asian crisis monetary policy in selected Asian countries. Based on post-Asian crisis economic performance, he warns that low inflation, just as much as high inflation, can be harmful for growth. Too low an inflation rate may lead to a *stabilisation trap*, a situation of low inflation and insufficient growth for poverty alleviation.

Existing literature providing a post-crisis analysis of the IMF policy stance, particularly in respect of inflation in developing countries, is inadequate. Perhaps the only two

Table 1. Selected cross-country studies on the threshold effect of inflation on growth in developing countries.

Study	Period	Number of countries	Findings on inflation threshold
Muzaffar and Junankar (2014)	1961–2010	14	Between 7% and 14%
Yilmazkuday (2013)	1965–2004	84 countries	Between 8% and 15%
Lopez-Villavicencio and Mignon (2011)	1961–2007	44 countries	Threshold inflation differs strongly between developed and developing countries. For developing countries, it is 17.5%.
Bick (2010)	1960–2004	40 developing countries	12% and 19% with and without regime intercept, respectively
Espinoza et al. (2011)	1960–2007	165 countries	Between 7% and 13% for developing countries
Pollin and Zhu (2006)	1961–2000	80 middle-income and low-income countries	Between 15% and 18%
Drukker et al. (2005)	1950–2000	138 countries	Around 19% in the full sample
Sepehri and Moshiri (2004)	1960–1996	92 countries with 26 lower-middle-income and 28 low-income countries	15% and 11% for lower-middle-income and low-income countries, respectively.
Burdekin et al. (2004)	1965–1992 and 1967–1992 for developed and developing countries, respectively	21 industrial and 51 developing countries	Higher inflation threshold for more advanced countries; 8% and 3% for industrial and developing countries, respectively.
Khan and Senhadji (2001)	1960–1998	140 countries	1%–3% and 11%–12% for industrial and developing countries, respectively. The positive effect of inflation on growth is present up to 18% for developing countries.
Ghosh and Phillips (1998)	1960–1996	145 countries	2%–3%
Bruno and Easterly (1998)	1961–1992	26 countries	No cross-sectional correlation between long-run averages of growth and inflation below inflation rate of 40%.
Sarel (1996)	1970–1990	87 countries	8%

Source: Adapted from Muzaffar (2013: 47–49).

comprehensive studies in the case of developing countries involving a content analysis using Article IV consultation staff reports are Roy and Ramos (2012) and Anwar and Islam (2011). Roy and Ramos (2012) review the 2010 reports for 26 developing countries and find little evidence of a policy shift in line with the need for a change suggested above. There has been no cost benefit analysis to support recommendations for reducing inflation and recommendations still focus on the use of monetary policy only, regardless of the source of inflation (Roy and Ramos, 2012: 20). One drawback of the study is that it limits itself to content analysis only and does not provide any empirical (historical) evidence in support of its conclusion.

Based on their content analysis of recent Article IV consultation reports for 19 developing countries, Anwar and Islam (2011) conclude that the IMF's preference is towards low single-digit inflation mostly around 5% or below, but offering no clear rationale for it. Their study shows that no significant benefit is achieved by the IT of developing countries, in terms of addressing problems of labour productivity, vulnerable employment, working poverty or growth, compared to their non-IT counterparts. In short, the study provides an important conclusion that the argument of low inflation being beneficial for growth is weak. This study takes this analysis further.

Data and method

We select IMF staff reports on Article IV consultation, publicly released during 2009–2010 for 12 Asian developing countries. These reports, containing the IMF's recommendations to the individual countries as part of its surveillance responsibilities, are released periodically often in a 12- or 24-month cycle. Therefore, our selection of country reports was dictated by the availability of reports released around the period 2009–2010. To facilitate our discussion, we classify the countries into three groups: South Asia which includes Bangladesh, Bhutan, India, Nepal, Pakistan and Maldives; the transition economies which include China, Cambodia and Lao PDR; and South-East Asia that includes Indonesia, Malaysia and the Philippines. The selection of countries shows enough variation in country-specific circumstances and levels of economic and social development to help us understand whether they matter in explaining the historical trends in growth and inflation, and also whether the IMF policy advice has varied accordingly. For instance, in the list we have China, the largest country in Asia in terms of size and population with predominantly a command economy where markets are allowed to function within a tight regulatory environment. We also have Bangladesh, a geographically small, but densely populated country with a population of 160 million and a growing middle class. It initially followed a socialist path, but rapidly moved into a more market-oriented system. We also include Nepal, a land-locked country emerging from a period of social conflict.

To provide some empirical support to the content analysis, we present data on inflation and growth rates of each country. In each case, the mean values of inflation and growth in 2009 and 2012–2013 are shown to reflect the current situation and forecasts at the time when the reports were released. In addition, long-run median and decadal median values between 1960 and 2009 are included to reveal the historical pattern of growth and inflation experienced in each country. The median values are used to avoid outliers resulting from extreme episodes of inflation. The data were gathered from the standard sources such as the World Bank's World Development Indicators, International Financial Statistics and the IMF World Economic Outlook.

A review of country-specific reports

South Asia

We provide the data on growth and inflation in Table 2 and country summaries in the following subsections.

Bangladesh. The long-run median growth is only 4.72%, and it seems to be held back by infrastructural bottlenecks (see IMF, 2010a: 15). Despite the fact that inflation remained below 6% in 2009, the consultation report (IMF, 2010a) warned that monetary policy was 'too accommodative' for domestic conditions and preventing an increase in inflation is an 'immediate policy concern'. This advice was offered despite the fact that the inflationary pressure was due mainly to food and fuel price rises in the international markets, exchange rate depreciation (from around 70 taka[3] a dollar to about 83 taka a dollar) and the removal of subsidies or administrative adjustment of prices upward. Although the report identified that external supply shocks such as international food and commodity prices were factors contributing to inflation, it suggested employing tight monetary policy. The IMF staff suggested that the central bank should take 'a pre-emptive and bold action' to contain 'signs of a pickup in prices' (p. 15). The higher interest rate was believed to be a 'small price to pay to prevent a harmful acceleration of inflation' (p. 15).

This fear of inflation going out of hand was not justified, given the inflation history of Bangladesh. Table 2 shows that inflation in 2009 was well below the long-run historical inflation rate of 8.4%. The figure was also lower than the decadal medians for 1990s and 2000s. The forecast values of inflation do not show signs of runaway inflation either (inflation was expected to go down in 2013).

On the other hand, growth was seen by the report as performing 'remarkably well' in the face of global recession (p. 14). The fiscal conservatism of the government was said to be responsible for this and maintaining 'fiscal prudence and sustainability' was advised to unleash Bangladesh's potential (p. 15). However, one wonders how fiscal conservatism is going to resolve the country's huge infrastructure shortage, which is also a contributory factor to higher inflation, in addition to being a major obstacle to growth.

Bhutan. Bhutan, except for the 1990s, has shown strong growth performance at around 7% and growth was expected to reach nearly 10% in 2013. On the other hand, inflation in 2009, at 4.36%, remained well below its long-run median, at 7.03% as well as the common 5% benchmark of the IMF. Inflation in Bhutan is driven by inflation in India as Bhutan's currency is pegged to the Indian currency. This is also evident from the historical median inflation for both the countries, at around 7%.

Although inflation was stable and future inflation was expected to remain close to its historical median, the staff appraisal warned of a potential overheating in the economy. This was, the report suggests, a likely result of 'spill-overs from the hydropower and development spending as well as rapid credit growth, financial sector vulnerabilities, and

Table 2. Average growth and inflation (%) in selected South Asian countries.

Country	Indicators	2009	2012*	2013*	Long-run median	Decadal median				
					1971–2009	1960–1969	1970–1979	1980–1989	1990–1999	2000–2009
Bangladesh	Growth	5.58	5.9	6.4	4.72	–	3.27	3.42	4.78	5.77
	Inflation	5.42	10.4	7.9	8.40	–	16.60	10.25	5.75	6.22
Bhutan	Growth	6.51	7.0	9.9	6.75	–	–	7.50	5.33	7.18
	Inflation	4.36	8.4	7.3	7.03	–	–	9.90	9.74	4.48
India	Growth	8.71	6.9	7.3	5.47	6.08	2.45	5.44	5.69	8.03
	Inflation	10.87	8.2	7.3	7.16	3.58	5.99	8.76	9.59	4.32
Maldives	Growth	−2.32	4.4	3.5	6.97	–	–	–	9.01	5.98
	Inflation	3.98	11.5	8.3	4.73	–	–	–	5.84	2.51
Nepal	Growth	4.31	4.2	3.8	3.95	1.89	2.75	4.35	4.42	4.31
	Inflation	11.6	7.8	7.4	8.24	4.05	7.98	10.94	8.29	5.90
Pakistan	Growth	3.56	3.4	3.5	4.98	5.81	3.99	6.44	4.01	4.26
	Inflation	13.64	12.0	12.5	7.15	3.18	7.71	6.22	10.17	7.52

Source: World Bank, *World Development Indicators*; IMF, *International Financial Statistics*, and *World Economic Outlook*, and authors' calculations. Growth and inflation refers to real GDP growth and CPI inflation, respectively. The data for the year 2009 are stated because it best reflects the current condition at the time of the release of staff reports for Article IV consultation.
GDP: gross domestic product; CPI: Consumer Price Index; IMF: International Monetary Fund.
*Projected figures taken from the IMF, *World Economic Outlook*. The figures for the decade 1960s are not reported for Bangladesh as it was a part of Pakistan during that period.

concerns about debt sustainability' (IMF, 2009a: 9). The government, according to the report, should be careful about fiscal management, as the budgeted fiscal deficit for 2009–2010 exceeded the government's implicit policy to limit the deficit to under '5% of GDP' (p. 10). In line with this, the IMF staff felt that a near-term 'tightening bias' was necessary to ensure macroeconomic stability.

However, it is not clear if public investment in hydropower and development spending are growth promoting, how debt can become unsustainable or how the economy can overheat. Instead of advocating a tightening bias, the advice should have been on ensuring spending on the sectors with the greatest growth potential, and on revenue collection by enhancing progressivity of the tax structure and efficiency of tax administration. If this can be done, the debt can be repaid from higher growth and consequent revenue dividends. Thus, the IMF's advice seems biased towards the short term and followed from the belief that macroeconomic stability in a narrow sense is both a necessary and sufficient condition for growth and development.

India. A strong growth performance, at about 8%, in recent decades has made India a major emerging country of the world. According to the IMF (2010b) staff appraisal, the economy rebounded ahead of most countries in the world but inflation was intensifying (p. 3). Inflation in 2009 was at 10.87% but nevertheless was expected to come down and remain close to its historical long-run median around 7%. Still the report identified 'elevated inflation' as a major risk which could 'stall the recovery' (IMF, 2010b: 4). An exit strategy from the accommodative policy was recommended, based on reducing fiscal deficits and gradually tightening monetary policy to anchor inflation. In addition, the government was advised to work under a framework anchoring the debt target to reduce it at 60%–65% of GDP by 2015 (p. 3). To achieve this target, the report suggested that more privatisation and reduction in the public sector's claim on resources were required (p. 3). It is interesting to note that the report also observed that 'there is a risk that private demand may not be broad enough to carry the growth momentum' (p. 5).

Maldives. The external shocks due to the global recession prompted a severe decline in economic activity in the Maldives and growth dipped by about 4%, reaching −2.32% in 2009. The future economic outlook also indicated that growth would be modest at around 4% in the years 2012 and 2013, well below its average median value, 6.97%, since the 1990s. Consistent with a slowing economy, inflation remained below 4% in 2009 but showed signs of an increase in 2012 and 2013. This could be due to supply shocks resulting from a rise in international fuel prices and domestic electricity tariffs (IMF, 2010d: 3). In short, the key problem has been that the country is in a recession with problems arising mainly from supply-side shocks. Despite this grim prospect of growth and slow recovery, the country report on the Maldives notes that the crisis has led to 'an unsustainable fiscal expansion', turning it into 'a serious near-term risk to macroeconomic stability' (IMF, 2010d: 3). Monetary policy, on the other hand, according to the IMF staff, had been constrained by fiscal dominance because of the government's borrowing without limit from the Maldives Monetary Authority (p. 6). It seems keeping inflation at around 3% was viewed in the report as the benchmark for attaining macroeconomic stability. Thus, the report recommended pursuing tighter monetary and fiscal policy to 'help inflation decline gradually to about 3% in 2012–2014' (p. 10).

Nepal. Nepal is one of the poorest countries in Asia, with 25.2% people living below the poverty line.[4] Its growth performance is also poor with historical median value, since the 1960s, standing below 4%. The IMF (2010e) itself admits that the structural problems of the economy have stopped Nepal achieving a higher growth path (p. 8). In spite of the lacklustre growth performance, the country report on Nepal praised the fiscal discipline maintained by the country and it was seen as a 'remarkable achievement' (IMF, 2010e: 4). Fiscal policy was said to have continued to be 'broadly prudent and public debt has declined to 40% of GDP' (p. 4). The report's attention to inflation over growth was also noticeable. It noted that loose monetary conditions of 2008–2009, which led to rapid credit growth, were responsible for double-digit inflation in 2009 (see pp. 3, 7). In 2009, inflation reached around 11%. The staff-appraisal, therefore, thought that it was a challenging task to manage the economy since tighter monetary policy would contain inflation but hurt economic growth (see p. 3). The case of Nepal is a classic example where a country sacrifices growth opportunities in order to keep inflation at a single-digit level in line with the IMF prescription.

Pakistan. Pakistan's recent and historical median growth performance does not show promising signs. Growth was 3.56% in 2009, while the long-run median growth rate is 4.98%. Inflation reached a double-digit figure in 2009 and is expected to remain so in the near future. Supply shocks resulting from increased oil and food prices and an energy subsidy financed by the central bank have fuelled the inflation (IMF, 2009e: 5). Adverse security developments are also responsible for deteriorating conditions in Pakistan. Despite the dismal growth performance, the authorities have embarked on a stabilisation programme incorporating 'a significant tightening of fiscal and monetary policies to bring down inflation and strengthen the external position' (IMF, 2009e: 5). The authorities believe that the scope for countercyclical fiscal policy is limited given the inflation situation of the country, and they remain committed to achieving a fiscal deficit of 4.3% of the GDP (see IMF, 2009e: 15). In the case of monetary policy, the authorities think that it is 'premature to reduce the discount rate at this juncture, as core inflation remains elevated' (IMF, 2009e: 16). These steps taken by the authorities have received approval in the staff-appraisal which states that 'Pakistan's stabilization program is on track' (IMF, 2009e: 21).

Transition economies

Table 3 presents data on inflation and growth for China, Cambodia and Lao PDR. It is followed by key points from IMF country summaries.

China. The IMF (2010f) report claimed that fiscal stimulus and loosening of monetary policy in the face of global recession have played an instrumental role in mitigating the effects of the shocks in the Chinese economy (p. 4). However, there did not seem to be a tendency of inflationary pressure amidst this strong growth performance. Inflation was

Table 3. Average growth and inflation (%) in China and selected transition economies.

Country	Indicators	2009	2012*	2013*	Long-run median	Decadal median				
					1971–2009	1960–1969	1970–1979	1980–1989	1990–1999	2000–2009
China	Growth	8.8	8.2	8.8	8.84	9.84	7.32	9.53	9.21	9.53
	Inflation	−0.70	3.3	3.0	2.15	–	1.05	6.25	4.94	1.31
Cambodia	Growth	−1.89	6.2	6.4	7.73	–	–	–	5.86	8.16
	Inflation	−0.66	4	3.6	3.92	–	–	–	4.00	3.57
Lao PDR	Growth	7.21	8.4	7.1	6.07	–	–	4.77	6.19	6.86
	Inflation	0.03	6.7	5.3	10.63	–	–	61.33	16.51	7.72

Source: World Bank, *World Development Indicators*; IMF, *International Financial Statistics*, and *World Economic Outlook*, and authors' calculations. Growth and inflation refers to real GDP growth and CPI inflation, respectively. The data for the year 2009 are stated because it best reflects the current condition at the time of the release of staff reports for Article IV consultation.
GDP: gross domestic product; CPI: Consumer Price Index; IMF: International Monetary Fund.
*Projected figures taken from the IMF, *World Economic Outlook*.

in negative territory in 2009 and was predicted to remain around 3% in the upcoming years. Despite this, the country report raised concerns about inflationary pressure in the period ahead because of rapid expansion of monetary aggregates and credit growth (IMF, 2010f: 8). The Chinese authorities, however, opposed raising the nominal interest rate at this point, as they believed that the inflation outlook was still benign (p. 8).

Cambodia. At the time of the consultation, strong growth performance had been registered by the Cambodian economy for several years, the 2000–2009 average standing at 8%. The report on Cambodia (IMF, 2009b: 3) acknowledged the country's strong growth performance and significant reduction in poverty.[5] But the global recession seems to have buffeted the economy causing growth to plummet to −1.89% in 2009. At the same time, inflation was negative in 2009 and forecasts also show that it would remain below 5% in the near future. The decline in both growth and inflation indicates that expansionary macroeconomic policies were required to boost aggregate demand for growth to recover.

Yet, the staff-report saw an upside risk due to an 'overly expansionary' fiscal stance (p. 19), exerting 'pressure on inflation' (p. 3), and undermining 'stability' (p. 10).[6] The report, however, admitted that fiscal easing in the face of weak demand in 2009 was appropriate but raised concern that the 2009 fiscal deficit was expected to widen to 6.75% of GDP against the target of 4.25% (p. 10). The report was also against further easing of monetary policy; particularly lowering reserve requirements. It is 'neither warranted based on monetary conditions nor desirable from a prudential perspective', according to the report (see p. 14). However, the report does not offer any advice as to how to support recovery. It displays unwavering faith in macroeconomic stability in terms of inflation below 5% and budget deficits below 3% to deliver growth and economic recovery.

Lao PDR. As a transition economy, Lao PDR has performed well in recent decades with growth remaining above 6% on average. Acknowledging this, the consultation report on the country identified that the expansionary policies were responsible for this robust growth particularly in the face of the global recession (IMF, 2009d: 3). According to the report, inflation was expected to remain low and stable, assuming no significant rise in commodity prices (p. 3). Indeed, inflation was almost zero in 2009 and forecast figures were well below the country's historical median inflation at 10.63%. Yet, when it comes to policy advice, the staff-appraisal took the typical stance. It concluded that 'overly expansionary fiscal and credit policies pose a risk to macroeconomic stability' (IMF, 2009d: 3). The authorities were advised of the need for a 'prompt and determined tightening of monetary and fiscal policy' (p. 15). The report feared that continued credit growth 'could fuel inflation down the road'. It was therefore imperative, as the report suggested, to send strong signals to the banks to check credit growth by significantly raising the required reserve ratio (p. 3).

South-East Asia

We present the data on inflation and growth for East Asian countries in Table 4, followed by a summary of advice for each country: again illustrating the one-size-fits-all tendencies already identified.

Table 4. Average growth and inflation (%) in selected East Asian countries.

Country	Indicators	2009	2012*	2013*	Long-run median	Decadal median				
					1971–2009	1960–1969	1970–1979	1980–1989	1990–1999	2000–2009
Indonesia	Growth	4.47	6.1	6.6	5.96	2.81	7.71	6.54	7.14	4.91
	Inflation	6.38	6.2	6.0	10.46	128.8	14.30	9.38	8.97	8.34
Malaysia	Growth	−1.72	4.4	4.7	6.81	7.08	7.72	6.38	8.72	5.62
	Inflation	0.58	2.7	2.5	2.81	−0.10	4.07	3.25	3.51	1.67
The Philippines	Growth	1.14	4.2	4.7	4.61	4.82	5.35	3.46	3.01	4.66
	Inflation	3.22	3.4	4.1	7.51	5.40	12.14	10.40	7.93	4.96

Source: World Bank, *World Development Indicators*; IMF, *International Financial Statistics*, and *World Economic Outlook*, and authors' calculations. Growth and inflation refers to real GDP growth and CPI inflation, respectively. The data for the year 2009 are stated because it best reflects the current condition at the time of the release of staff reports for Article IV consultation.
GDP: gross domestic product; CPI: Consumer Price Index; IMF: International Monetary Fund.
*Projected figures taken from the IMF, *World Economic Outlook*.

Indonesia. Growth in Indonesia was moderate in 2009, at 4.47%. In fact, the median growth between 2000 and 2009 was 4.91% and was about 2 percentage points lower than the median figures of the previous three decades. The Indonesian economy managed to grow at around 7%, on average, in the 1970s, 1980s and 1990s. The relatively poor performance in the 2000s was due to the fact that Indonesia was hard hit by the Asian Currency Crisis of 1997. The impact of the crisis is reflected in the country's apparent difficulty in regaining its past robust growth path. On the other hand, inflation was around 6% and was expected by the IMF team to remain at that level in 2012 and 2013. Hence, inflation did not seem to impose any threat. The figure was still at least 2 percentage points less than the decadal median values since the 1980s. The Indonesian economy has had the experience of growing faster with higher inflation rates (see the decadal median values of the 1980s, 1990s and 2000s).

The country report on Indonesia (IMF, 2009c: 11) found the fiscal stimulus and monetary easing in the aftermath of the global financial crisis to be appropriate, as it had supported the 'weaker domestic demand'. Indonesia, before the fiscal stimulus package for 2009, followed several years of prudent fiscal management and achieved a primary fiscal surplus of about 2% of GDP per year (IMF, 2009c: 6). This is the reason why the report was also positive about the fiscal stimulus, seeing it as unlikely to hamper medium-term public debt consolidation.

Although inflation figures did not appear to be alarming, nevertheless the staff-appraisal suggested that the central bank should be more cautious. It argued that there was 'ample stimulus in the pipeline' (p. 19), in the form of interest rate cuts and 'abundant liquidity in the banking sector' (p. 10), 'leading to higher credit growth and inflationary expectations' (p. 10). In addition, referring to a Taylor rule-based calculation,[7] the report indicated that the central bank's 'policy stance has generally tended to have an expansionary bias over time' (p. 10). Therefore, it underscored a need for a concerted effort 'based on a more credible and objective inflation targeting framework to consistently lower inflation and guide inflationary expectations towards a medium-term target range of 3%–4%' (p. 11). This was believed to be required to 'enhance policy credibility and lower economic costs' (p. 11).

Malaysia. Malaysia posted negative growth in 2009, and the country report stated that 'forceful counter-cyclical policies' have helped the country to emerge from 'the global recession with strong forward momentum' (IMF, 2010c: 4, 19). The country's growth forecasts of around 4% were still well below its historical standard at 6.81%. There was also no sign of overheating as inflation was expected to remain at about 2%. Therefore, the full recovery did not seem to have taken place. Yet, the IMF report stated that a policy of fiscal consolidation and normalisation of monetary policy should be underway. The staff-appraisal suggested that raising the policy rate after aggressive loosening in 2009 was consistent with Taylor rule calculations (IMF, 2010c: 10). The IMF team was concerned about 'side-effects of abnormally low interest rates' (p. 10). Higher interest rates were believed to send a signal against 'investor's complacency in the pricing of risks after a year and a half of loose monetary conditions' (p. 10).

The Philippines. The historical evidence suggests that the Philippines have yet to show a strong growth performance. Its long-run median growth is below 5% and the figure dropped to 1.14% in 2009. The IMF (2010g) country report stated that the slowdown in growth had been 'cushioned by supportive fiscal and monetary policies and resilient remittances' (p. 3). The report praised the inflation condition of the country, noting that credit growth decelerated and inflation remained low. Inflation expectations were said to be well anchored at a level consistent with the central bank's inflation target (IMF, 2010g: 12). Although the recovery was not promising, the report nevertheless suggested 'fiscal withdrawal' and capping the fiscal deficits at 3.5% of GDP, in order to contain the high public debt level and to avoid jeopardising investor confidence (p. 9).[8]

Overall, the analysis of country reports shows little evidence of a change in the advice on policy by the IMF staff. This finding is mostly consistent with that of Anwar and Islam (2011) and Roy and Ramos (2012). The decadal median figures for inflation show enough variation, and hence, it is difficult to suggest a unique inflation target that can be followed for all the countries. It provides a strong case for advising an inflation target considering the country-specific circumstances that is stated in the preamble of IMF's Article IV itself.

Alternative strategies

The exclusive focus of monetary policy on a single-digit inflation rate, usually 5% or less, in developing countries fails to address concerns such as employment creation and poverty reduction. Indeed, several decades of experience with this inflation-focused approach has been rather disappointing for many countries. In a number of countries, inflation has come down, but the hoped for gains in employment and poverty reduction have, generally, not materialised (Epstein and Yeldan, 2006).

Thus, many economists argue that the central banks should target a moderate inflation rate. The extant literature cited here shows that Asia-Pacific developing countries can choose flexible inflation targets within a wide band. This can range, according to Muzaffar and Junankar (2014), from 7% to 14%, depending on their level of development and economic characteristics (see Table 5).

A rigid inflation target of 5% or less can be harmful for growth and employment and hence for poverty reduction. Monetary policy objective setting should distinguish between the need to safeguard price stability as a core principle and the more restrictive notion of targeting a specific inflation rate. This would allow monetary policy to consider other objectives, such as *orderly economic growth*, while keeping inflation in check – an approach enshrined in the preamble of the IMF's Article IV. This flexible approach would also allow monetary authorities to design instruments based on sources of inflationary pressure, rather than simply raising policy rates, an approach that can exacerbate the adverse output and employment effects of supply shocks.

Conclusion

We have shown that IMF policy advice in the aftermath of the global crisis of 2008–2009 is not consistent with the recent suggestions made by leading and influential economists.

Table 5. Level of economic development and inflation threshold in selected group of Asian developing countries.

Indicator		Inflation threshold (%)
Mean real GDP per capita (USD)	534.24	14.28
	1099.92	11.07
	1268.83	8.31
Most agriculture dependent	Agriculture/GDP > sample mean 24.63%	13.51
Least agriculture dependent	Agriculture/GDP < sample mean 24.63%	10.7
Most financial deepening	M2/GDP > sample mean 45.25%	7.83
Least financial deepening	M2/GDP < sample mean 45.25%	13.91
Most trade openness	Total trade/GDP > sample mean 88.08%	7.92
Least trade openness	Total trade/GDP < sample mean 88.08%	11.2

Source: Muzaffar and Junankar (2014). Note that results are from a panel study using System Generalized Method of Moments. Most agriculture-dependent countries are Lao PDR, Cambodia, Kyrgyz Republic and Papua New Guinea. Least agriculture-dependent countries are Kazakhstan, Thailand, Malaysia and Indonesia. Most financial deepening countries are Malaysia, Thailand, The Philippines and India. Least financial deepening countries are Tajikistan, Lao PDR, Cambodia and Kyrgyz Republic. Most trade openness countries are Malaysia, Papua New Guinea, Vietnam and Thailand. Least trade openness countries are India, Bangladesh, Pakistan and Indonesia.
GDP: gross domestic product.

Nor does it comply with historical country-specific experience. However, to some extent, this should not be surprising when one considers the fact that 'rethinking macroeconomic policy' as well as its 2013 sequel was written largely from the perspective of advanced economies (Blanchard et al., 2010, 2013).

Our critique on the continued policy advice by the IMF finds inconsistency at three levels: (a) with the shift in the IMF's own thinking as revealed by its senior economists, (b) with the history of inflation and growth and country circumstances, and (c) with findings from the literature. The IMF policy still tends to follow a pre-set view with predictable conclusions that do not allow for alternative perspectives. Our analysis reiterates the need for a change in the narrow policy advice and put it firmly on its already stated principle of 'fostering economic growth with reasonable price stability'.

Findings from our discussion and the existing literature suggest that developing countries should not be alarmed when inflation crosses the 5% boundary. For example, Asia-Pacific developing countries can choose flexible inflation targets within a band between 7% and 14% depending on their country-specific circumstances. There are benefits from such flexible inflation targets. For instance, moderate inflation enhances fiscal space, providing finance to help close the large physical and social structural deficits that exist in developing countries.

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Notes

1. The target was inflation, and the instrument was the policy rate.
2. This is because of the problem of the zero bound to the nominal interest rate.
3. Bangladesh currency.
4. Poverty headcount ratio at national poverty line (% of population) (The World Bank, 2014).
5. According to the country report (p. 4), the poverty level went down from 50% in the mid-1990s to 30% in 2007.
6. In fact, the report underscores the need to keep the budget deficits within 5.75% of GDP which it believes will be 'appropriately accommodative in providing adequate space for development objectives, but eliminating the domestic financing requirement and setting the stage for medium-term fiscal consolidation' (p. 11).
7. The *Taylor Rule* was developed by John B. Taylor of Stanford University in the early 1990s (see Taylor, 1993). It provides a guideline for the central bank on how to set the short-term real interest rate in order to stabilise the economy and achieve inflation target. The rule can be written as follows: $r = 0.01 + 0.5y + 0.5\pi$, where r is the real interest rate set by the central bank, y is the percentage deviation of real GDP from a target and π is the inflation rate.
8. This suggestion was made in view of the government's plan to target a deficit of 3% of GDP in 2010 so as to attain a balanced budget by 2013 (see IMF, 2010g: 9).

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