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Review

Indonesia during two big economic crises 1997/98 and 2008/09: How was the impact and what was the main difference between the two crises?

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This paper aims to examine the Indonesian experiences with the 1997/98 Asian financial crisis and the 2008/09 global economic crisis. It has three main parts. The first part gives a theoretical explanation of the main transmission channels through which the two crises have affected the Indonesian economy. It also provides a list of key indicators of these types of economic crises. The second part is the empirical part about the impacts of the crises on economic growth, employment, remittances and poverty in Indonesia. One important finding from this study is that the Indonesian economy was much more resilient to the last crisis as compared to the first crisis. During the first crisis, Indonesian economic growth was negative and poverty increased significantly; whereas during the second one, Indonesia managed to keep a positive economic growth rate (though declined), and poverty kept declining. The third part provides a list of main reasons for the difference, and sound banking sector after the first crisis is among the list.

Key words: 2008/09 crisis; 1997/98 crisis; Economic growth; Remittance; Poverty; Unemployment.
JEL Classification: E24, F24, F43, I32.

INTRODUCTION

Indonesia now is much more vulnerable to any economic shock than, say, 30 years ago, for the following reasons. First, since economic reforms started in the 1980s toward trade, banking, investment, and capital account liberalizations, the Indonesian economy has become more integrated with the world economy. Second, though at a decreasing rate, Indonesia is still dependent on exports of many primary commodities, i.e. mining and agriculture. This means that its economy is still sensitive to any world-price/demand instability for those commodities. Third, Indonesia has become increasingly dependent on imports of a number of food items such as rice, food grains, cereals, wheat, corn, meat, dairy, vegetables and fruits, or even oil. Any increases or instabilities of world prices or world production failures of these commodities will have big effects on domestic consumption and food security in Indonesia. Fourth, more of the Indonesian working population, including women, went abroad as migrant workers, and hence livelihoods in many villages in Indonesia have become increasingly dependent on remittances from abroad. Any economic crisis hit the host countries (such as happened in Dubai during its financial crisis in 2009) will hit the Indonesian economy too. Finally, as a huge populated country with increasing income per capita, domestic food consumption is not only high but it also keeps increasing. Accelerating output growth in agriculture is therefore a must for Indonesia, and this depends on various factors, including climate, which is an exogenous factor. As Indonesia is located between the Pacific ocean and the Indian ocean in the line of equator, the country is always vulnerable to El Nino/La Nina phenomenon which may cause failures in rice (and other commodities) harvest and therefore will generate a hyperinflation.

In the past 12 years, Indonesia has experienced

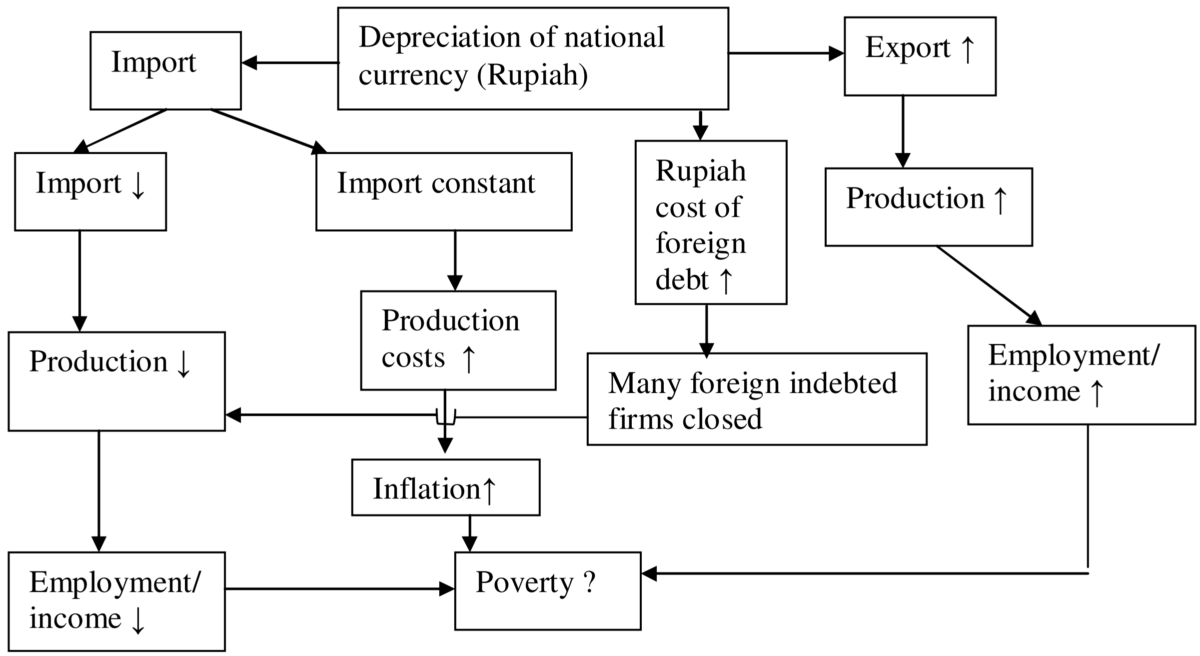

Figure 1: Theoretical Explanation on the Transmission Channels of the Effects of the 1997/98 Crisis on the Indonesian Economy

two economic crises, i.e. the Asian financial crisis started by mid. 1997 and reached its peak in 1998, and the global economic crisis in 2008 and 2009. This paper aims to examine the Indonesian experiences with these two crises. It addresses two key questions. First, what were the main transmission channels through which the two crises affected the Indonesian economy. Second, was the impact on the Indonesian economy different between the two crises, and if yes, what made the difference?

The paper has three main parts. The first part gives a theoretical explanation on the main transmission channels through which the two crises have affected the Indonesian economy. The second part examines empirically the impacts of the two crises on the Indonesian economy focusing on economic growth, export, employment, remittances and poverty. The third part gives the most likely reasons that made the impact of the 1997/98 crisis different than that of the 2008/09 crisis.

Main Transmission Channels

The 1997/98 Crisis

In Indonesia, the 1997/98 Asian financial crisis was triggered by a sudden capital flight from the country which led its national currency, rupiah, to depreciate significantly against the US dollar. [i]The depreciation was soon followed by a national banking crisis and ended up as a national economic crisis (Rajan 2001). Thus, for Indonesia, the 1997/98 crisis was initialy a currency crisis. Theoretically, its direct impact would be mainly on Indonsian export and import (Figure 1). [ii]By assuming other factors constant, Indonesian export, and hence, production, employment and income in its exporting firms/sectors and in their backward as well as forward linked firms/sectors would increase, and poverty would decline. This is the “export-side effect” of a currency depreciation(Talvi 1997; Obstfeld and Rogoff 1995; Obstfeld 1986, 1996, 1997; Kenen 1996; Krugman 1979, 1996; Radelet and Sachs 1998a,b; World Bank 1998; Berg 1999; Rajan 2001).[iii]

On the import side, domestic prices of imported consumption and non-consumption goods will also increase. In the case of non-consumption goods (i.e. raw materials, capital and intermediate goods, components/spare parts), as a response to higher prices (in national currency) of these imported goods, two scenarios are possible: (1) imports decline and, consequently, total domestic production and employeemnt would drop, and poverty would grow; or (2) imports may stay constant, but, consequently, domestic production cost would increase and finally it would lead to higher domestic inflation and more poverty. This is the “import-side effect” of a currency depreciation.

The rupiah depreciation would also make the value in rupiah of foreign debts (in foreign currency against which rupiah has depreciated) owned by domestic firms to rise. Many highly foreign indebted domestic firms would face a serious financial crisis. If many of them have to reduce their production or even collapse, domestic total production and employment would then further decline, and more poverty as the result . This can be called as the foreign loan cost-side effect of a currency depreciation.[iv]

During the crisis, domestic interest rate also increased significantly as the result of the Indonesian monetary authority's direct response to stop capital flight and rupiah to fall further. Theoretically, higher interest rate would reduce credit demand on one hand, and, increase non-performing loan (NPL) of highly indebted firms, on the other hand. The increase in total number of domestic firms with high NPL together with bank panic would make the banking sector to collapse and credit scarce. So, the combination of the rupiah depreciation and the banking collapse (caused by higher interest rate) would hit not only higly import-depending firms but also high bank loans-depending firms. Further, this would lead to domestic inflation, unemployment, and increase in poverty. This can be called as the "domestic loan cost-effect" of a currency depreciation (Tambunan, 2010; Corsetti 1998; Corsetti et al. 1999a,b, 2001; Chinn and Kletzer 2000).[v]

Thus, with the many possibilities that can happen as a result of currency depreciation as explained above, the overall net impact of a national currency depreciation on poverty can be thus positive, negative or even no effect at all. It would depend much on whether the export-side effect (positive) is larger, equal to or smaller than the combination of the import-,foreign loan cost-, and domestic loan cost-side effects (negative) of the depreciation. The key issue here is the response in the export-side. The question is that when the rupiah is weakening, would export increase significantly that it can overcompensate the negative import- and loan costs-side effects. The answer is that it would depend at least on two main factors. First, the proportion of imported inputs in the export products, because it would determine to what extent the price competitiveness of the products would increase when rupiah depreciates. Second, domestic production capacity of the export goods, which determines to what extent the production would increase when their price competitiveness increases (Tambunan,2010).

The 2008/09 Crisis

The 2008/2009 crisis has been called by many economists as the most serious economic or financial crisis since the great depression in the 1930s. The crisis impacted many countries through various channels: exports, investment (including foreign direct investment/FDI) and remittances (Chhibber et al., 2009; Griffith-Jones and Ocampo 2009; IDS 2009).[vi] However, for Indonesia and many other developing countries the most important channel was export. Retrenchments mounted in many export-oriented manufacturing firms in these countries, while working time fell along with increased downward pressure on wages. Also many employees in these firms were laid off and many of them migrated back to rural areas and shifted to informal and vulnerable employment.

For Indonesia and most other affected countries, the 2008/09 crisis was therefore considered primarily as a world demand/export market crisis. Theoretically, as illustrated in Figure 2, this kind of shock would affect the economy of these countries at the first stage through its effects on domestic export-oriented firms. It leads further to less production and employment in these firms and in other related firms. The employment reduction causes decline in incomes of many households and it would result further in lower market demands for goods and services and hence production cuts in many industries/sectors. Finally, unemployment and poverty would increase (Tambunan,2010).

In large countries like Indonesia which consists of many islands or regions (i.e. provinces, districts and subdistricts), the impact may vary by region, or even the impact in some regions within the country may be more severe than at the national level. For instance, if the decline in average household income in Java island (where most export-oriented manufacturing industries are located) is higher than that in the rest of the country and the proportion of the affected households in Java is significantly large, then total income in Java would decline faster than that in the rest of the country, *ceteris paribus*.

By assuming that other factors do not change, if remittance inflows to Java from foreign countries also affected by the crisis also decline, then the income in Java would drop further. If remittances to other regions outside Java also decline, then the national income or the economic growth rate would decrease. In other words, if only one region in Indonesia was affected by the crisis and the region's economy is not significantly important to the national economy based on gross domestic products (GDP) distribution by region, the effect at the national level might be insignificant, even if the impact in that particular region was significant. On the other hand, if Java is the highest Indonesia's GDP contributor, even a small impact of the crisis on Java would produce a serious shock for the national economy.

Thus, depending on: (1) the importance of the affected export commodities in Indonesia's total export; (2) the importance of the commodities and their related sectors (through backward and forward production linkages) in the economy of the regions of

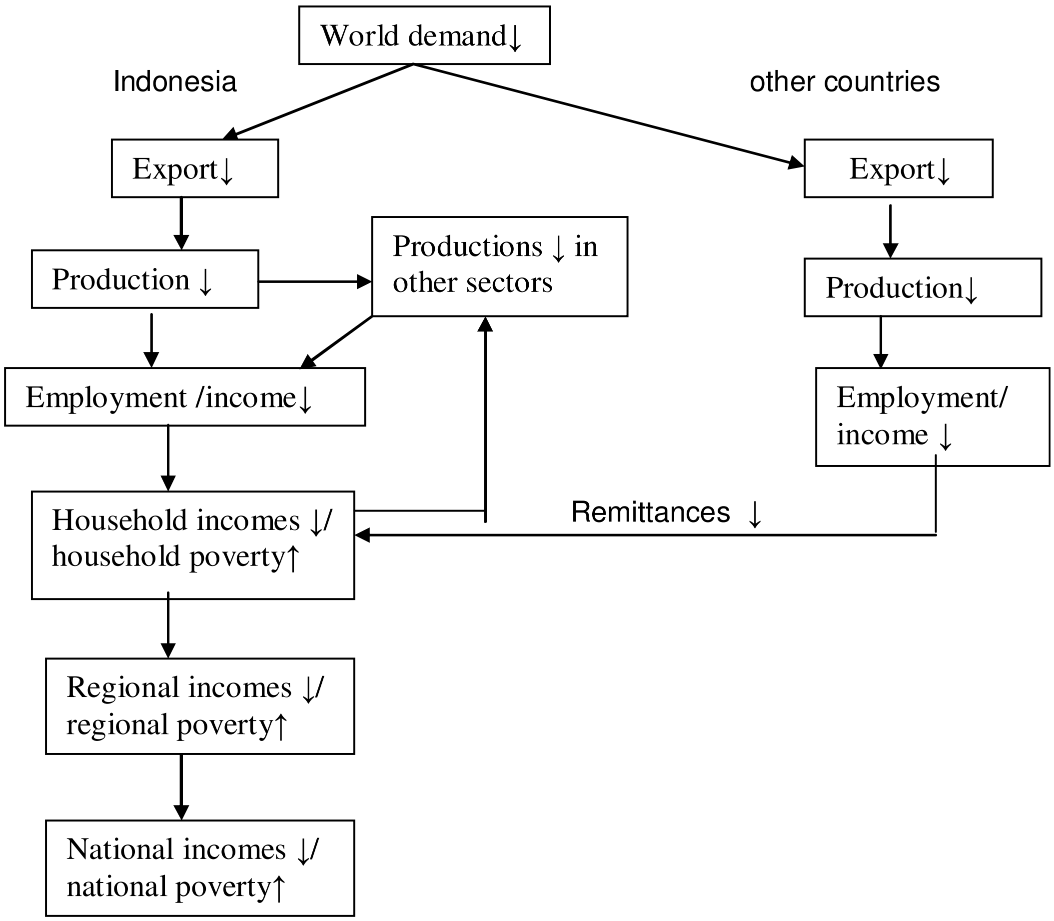

Figure 2: Theoratical Explanation of Transmission Channels of the Effects of the 2008/09 Crisis on the Indonesian Economy

origin; (3) the importance of the regions' economy in the Indonesian economy; and (4) the crisis-coping measures taken by the affected firms to mitigate the effect of the crisis, the impact or outcome of the 2008/09 crisis on the Indonesian economy and hence poverty can be large or small. Therefore, as an analytical approach, the impact of the crisis on Indonesia's economy and poverty should be examined by analysing the followings: (a) export commodities which have been hit by the crisis; (b) regions/provinces where those commodities are concentrated; (c) linkages of those commodities with the rest of the economy; and (d) types of workers and their households who are mostly affected in those agricultural subsectors and in those regions in general.

However, since there is no data on Indonesian export commodities by region/province and especially no information about economic linkages between commodities and other regional sectors, the above proposed analytical approach can not be carried out in this study.

SUMMARY

From the above discussion, Table 1 summarizes the key transmission channels through which the 1997/98 and 2008/09 crises affected the Indonesian economy. With respect to the 1997/98 crisis, the key transmission channels through which the crisis affected the Indonesian economy were changes in total exports and imports and in total rupiah costs of domestic and foreign debts. Regarding its impact on poverty, the next transmission channels were changes in employment, income and inflation rate. Since the banking sector collapsed and interest rate increased during the crisis period (as discussed before), changes in credit and interest rate should also be considered as transmission channels. With respect to the 2008/09 crisis, the key transmission channels were changes in total exports, remittances, output, and employment or income.

Regarding the time that the effect reveals, the channels can be ranked as the first channel (*), that is the first revealed effect of a crisis, the second

Table 1: Main Transmission Channels of the Effects of the 1997/98 and 2008/09 Economic Crises

Period	Known as	Type of Economic Crisis	Main Transmission Channels
1997/98	Asia Financial Crisis	Currency crisis (National currency depreciated)	Export* Import* Credit* interest rate* Output** Employment*** income*** Inflation***
2008/09	Global Economic Crisis	World demand/export crisis (world demand declined)	Export* Remittances* Output** Employment*** income***

Table 2: Main Indicators of the 1997/98 Crisis and 2008/09 Crisis

Type of crisis	Main Indicators
Currency crisis (1997/98)	Export by sector and region Import by sector and region Domestic loans by sector and region Foreign loans by sector and region Output by sector and region Empoyment by sector and region Household income by sector and region Poverty by region
Export crisis (2008/09)	Export by sector and region Output by sector and region Empoyment by sector and region Household income by sector and region Remittances by region Poverty by region.

channel (**), i.e. the second effect revealed after the first one, and the third channel (***), and so on. However, when an economic crisis occurs its effects may take place through more than one channels simultanously, depending on type of the crisis. For example, the currency crisis has two first transmission channels simultanously namely export and import: when rupiah is depreciating, theretically, both export and import would change directly and simultanously.

Key Indicators

An economic crisis has not only main transmission channels, but also main indicators for monitoring the impacts of the crisis. Table 2 provides lists of main indicators for each of the two crises. For the 1997/98 crisis which was a currency crisis, the main indicators are export and import (in volume or value), costs of loans in rupiah from both domestic and foreign sources, output (volume or value), total employment (or unemployment), household incomes, and poverty. These are also the main indicators for the 2008/09 crisis which was a world demand or an export crisis, but without costs of loans and with one extra indicator, namely total remittances. Since the impact of an economic crisis on domestic economy may vary by region and sector, all indicators should therefore be based on disaggregated data by region (e.g. province, district or subdistrict) and sector (e.g. agriculture, industry manufacturing, mining, etc.)

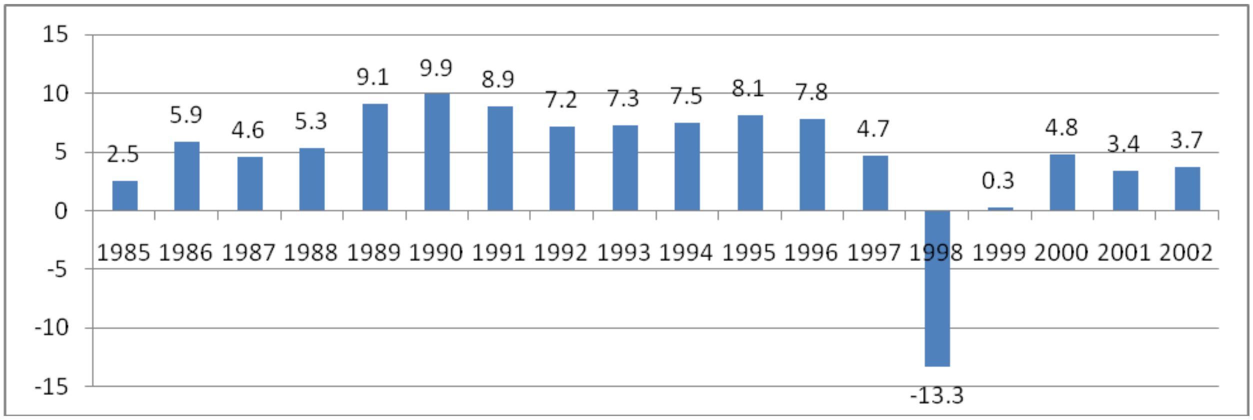

Figure 3: Indonesian GDP Growth rate during the 1997/1998 Crisis
Source: Statistical Yearbook of Indonesia (various years), Indonesian National Agency of Statistics (BPS) (www.bps.go.id).

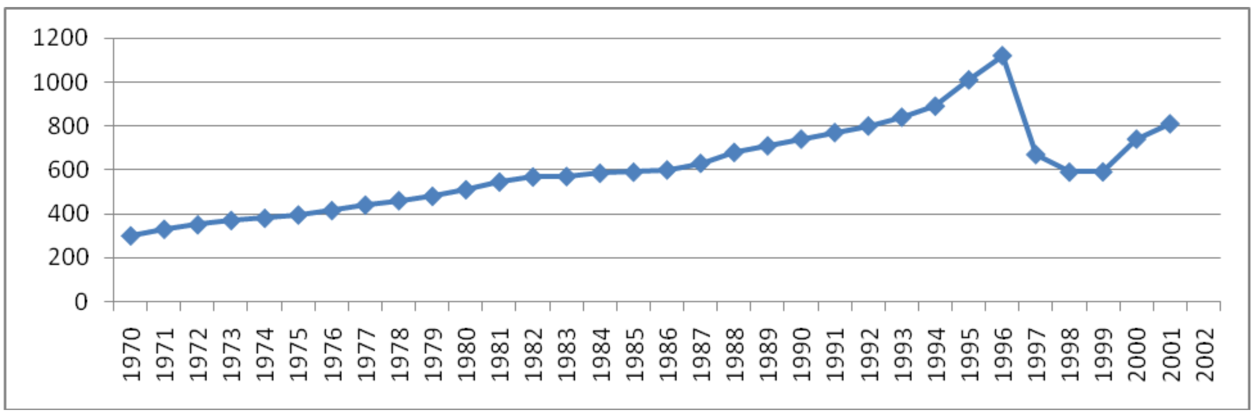

Figure 4: Development of Indonesian Income per Capita during the 1997/98 Crisis Period (US dollar).
Source: Statistical Yearbook of Indonesia (various years), BPS (www.bps.go.id).

Empirical Analysis of the Impacts

The 1997/98 Crisis

The 1997/98 crisis hit many countries especially in East and Southeast Asia including Indonesia, Thailand, Singapore, Malaysia, Philippines and South Korea. However, the impact varied by country. Indonesia together with South Korea were among the most severely affected ones. The Indonesian economy had plunged into a deep recession in 1998 with overall growth at minus 13.7 per cent (Figure 3). The worst declines were in the construction sector (-39.8 per cent), financial sector (-26.7 per cent), trade, and hotel and restaurant (-18.9 per cent). Other sectors, which had large contractions, were manufacturing (-12.9 per cent) and transport and communication (-12.8 per cent). Mining and other services sectors experienced a contraction of about 4.5 per cent. The agricultural and utility sectors still experienced positive growth at about 0.2 per cent and 3.7 per cent respectively (Feridhanusetyawan, et al., 2000). The crisis also led to a significant drop in income per capita (Figure 4) and a significant increase in poverty rate (Figure 5). All this evidence may suggest that the rupiah depreciation was more negative rather than positive for the Indonesian economy (Tambunan, 2010).

The increase in poverty and the decline in income per capita were consistent with output contractions in many sectors as expained before. There were three main reasons why the rupiah depreciation had caused a serious decline in Indonesia's aggregate output. First, despite the fact that Indonesia had adopted an import substitution strategy during the New Order era (1966-1998) Indonesia, especially the manufacturing industrty, has been increasingly dependent on imported capital and intermediate goods, components and spareparts and some processed raw materials. So, the rupiah depreciation

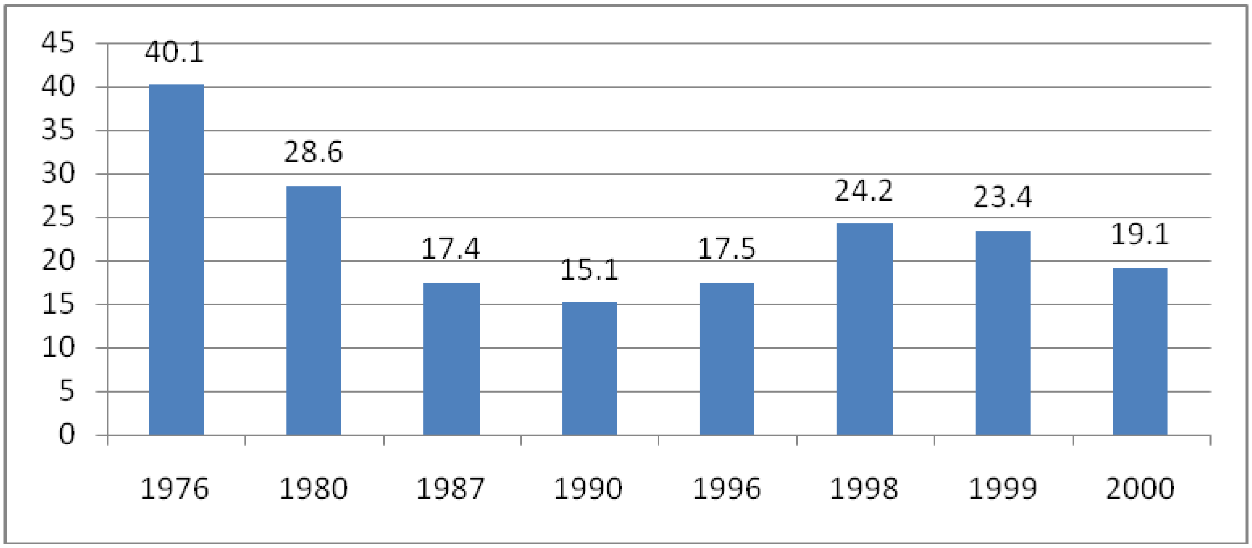

Figure 5: Poverty rate in Indonesia During the 1997/98 Asian Financial Crisis; Source: BPS (2009c).

prevented many export-oriented firms from gaining better world price competitiveness, while, on the other hand, many domestic market-oriented firms had to close down or to cut their production volume because they could not purchase any more very expensive imports. Second, many firms, expecially conglomerates, during that era had borrowed a lot money from foreign capital markets; mostly were short-term loans. They went bankrupt when rupiah depreciated and many other firms which had business relations with them were also in serious trouble. Third, the national banking sector was also collapsed. By the end of 1997 a total of 16 commercial banks were closed down, and access to credit then became very difficult and interest rate increased significantly. This has contributed significantly to output contractions in many sectors (Tambunan, 2010).

There is some evidence that the crisis not only increased poverty but also reduced the quality and supply of education and health services. Chhibber et al., (2009) report that the crisis decreased enrolment rates among children aged 8-13 years and increased enrolment rates among children aged 14-19 years, although these changes were small, just about one percentage point of enrolment. The impact on school enrolment, however, varied by region suggesting that different regions in the country may have experienced it differently with the crisis. Another important study is a 1999 report issued by the Australian Agency for International Development (AusAID). It shows that the crisis had numerous adverse health impacts in Indonesia, including: (1) declines in, respectively, personal and government expenditures on primary care. The use of health services for primary care also declined; (2) decline in purchases of medicines; (3) declines in DTP3 immunization rates and polio rates. Vitamin A supplementation also fell. The declines most likely occurred among the poorer populations; (4) decline in the lowest wealth quintile in child visits to health facilities; (5) a halt in the 1990s downward trend in infant mortality; and (7) mortality increases (AusAid, 1999).

The 2008/09 Crisis

Up to the end of 2008, countries like Thailand, Malaysia, Singapore, Philippines and Indonesia still showed some resilience towards the crisis. However in the first quarter of 2009, they experienced deteriorating economic performance, except Indonesia (Figure 6). Singapore suffered the most and recorded -8.9 per cent in real GDP growth rate (year-on-year basis) in the first quarter of 2009. This was not surprising, given the fact that as a small economy, Singapore is fully integrated with the global market for goods, services and finance. Consequently, its economy is fully sensitive to any external economic shocks. The country's economy then started to recover with positive growth again in the third quarter. Similarly with Singapore was Thailand which has also been seriously hit by the crisis since the third quarter of 2008 and the economy contracted by 7.11 per cent in the first quarter of 2009. Thailand achieved again positive growth in the last quarter of 2009. Malaysia which experienced a slightly positive growth of around 0.1 per cent in the last quarter of 2008, also suffered

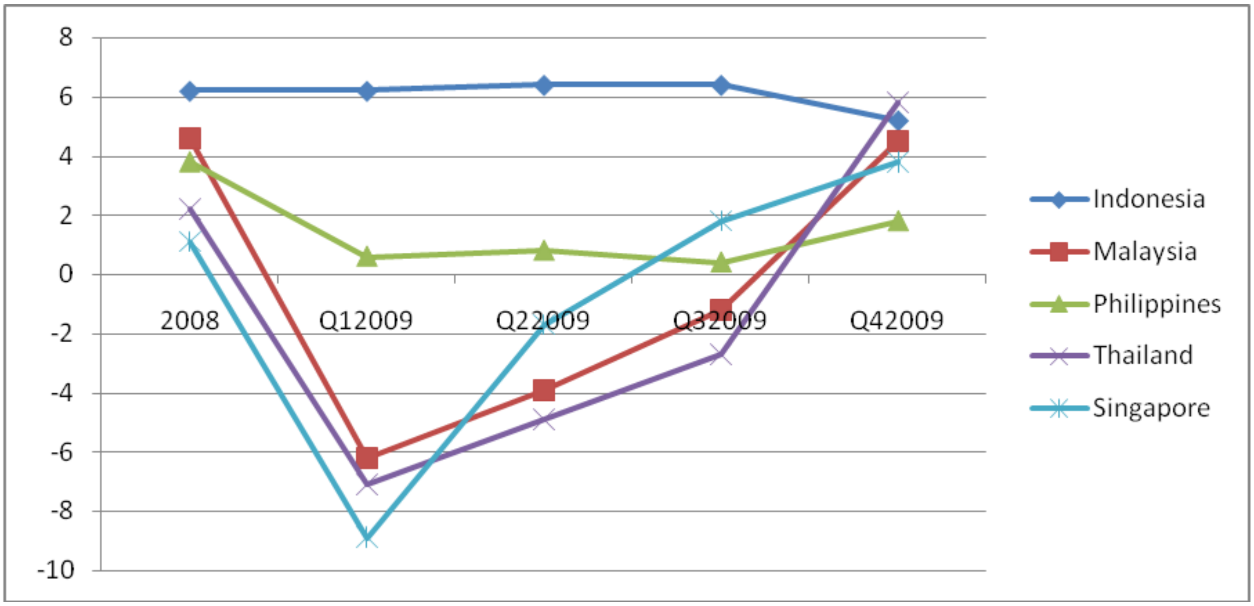

Figure 6: Economic Growth Rate in Selected ASEAN member countries, 2008 and 2009 (% change year-on-year)
Sources: World Bank database (country indicators) (http://web.worldbank.org/WBSITE EXTERNAL/COUNTRIES/).

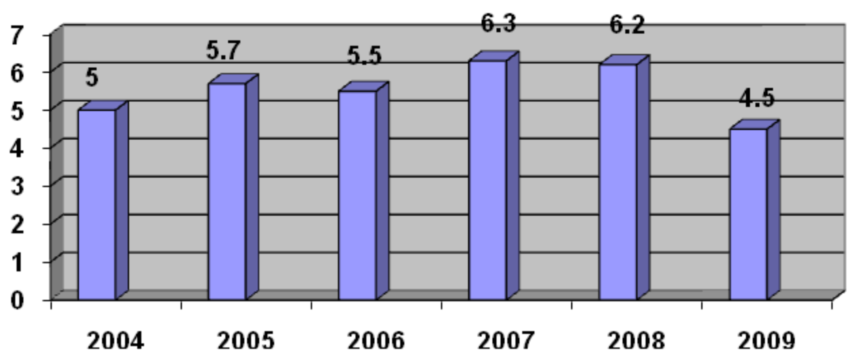

Figure 7: Indonesian Annual Economic Growth 2004-2009 (%)
Source: Statistical Yearbook of Indonesia (various years), BPS (www.bps.go.id).

economic contraction by 6.20 per cent in the first quarter of 2009. Meanwhile, Indonesia and the Philippines managed to keep positive growth though at declining rates during the crisis period. In the first quarter of 2009 Indonesia achieved 6.2 per cent growth, but in the last quarter it was lower at 5.2 per cent.

While the economy of other countries in the group was deteriorated significantly especially during the first months in 2009, Indonesia has not only positive but also slightly higher GDP growth rates during the second and third quarters of 2009. In overall, however, official data (National Agency of Statistics/BPS) show that the growth rate of Indonesian economy was at around 4.5 percent, much lower than the growth rate achieved in 2008 (Figure 7). This may suggest that the Indonesian economy was also affected by the world economic recession in 2008/09, but nevertheless the country was able to keep postive economic growth rates during the crisis period.

Further as shown in Table 3, besides Indonesia, there were other few countries in the region e.g. China, India, Pakistan and Bangladesh which also managed to mitigate the impact of the crisis on their domestic economy. Interestingly, the table shows that within the developing world, countries in Asia and the Pacific region performed much better than those in other parts of the world during the crisis. Of course, many explanations can be thought of, including that

Table 3: Economic Growth in the Developing World by Region, 2007-2009

Region	2007	2008	2009
East Asia and Pacific	11.4	8.0	6.8
-PRC	13.0	9.0	8.4
-Indonesia	6.3	6.2	4.5
-Thailand	4.9	2.2	-2.7
Europe and Central Asia	7.1	4.2	-6.2
South Asia	8.5	5.7	5.7
-India	9.1	6.1	6.0
-Pakistan	5.7	2.0	3.7
-Bangladesh	6.4	6.2	5.9
Latin America and Caribbean	5.5	3.9	-2.6
Middle East and North Africa	5.9	4.3	2.9
Sub-Saharan Africa	6.5	5.1	1.1

Source: World Bank (2010a).

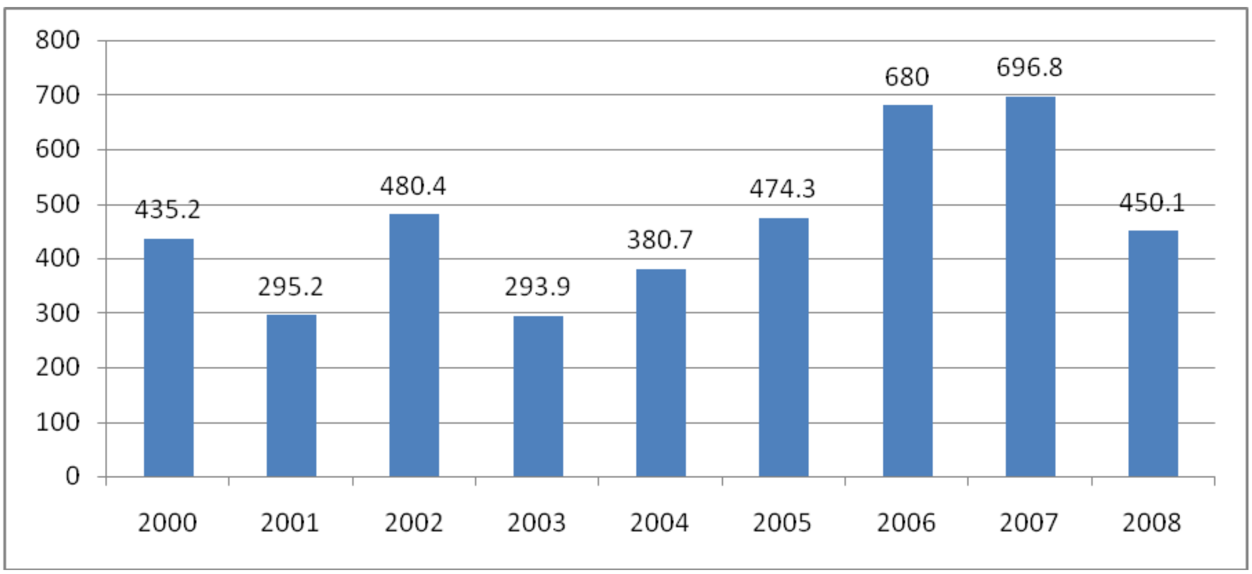

Figure 8: Total Number of Indonesian Overseas Workers, 2000-2008 (000 persons)
Source: Yudo et al.(2009)

the variation in the impact of this kind of crisis on domestic economy is strongly related to the degree of integration of the particular country with the world economy. Rapidness and effectiveness of crisis-coping policy measures in the partuicular country may also have played an important role.

With respect to remittances, according to ILO (2009) the number of Indonesian workers abroad had been on an upward trend until the crisis deepened in mid 2009. Yugo et al., (2009) provide data which show that the number of Indonesian workers that departed overseas increased with 258,000 workers by the end of December 2008 or around 54 percent as compared to the end of September 2008 with 168,000 workers. However, the total Indonesian workers tat went abroad in 2008 was less than in 2007 (Figure 8). However, according to Yugo, et al., (2009) estimation, total remittances inflows from overseas Indonesian workers declined slightly to approximately US$1.589 billion in the end of first quarter of 2009 from US$1.61 billion in December 2008. It is not sure whether the less number of Indonesian overseas workers in 2008 compared to 2007 or the slight decline in remittances inflows was caused by the crisis?

With respect to the impact of the crisis on employment, according to ADB (2009), unemployment in many Asian developing countries increased during the 2008/09 crisis, particularly in the more export-dependent economies of Hong Kong,

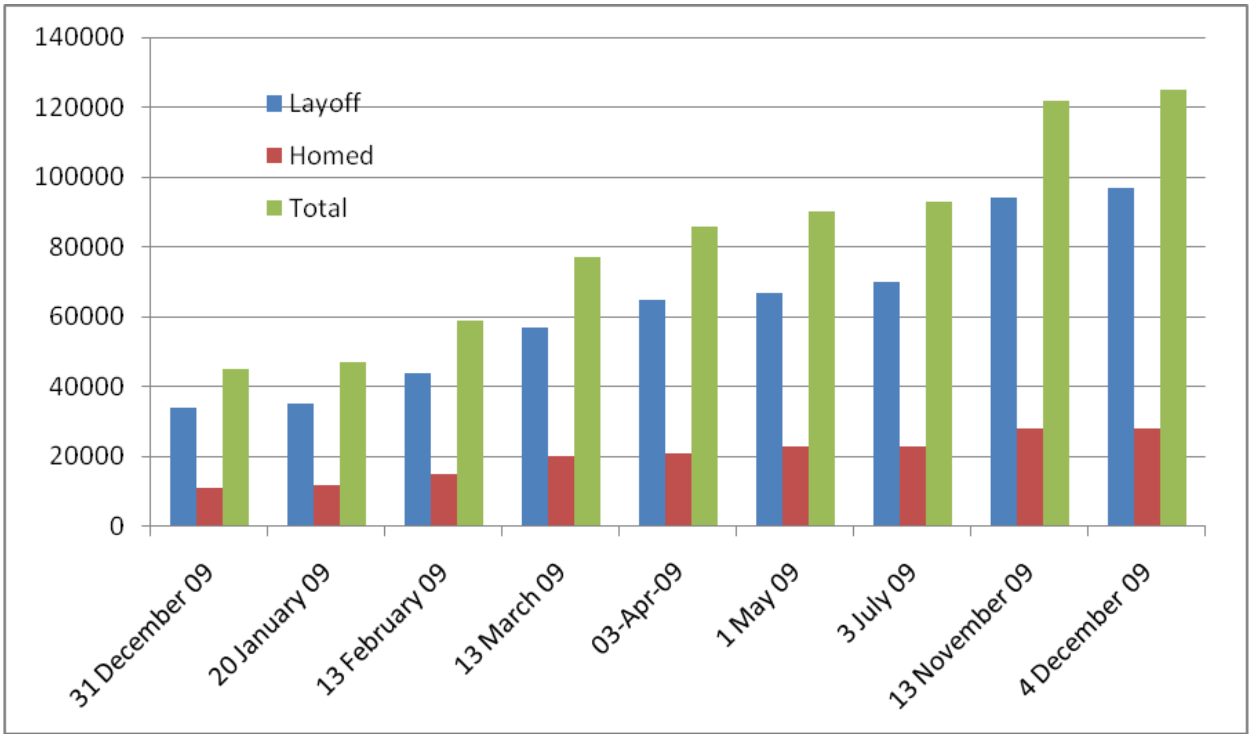

Figure 9: Number of Laid off and homed workers in the formal sector, 31 December 2008-4 December 2009
Source: Ministry of Manpower and Transmigration, and BPS (www.bps.go.id/sakernas).

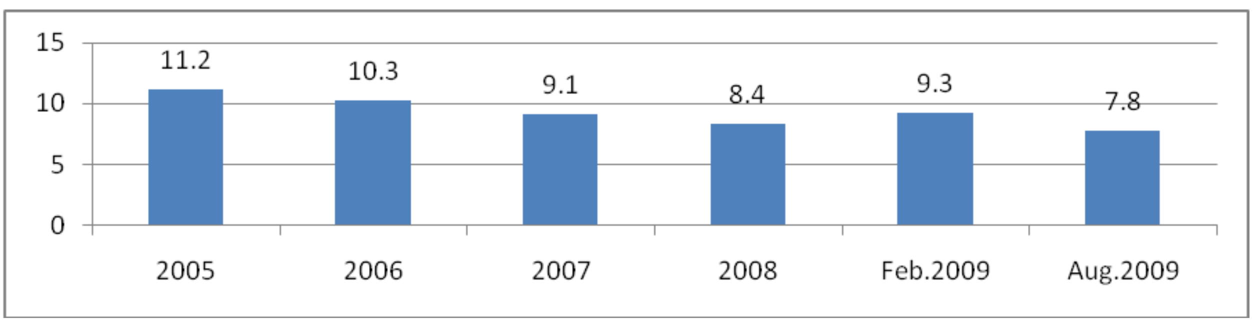

Figure 10: Open Unemployment Rate, 2005–2009 (%) Source: BPS (www.bps.go.id/sakernas).

China; Singapore; and Taipei,China. In Indonesia, the number of workers dismissal and homed in the formal sector steadily increased during end December 2008 and early December 2009 (Figure 9). While, according to ILO (2009), the crisis prompted a steep fall in the growth of wage employment, which grew by about 1.4 percent during the period of February 2008-February 2009, compared to 6.1 percent during the same period in the previous year.

But, surprisingly, open unemployment has not increased significantly in that period. Even, it declined between February-August 2009 (Figure 10). One explanation is that Indonesia has a large informal sector which absorbed laid-off employees from crisis-affected firms in the formal sector. In other words, the impact of the crisis on Indonesia's labour market was not the significant increase in open employment but in disguised unemployment working in the informal sector.

Finally, the impact of the crisis on poverty in Indonesia was the most concern in that time. As shown before, in the aftermath of the 1997/98 crisis, poverty increased dramatically from around 17.47 per cent in 1996 to about 24.23 per cent in 1998, when the crisis reached its climax. However, in 1999

Table 4: Poverty in Indonesia, 2000-2011

Year	Number of Poor (million)			Percentage of poverty (%)		
	Urban	Rural	Total	Urban	Rural	Total
2000	12.30	26.40	38.70	14.60	22.38	19.14
2001	8.60	29.30	37.90	9.76	24.84	18.41
2002	13.30	25.10	38.40	14.46	21.10	18.20
2003	12.20	25.10	37.30	13.57	20.23	17.42
2004**	11.40	24.80	36.10	12.13	20.11	16.66
2005**	12.40	22.70	35.10	11.68	19.98	15.97
2006*	14.49	24.81	39.30	13.47	21.81	17.75
2007*	13.56	23.61	37.17	12.52	20.37	16.58
2008*	12.77	22.19	34.96	11.65	18.93	15.42
2009*	.11.91	.20.62	.32.53	.10.72	.17.35	14.15
2010*	.11.10	19.93	31.02	.9.87	16.56	13.33
2011*	..	..	..	..	..	12.49

Note: *= March;** February; Source: BPS (www.bps.go.id).

poverty started to decline gradually, though first very slightly up to 2005. In 2006 due to the high increase in world fuel prices and as Indonesia has become increasingly dependent on imports of oil, the poverty rate increased again on average between 1.8 percentage point per year or about 4.2 million people fell into poverty between the period 2005-2006. Only after some policy adjustments and macroeconomic stabilization, the poverty rate started to decline again in 2007. In relative terms, the poverty rate in 2007 was the same as that before the 1997/98 crisis. However, in absolute terms, the number of those living under the current poverty line was still higher than that in the pre-1997/98 crisis period. During the 2008/09 crisis, poverty rate kept declining (Table 4), which may suggest that in overall the crisis did not have a negative impact on poverty in Indonesia (as compared to the 1997/98 crisis).

Main Factors that Made the Difference

By now it is well known that Indonesia was not only weathering the 2008/09 global economic crisis better than most other countries, but it was also much different than during the 1997/98 Asian financial crisis. The World Bank concludes the following: One year after the global financial crisis and economic downturn, Indonesia's economy appears to be broadly back on track. Economic activity has been picking up, inflation has remained moderate, financial markets have risen, and the newly reelected government, having established the strong fundamentals that supported Indonesia through the global crisis, appears to be now gearing up for new investments in Indonesia's physical infrastructure, human services and institutions of state. Indonesia seems well-positioned to get back on its pre-crisis growth trajectory, with the possibility of further acceleration and more inclusive growth (World Bank, 2009a).

Was the difference because the Indonesian government's response this time was quickwe or was better prepared than during the 1997/98 crisis, or were there other factors? There are various reasons, and the most important ones are the followings (World Bank, 2009b, 2010b; Djaja 2009; Zavadjil 2009 and ADB 2009, 2010a):[vii]

From a regional perspective, the Indonesian economy performed well in the years before 2008 (with one of the best growth rates in Asia after the 1997/98 Asian crisis up to 2008, particularly during the period 2005-2008); the banking sector remained in good health (which was not the case in the years before the 1997/98 Asian economic crisis), although bank lending growth reduced in line with the slowing economy; consumer prices kept stable, allowing the Indonesian central bank, Bank Indonesia, to loosen monetary policy (which is important to keep consumption growth); Indonesia's external position remained sound, the country's significant external financing obligations are being met, and foreign exchange reserves have risen slightly; Indonesia's public finances are strong (which was not the case during the 1997/98 Asian crisis), allowing policy makers to quickly move to offset the global downturn's effects on Indonesia with a fiscal stimulus; also based on the experience of the 1997/98 crisis, cautious policies by Indonesia's government, banks, and corporations, over the past decade have resulted in low debt levels and limited refinancing needs. This served the country especially well in late 2008 and early 2009, when liquidity tightened around the world; compared with some Asian countries, Indonesia is a relatively “closed economy”(Djaja 2009);[viii] consumers kept spending despite the fact that banks tightened credits in late 2008. Much of this spending might also be linked to the election related activities; and based on the experience of the 1997/98 Asian crisis, this time the Indonesian government was quick and more active in response with appropriate measures to the crisis, e.g. by providing the stimulus through fiscal and monetary policies.

While the main reasons given by the Asian Development Bank, that made Indonesia was more resilience than other countries during the 2008/09 crisis are the followings (ADB, 2010b): the impact of a spike in risk aversion was muted by steady policy responses in Indonesia and the stabilising impact of co-ordinated global counter-measures on global financial markets; the income impact of the fall in commodity prices was mitigated by the fact that the preceding years had seen record high prices for these same commodities, allowing rural households to build up a savings buffer to help them smoothen out consumption spending; the global recession was of relatively short duration, the lagged effects of the financial crisis were avoided; the government’s good housekeeping of previous years provided it with the space to take swifter and more effective policy responses than in previous episodes of external shocks; and the balance sheets of the banking, corporate, and household sectors were much stronger.

Concluding Remarks

This study has examined the Indonesian experiences with two big economic crises namely the 1997/98 Asian financial crisis and the 2008/09 global economic crisis. From the Indonesian perspective, the 1997/98 crisis was significantly different from the 2008/09 crisis: the first was initially a currency crisis, while the second was a world demand crisis. The study comes with several important findings. First, the Indonesian economy was much more resilient to the last crisis as compared to the first crisis. During the first crisis, the Indonesian economic growth was negative and poverty increased significantly; whereas during the second crisis, Indonesia managed to keep a positive economic growth rate (though declined), and poverty kept declining. There were a number of reasons, and among them were the sound banking sector that Indonesia has achieved after the first crisis, and the better performance of the Indonesian economy in the years before 2008.

Secondly, despite many laid-off workers in the formal sector, reported during the 2008/09 crisis period, the official (open) unemployment has not increased significantly. Even, by August 2009, the rate declined compared to the level by February 2009. The most possible reason for this was that most (if not all) of the laid off employees ended up in economic activities in the informal sector, either es low-paid workers or owners of micro or small businesses. This reason is most likely due to the fact that Indonesia does not have a social security system as the one known in the west which provides unemployment benefits to those who have none, while looking for jobs. Thus, for the laid off employees from the formal sector who were engaged in informal economic activities, they did that just as a means for them to survive. The informal sector has proved to be very important during the crisis as the last resort for them.

Thirdly, the poverty level in Indonesia has not increased as what happened during the 1997/98 crisis, when poverty rate increased from around 17.5 per cent in 1996 to 24.2 per cent in 1998 with the negative economic growth at around 13 per cent in 1998. Even, poverty kept decreasing during the 2008/09 crisis period. At least, two main reasons that can explain this. First, despite the crisis, Indonesia managed to keep a positive economic growth in 2009, although at a lower rate than in 2008. In other words, although many employees were laid off in the formal sector, many people still had their jobs. Second, as explained before, the informal sector has provided alternative income sources to the laid off employees, which kept them away from falling to poverty.

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End Notes

I. [i]As shown in Rajan (2001), the collapse of the rupiah and of other regional currencies such as the Thai bath and the Korean won was primarily caused by reversals in capital flows from the banking sector rather than by reversals in portfolio equity investments.

II. [ii]Of course with the assumption that domestic prices (in the rupiah) of imported goods and foreign prices (in US dollar) of Indonesian exported goods are free to move (i.e. no fixed price regulation), the price elasticities of demands for import and export are non-zero, and other determinants of import and export are constant. For theoretical discussions of the impact of a currency depreciation/devaluation on trade (export and import), see, among many others, Talvi (1997), Obstfeld and Rogoff (1995), Obstfeld (1986, 1996, 1997), Kenen (1996), and Krugman (1979, 1996).

III. [iii]The 1997/98 Asian financial crisis which was also known as the Southeast Asian currency crisis has inspired widespread interest in currency-crisis models and their economic policy implications. Since the crisis, many studies have been done, both the descriptive studies about the crisis, or studies about individual-hit Southeast Asian countries like Indonesia, Thailand, South Korea, and the Philippines. Among those studies are Radelet and Sachs (1998a,b), World Bank (1998), Berg (1999) and Rajan (2001).

IV. [iv]Theoretically, financial condition of the Indonesian government which borrowed a lot of money from abroad would also deteriorate as rupiah depreciates. However, during the 1997/98 crisis, the impact on domestic production and employment was not evident. Even, during the crisis the government could increase its expenditure on fuel, health and education to mitigate the impact of the crisis on the poor. A large part of the increased expenditure was from loans provided by the International Monetary Fund (IMF),

V. [v]See also such as Corsetti (1998), Corsetti et al. (1999a,b, 2001) and Chinn and Kletzer (2000) in their analyses about the significant importance of the banking collapse in determining the seriousness of the 1997/98 Asian financial crisis.

VI. [1]Since the crisis, many studies have been conducted with the aim to examine the likely impacts of the crisis on many countries, especially in the developing world. See for instance, Chhibber, et al. (2009), Griffith-Jones and Ocampo (2009), and IDS (2009).

VII. [vii]See also, World Bank, (2009b, 2010b) Djaja (2009), Zavadjil (2009), and ADB (2009, 2010a).

VIII. [viii] In his study, Djaja (2009) shows that the share of Indonesia's exports to GDP was 29.4 per cent in 2007. The figure in the next three quarters of 2008 was 30.0 per cent on average. About 85 per cent of goods and services produced by Indonesian economy were used domestically in 2005, while only about 15 per cent went to foreign buyers. This indicates that Indonesia is not so strongly integrated with the rest of the world, at least from an export point of view. With such low exports, a sudden drop in world income and hence in world demand for Indonesian exports will not affect significantly domestic production.