ufacturing sectors and both need significant infrastructure investment to support a rapidly growing domestic demand. From an Australian company's point of view, the political and economic ties that Australia has shared with these two countries provide brand-name recognition that may be lacking elsewhere. In other words, Indonesia and Vietnam may be the next big thing for Australian firms.

GO FOR GROWTH

After China, Indonesia and Vietnam boast some of the Asia Pacific region's highest growth rates. This year, real GDP is expected to expand by 6.0 per cent in Indonesia and 8.5 per cent in Vietnam, with similar rates projected for 2008 and 2009. However, the factors driving growth in Indonesia and Vietnam are quite different.

Indonesia is essentially making up for lost time following the 1997-1998 financial crisis. The political upheaval and transition to democracy that followed contributed to a tremendous economic setback, and it was only in 2005 that personal incomes and asset prices returned to pre-crisis levels.

In recent years, Indonesia's rising growth rate has been fuelled by classic reform that has brought Indonesia close to an OECD-style economic policy framework. The government's fiscal accounts are vastly improved, and the stock of public sector debt has declined from more than 100 per cent of GDP in the aftermath of the crisis to less than 40 per cent today. Falling government debt levels are 'uncrowding' the financial system and freeing up funds for private investment.

This reduction in debt has been accomplished while the government restructures the banking system, with the largest 15 banks now reporting a non-performing loan (NPL) ratio below 8 per cent and a liquidity ratio in excess of 100 per cent. The Central Bank has fully floated the currency and moved to an inflation-targeting framework, which will produce stable interest rates in a low inflation environment over the medium term. In fact, the Indonesian rupiah is arguably one of the only truly floating currencies in the region.

As with the Australian experience with the float of the A$ in the mid-1980s, the float of Indonesia's currency combined with financial sector reform provides an important market-driven buffer to external changes. In this vastly improved economic environment, Indonesia will be able to sustain its long-term potential rate of economic growth, estimated by ANZ Bank to be around 6 per cent per annum. If the forecasts prove correct, the size of Indonesia's economy will expand from US$960bn at present to more than US$2 trillion by 2020, raising Indonesia from the 15th largest economy in the world to within the top 10 over that period.

In contrast, Vietnam's high growth rate is the result of an initial process of economic opening and industrialisation, started across East Asia more than 20 years ago. The process of industrialisation is clear, with agricultural production down from 30 per cent of GDP in 1990 to 20 per cent today. Meanwhile, industrial production rose from 25 per cent of GDP in 1990 to 40 per cent now. The process of industrialisation has been driven by the reform of the state-owned sector, which has seen a considerable decline in the number of state-owned enterprises – from more than 12,000 in 1990 to less than 4,000 today. Another contributing factor has been the opening of the economy to external trade. Exports now account for more than 60 per cent of GDP in Vietnam against 45 per cent of GDP just five years ago. Of that, foreign-invested firms are responsible for the production of roughly half of Vietnam's exports.

Vietnam has become an alternative manufacturing base to southern China, with more than 60 per cent of foreign direct investment (FDI) in the manufacturing sector having originated in Taiwan, Korea

DEVELOPING COUNTRIES

Poverty and deficits linger

Structural adjustment programs (SAPs) are conditional policy changes implemented by the World Bank and the International Monetary Fund in developing countries to reduce a country's fiscal imbalances. They reduce the role of government and focus on macroeconomic reforms such as promoting free trade and deregulating financial, legal and regulatory frameworks.

The policies of SAPs typically constitute a phase of 'stabilisation'. These policies can include a 0–1 per cent budget deficit, control of inflation, a new competitive exchange rate through devaluation and equilibrated balance of payment and a phase of 'structural change' that includes liberalisation of trade and capital flows, privatisation of public industrial and service enterprises and financial and administrative reforms to introduce market forces in the public and Japan. Intel, Nike and Canon have set up there, and FDI has risen from 25 per cent of GDP in 1990 to 66 per cent today, with the bulk going into the manufacturing sector.

Vietnam's entry into the World Trade Organisation (WTO) in late 2006 is expected to provide a further impetus for growth, not just in terms of opening export markets, but also because of the ongoing deregulation of the local market. For example, before last year, foreign companies were not allowed to participate in distribution to the retail market in Vietnam and, as a result, there were no foreign franchise outlets to be seen in Vietnam's major cities. Meanwhile, more than 70 per cent of households avoid bank loans to finance a motorbike or build their homes and rely instead on family or friends. The opening up of these new markets to foreign firms and the infrastructure required to support these activities will drive Vietnams' economy towards rates in the vicinity of 7-8 per cent per annum over the next five years.

THE YOUNG ONES

Indonesia and Vietnam's demographics compare favourably to China's. Indonesia has 222 million people and Vietnam 84 million. By 2015, Indonesia is expected to have a population of 251 million and Vietnam 96 million.

The populations are large and young. Comparing countries by median age of the general population, Indonesia ranks 83rd (median age 26.5) and Vietnam ranks 95th (median age 24.9), far younger than China which ranks 57th (32.6 years) and Australia in 36th place (36.6 years). The demographics have implications for consumer behaviour in the future, as a lower dependence ratio in Indonesia and Vietnam means that the younger segments of the population will be under less pressure to support their elderly relatives. In contrast, the savings rate is expected to remain high in China until a social safety net is secured.

Well-educated, dynamic and fun to be around

sector. Although SAPs have successfully opened many economies by eliminating excessive and inefficient state control, they have mostly failed to control fiscal deficits and, more importantly, to alleviate poverty. Launched in 1997 with the consent of the World Bank, the Structural Adjustment Program Review Initiative Network (SAPRIN) investigated the impact of SAPs in eight countries: Bangladesh, Ghana, Uganda, El Salvador, Mali, Zimbabwe, Ecuador and Hungary. It found that structural adjustment measures have significantly increased poverty, inequality and social exclusion. Meanwhile, a study of Sub-Saharan Africa (SSA) found that even after three decades of SAPs, 'sustainable economic and market viability is yet to be restored in any single country'.

So what went wrong?

GOOD GOVERNANCE

The most common elements of good governance include political accountability, a sound judicial system, accountability and transparency and, most importantly, incorporation of market principles in the operation of public organisations. Good governance needs a high level of cooperation and collaboration between sectors to ensure synergetic relationships and lower governance transaction costs.

A World Bank-commissioned study from 2003 identified a set of governance indicators covering almost 200 countries for the period 1996-2002. It focuses on six dimensions: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption. These indicators are closely interlinked and it is reported that adherence to any of the six indicators causes a two-and-a-half-fold increase in per capita income, a four-fold decrease in infant mortality and a 15-25 per cent increase in literacy. The establishment of good governance – critical for the successful outcomes of the reforms – therefore remains as a great challenge for both International Financial Agencies (IFAs) and third world countries.

CONDITIONALITY AND POLICY OWNERSHIP

Aid conditionality has been used by the financial agencies as a popular instrument to promote policy reforms in third world countries. However, so far this

Although China has a much larger population, only 40 per cent of the population lives in urban areas against 48 per cent in Indonesia. Vietnam has a lot further to go on urbanisation but the process also implies opportunities for infrastructure development in the major urban centres around Hanoi and Ho Chi Minh City.

RESOURCE RICH

Both Vietnam and Indonesia are believed to have substantial oil and gas resources. Both export oil at the moment but are net importers of petroleum products due to a lack of domestic refining capacity. Indonesia has been aggressively developing its gas industry with an eye toward exporting liquefied natural gas through the region. Coal is one of the largest areas of industrial production in Vietnam, with strong growth also recorded in natural gas in recent years.

Indonesia and Vietnam also have substantial manufacturing bases that are viewed as globally competitive due to lower labour and land costs. While labour is arguably not as productive as in China, Indonesia and Vietnam are viewed as good alternatives to an increasingly expensive China. Their geographic location and multiple domestic ports – while still lacking world class infrastructure – make both countries well-suited for production for export markets.

In Indonesia, the up-and-coming sectors as judged by domestic investment flows are paper products manufacturing, chemicals and pharmaceuticals production and food processing and production. Foreign investment has lagged the domestic action. It has been a tiny fraction of domestic investment with a paltry US$3.7bn invested in the first half of this year. In Vietnam, from a production-for-export perspective, textiles and footwear has been a key focus, particularly as China's response to rising trade tensions with the US has been to tighten regulations that supported cheap manufacturing of these goods in China.

Finally, domestic demand for services in both countries is growing strongly. Vietnam literally cannot find enough professionals, whether it's in the legal, accounting or financial field. The take-off in both countries of Information and Communication Technology (ICT) and popular media provides huge opportunities as well. Going forward, the strong reputation of Australian firms in tertiary education and health care position them well to provide these services in the rapidly growing markets of Indonesia and Vietnam.

conditionality has not delivered the desired rates of compliance among the loan recipient countries. Despite the expansion of its use since the 1980s, conditionality is being questioned as ineffective, intrusive and corrosive. The problem with it lies in the actual ownership of the program. Put simply, country ownership of programs is essential as this not only generates a firm commitment from the national government, but it also increases the probability that programs will succeed and that money and resources provided will be used properly.

STAKEHOLDER INVOLVEMENT

Agreements on implementation of programs reached in non-transparent discussions between small groups of national government officials and the World Bank is a top down approach that can exclude important stakeholders such as local governments. Realising the importance of the involvement of stakeholders, Poverty Reduction Strategy Papers (PRSPs) now place a strong emphasis on making policies inclusive of all stakeholders. Reform policies promoted by the IFAs in third world countries have not been able to achieve their expected benefits in most of the cases. Realising the failure of the policies, the IFAs have considerably changed both their policy response and philosophy regarding third world countries. PRSPs have now become the basis for all debts/loans provided by the IFAs and are expected to be country-owned and involve the participation of all stakeholders.

There has been much attention about the importance of promoting good governance in third world countries but, in reality, the issues of good governance, stakeholder involvement and country ownership have not been addressed adequately. As a result, despite all the rescheduling and restructuring, economic development in third world countries remains elusive.

Dr Fara Azmat lectures at the Bowater School of Management and Marketing at Deakin University and **Ramanie Samaratunge** is a Senior Lecturer in the Faculty of Business and Economics at Monash University

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