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A Tale of Two Crises: Indonesia's Political Economy

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A Tale of Two Crises: Indonesia's Political Economy

Muhammad Chatib Basri*

Abstract

The global financial crisis caused major economic problems in many countries. Indonesia was obviously affected by this crisis; its export growth declined significantly. Nevertheless, the impact of the crisis on the Indonesian economy was relatively limited compared to other countries in the region, including Singapore, Malaysia and Thailand. This situation leads to the question of why was the impact of the global crisis on the Indonesian economy relatively limited? This was, after all, not the first time that Indonesia had experienced a financial crisis. In 1998, the Asian financial crisis had a very bad effect on Indonesia. An interesting question to ask is why the effects of the 2008 global financial crisis, which in terms of magnitude was much larger than the 1998 crisis, were relatively limited? This paper argues there are, at least, four differences between the 1998 crisis and the 2008 crisis: the origin of the crisis, the exchange rate regime, policy responses and the overall political economy situation. In addition, this paper argues that the structure of trade played an important role in the 2008 crisis. Indonesia survived the global financial crisis thanks to two factors: good policy and good luck. While highlighting these factors, this paper focuses primarily on the role of Indonesia's domestic political economy during these two crises. Lest it leaves an unduly optimistic picture of Indonesia's economic future, the paper closes with an assessment of several major hurdles that Indonesia must deal with in the coming years.

Keywords: Indonesia, Asian Financial Crisis, Global Financial Crisis

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Introduction

Prior to the 1997/1998 crisis, the Indonesian economy represented one of East Asia's major success stories of economic structural transformation. The economy grew on average by 7.6 percent from 1967 to 1996. Structural transformation took place in agriculture, manufacturing, utilities, and services. In line with high economic growth and structural transformation in several sectors, the poverty rate declined from around 40 percent (54.2 million people) in 1976 to 17.5 percent (34 million people) in 1996. Together with Malaysia and Thailand, Indonesia was classified as a member of the second tier of Newly Industrialized Economies (NIEs). However, the Asian Financial Crisis (AFC) in 1997 reversed the situation completely. Hill (2000) in his monograph called this situation 'The Strange and Sudden Death of a Tiger Economy'. The AFC, which hit in 1997–1998, had a major impact on the Indonesian economy, which contracted, registering a decline of 13.7 percent.

This economic crisis led to a series of political reforms that ended the existing authoritarian system and transformed Indonesia into the second largest non-Western democracy. This reform also brought Indonesia closer to a more open and institutionalized economic system. The management of reform in Indonesia was not easy. As the nation with the fourth largest population in the world and as the biggest Muslim nation with a secular constitution, the complexities of Indonesia's economic and political reform were substantial. Taking into account the complexity of such problems, it is clear that Indonesia faced far more substantial difficulties than Korea, Malaysia or Thailand who experienced the same economic crisis. Neither Korea nor Thailand and Malaysia radically altered their political systems in the wake of the crisis. Indonesia, in contrast, abandoned both its authoritarian regime and its centralized system of governance, embracing democratization

and decentralization almost overnight. Indonesia's reform experience is somewhat comparable to that of the Philippines after Marcos—of course on a different scale.

From this perspective, Indonesia has made significant progress. During the first years of the economic and political crisis, many observers pointed out the dangers of Balkanization in Indonesia. Furthermore, many argued that direct presidential elections in 2004 might lead to massive violence and bloodshed as the result of intense political conflicts. To make things worse, many observers envisaged the collapse of the Indonesian economy. The reality proved to be far different. Indonesia remains united: and the direct presidential election went very smoothly, and was even considered the most peaceful election in Indonesia. Income per capita rebounded and surpassed pre-crisis levels as did GDP, consumption and exports, although investment as a percent of the GDP ratio still remains below pre-crisis levels. The debt-to-GDP ratio has declined substantially to less than 40 percent, inflation has decelerated and the exchange rate is relatively stable. Corruption remains pervasive at many levels, yet even here there are some signs of improvement.

Ten years after the economic and political crisis, Indonesia faced the Global Financial Crisis (GFC), which, in terms of scale and magnitude, was far larger than the AFC. The GFC caused economic disruption and major problems in many countries. Indonesia was obviously affected by this crisis and its export growth declined significantly. Nevertheless, the impact of the crisis on the Indonesian economy was relatively limited compared to other countries in the region, including Singapore, Malaysia and Thailand. This situation raises the question why the impact of the global crisis on the Indonesian economy has been so limited? In particular, why, in contrast to the devastating effects of the AFC, were the effects of the 2008 GFC so much more limited?

This chapter argues that there are at least four important differences between the 1998 crisis and the 2008 crisis, which account for the relatively mild effect of the GFC on

Indonesia: the origin of the crisis, the exchange rate regime, policy responses, and the national political economy. The first three essentially involved economics, while the fourth, and what this paper primarily focuses on, is the linkage between domestic politics and domestic economics in how these two crises played out. The organization of this paper is as follows: section 1 gives a brief review of the history of the two economic crises in Indonesia. In section 2, I analyze what made the 2008 crisis different from that of 1997-1998. Section 3 provides an analysis of the role of the domestic political economy and the decision- making process in Indonesia, while section 4 lays out the key challenges that remain for Indonesia.

1. The Story of the Two Crises

The Asian Financial Crisis of 1997-1998

As discussed earlier, the Asian Financial Crisis (AFC) that hit in 1997–1998 had a devastating effect on the Indonesian economy, including an economic contraction of 13.7 percent. Figure 1 shows the difference between the 1998 crisis and the 2008 crisis.[1] In the first year after the onset of the crisis, the rupiah weakened from Rp2,500 against the United States dollar to only Rp10,000, peaking at Rp12,000 (Figure 2); meanwhile, inflation jumped to 70% (Figure 3). As a result of the inflation and the consequent increase in the prices of food, poverty increased substantially. The number of people living below the poverty line rose from 15.7 percent in February 1997 to 27.1 percent in February 1999 (Sumarto, Suryhadi, and Widyanti 2002). The unemployment rate rose from 4.7 percent in August 1997 to 5.5 percent in August 1998, while underemployment increased from 35.8 percent to 39.1 percent. At that time, Indonesia was haunted by a single question—when

1. Notes, for Crisis 1997-1998, Quarter 1 (Q1) begins in Q1 of 1997, whereas for Crisis 2008, Q1 begins in Q1 of 2008.

would the country begin to emerge from the crisis, and where would signs of improvement first appear?

Figure 1. Economic Growth 1998 vs. 2008

Figure 2: Exchange rate, 1998 vs. 2008

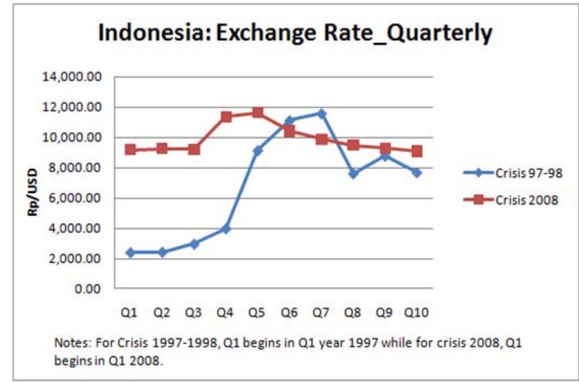
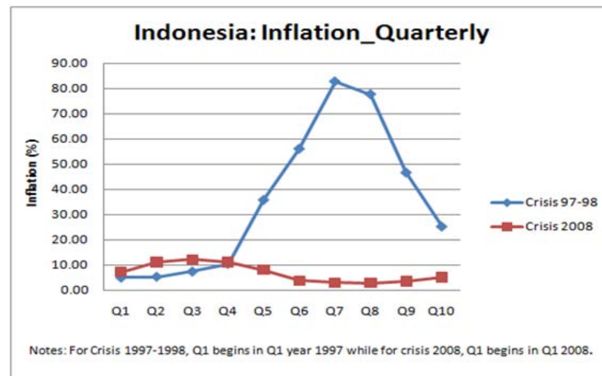


Figure 3. Inflation, 1998 vs. 2008



Adopted from Basri and Hill (2011)

The crisis began with Thailand. The contagion effect of Thailand's difficulties was responded to poorly by the Indonesian government with several errors made in policy responses such as tightening the budget and raising interest rates, the combination of which eventually brought the country even greater difficulties. Prior to 1997 there had been a lending boom in Indonesia, eventually accompanied by a high ratio of non-performing

loans (NPL) to total credit. As the economy went into deep recession, due to contractionary devaluation, many firms faced serious problems. Because the government and the central bank tightened their budgets and raised interest rates, the default rate escalated, which in turn increased capital outflow and brought Indonesia into a still deeper crisis. This experience shows that the economic crisis in 1997-1998 centered mainly on the banking sector, financial markets, exchange rates, the problem of short-term debt, capital mobility and the consequent political disturbances.

The Global Financial Crisis 2008[2]:

The 2008 Global Financial Crisis (GFC) initially began in the US sub-prime mortgage markets but it precipitated a wider global re-pricing of risk that was exacerbated by the disclosure of higher-than-expected losses by financial institutions. The balance sheet and liquidity problems in the US banking sector caused a global deceleration of credit growth. In the US, pressures in the financial sector caused a credit crunch because of the inability of the banking sector to provide credit.[3] In turn this hit the real sector and reduced both investment and consumption. Financial channels were affected by the freezing of foreign exchange liquidity that caused a liquidity shortage on international money markets as a result of the re-pricing of risks. This in turn could be traced to the tightening of financing conditions for emerging markets and developing countries (especially those systemic players that relied on international financial markets for funding) as well as increased funding costs from the issuance of international bonds. All of these put pressure on the balance of payments and exchange rates of the emerging markets. In addition, the many default cases in the US caused an overabundance of cheap assets as funds from emerging markets to the US were absorbed. This made it even more difficult for the

2. This section is heavily drawn from Basri and Rahardja (2010) and Basri and Rahardja (forthcoming)
3. This was caused by the lack of liquidity, repricing of risk, and higher concern of counter-party risk in inter-bank money markets.

emerging markets to obtain external funding. The result was the collapse of numerous stock exchanges and enhanced pressure on exchange rates. What was also of real concern was that the spread of the crisis had widened to drag in many more countries covering all geographic regions, further accelerating the downturn of global markets. This was indicated by the growing integration of the global financial system as well as the existence of more short-term fund flows in markets, especially within the emerging markets. In addition, trade channels were affected by slower global growth, which was the result of a reduction in the value of exports, a drop in commodity prices, reduced remittances, increased unemployment, and even more intense trade competition (as a result of efforts to shift products that used to be exported to the US and Europe to developing countries).

As for Indonesia, the effects of the global financial crisis were reflected by several indicators, such as the depreciation of the exchange rates and the decline in the stock market. The rupiah exchange rate had fallen by 30 percent by the end of 2008, while the Indonesia Stock Market Index experienced a drop of 50 percent in the same year. Banking credit growth also experienced a significant drop from 32 percent to 10 percent (Basri and Siregar 2009). In addition, banking confidence declined, as could be seen by the shrinking size of inter-bank borrowing and lending; this was down by 59.3 percent to Rp83.8 trillion in December 2008 from Rp206.0 trillion in December 2007 (Gunawan et al 2009). The desire by banks to expand their funding bases, added to again by increases in interbank rates, added to the sharp competition between banks.

It was primarily though trade channels that weak global economic growth had its biggest effect as we saw a reduction in demand for Indonesian exports starting from the fourth quarter of 2008. The drop in global demand led to weak demand for primary and mining exports, which in turn resulted in a drop in the price of commodities and mining goods. The drop in global economic growth also weakened demand for energy, leading also to a decline in the global price of oil. Papanek, Basri, and Schydlowsky (2010) pointed out

that the collapse of exports was mainly reflected in export prices rather than export volume. In fact, the demand for primary commodity exports, especially agriculture and mining, remained relatively stable, thanks to the continuing strong demand from China and India. With natural resources accounting for more than half of Indonesia's exports, this represented a life support system for the Indonesian economy. Moreover, the depreciation of the rupiah that took place after September 2008 partially compensated for the effects of the collapse in the demand for exports. However, data shows that the increase of demand due to the depreciation of the rupiah (substitution effect) was still smaller compared to the fall of demand due to the decline in income (income effect). As a result of this, all Indonesian exports experienced a drop.

As a result of this export weakness, in the fourth quarter of 2008, economic growth slowed down to 5.2 percent year on year (Figure 1). Even so, Indonesia's overall economic growth still reached 6.1 percent, which was the highest in Asia after China and India.

2. Economic Conditions that Differentiated the Two Crises: Good Policy and Good Luck

This economic crisis was, as noted, not the first crisis for Indonesia. Basri and Hill (2010) show that there had been at least six crises experienced by Indonesia – two severe crises in the mid-1960s, two mild ones in the 1980s, the one in 1997-1998, plus the GFC in 2008. As for the two most recent crises, the effects of the 2008 GFC, which in terms of magnitude was much larger than the 1998 crisis, were relatively limited in Indonesia. We argue that there are at least four significant differences between the 1998 and the 2008 crisis.[4] Three of the four are concerned with economic conditions and the fourth is with political economy.

4. This part is heavily drawn from Basri and Rahardja (2010)

The first economic difference concerns the origin of the crises. In 1998, the initial debate in the country centered on the link between currency depreciation and economic fundamentals. One view suggested that the Indonesian economy was basically as sound as it had been before, while others argued that the Indonesian economy was fundamentally poor or far worse than reported by the government or other bodies such as the World Bank (Soesastro and Basri 1998a, 1998b). Aswicahyono and Hill (2002) pointed out that there was no clear link between the current crisis and the Krugman 'myth,' i.e., that much of East Asia's dynamism had been due simply to increased mobilization of inputs such as capital and labor. They argued that the crisis in 1997-1998 had mainly to do with financial markets, exchange rates, problems of short-term debt, capital mobility and political disturbances. We have to admit, though, we agree with much of the latter argument that there was a fundamental problem in the Indonesian economy in 1998, especially in the financial sector. As pointed out by Soesastro and Basri (1998a, 1998b), Stiglitz and Greenwald (2003), Hill (1999), Fane and Macleod (2004), many banks in Indonesia were very weak and had made bad loans. Indonesia consequently saw a massive lending boom in the run-up to the 1997 crisis. The Loan-to-Deposit Ratio (LDR) was more than 100 percent in 1997, and the ratio of non-performing loans (NPL) to total credit was around 27 percent in September 1997.

On the other hand, however, the financial situation was relatively healthier on these fronts when the GFC hit in 2008 than it had been ten years previously. The NPL was less than 4 percent at the end of 2008 and the LDR was less than 80 percent, while the Capital Adequacy Ratio (CAR) was around 17 percent. Moreover, one should not overlook the fact that the currency crisis in Indonesia began in the wake of problems affecting other countries in the region.

In 1998 the economic origins of the crisis were both domestic and external (Soesatro and Basri 1998a, 1998b). When the financial crisis hit Thailand in 1997, the impact on the Indonesian economy was immense. Thus, the 1998 crisis was home grown

but not home alone. In contrast, the 2008 crisis was almost entirely external; to be more precise, it was triggered by the subprime crisis in the US.

The second big economic difference involves the exchange rate regime. Prior to the AFC, which hit in July 1997, Indonesia was applying the managed floating system under which there was no incentive for economic players to carry out any hedging because the rupiah constantly depreciated by 5 percent every year. When the Bank of Indonesia decided to abandon the managed floating system and adopted a free float for the currency, economic players were completely unprepared and panicked.

The situation in 2008 was far different. The free floating system had been adopted in 1997 and was continued thereafter. This had taught economic agents to live in a world of exchange rate fluctuations. Thus, unlike 10 years before, economic agents had now learned how to diversify their risks and were in the habit of doing so automatically. They diversified their portfolios, and hedged their assets. Therefore, even a sudden reversal of capital inflows would have a relatively small impact compared to what had happened in 1997-98.

The third difference involved the economic policy responses (Table 1). In 1998 the Bank of Indonesia responded to the crisis by implementing an extremely tight monetary policy by raising interest rates to a very high level. Deposit account interest rates reached 60 percent in the peak crisis period. The government also implemented a liquidity squeeze. In fiscal policy, the government entered the crisis with a budget surplus, but this was reversed as the government moved toward a large budget deficit. As argued by Stiglitz and Greenwald (2003), when an economy goes into a deep recession due to contractionary devaluation, many firms will go into distress. In 1998 the response of the Central Bank, namely raising interest rates, increased the rate of private default and thereby increased the probability of capital outflows.

In contrast, in 2008 the Bank of Indonesia responded to the crisis by lowering interest rates and ensuring that there was enough liquidity in the financial system. As a result, the rate of default was relatively low in 2008, thus minimizing any negative effect on non-performing loans owned by the banking sector.

Table 1 highlights the major differences in the economic policy responses to the two crises.

Table 1. Policy responses in 1998 and 2008

The 1998 Crisis	The 2008 Crisis
1. Monetary policy: extremely strict. The Bank of Indonesia increased interest rate levels to very high levels. Deposit account interest rates reached 60 percent in the peak crisis period. The government implemented a liquidity squeeze. 2. Fiscal policy: the original budget surplus was reversed by permitting a large budget deficit. 3. Banking health: Prudential banking regulations were extremely weak. NPLs reached 27 percent. LDR became more than 100 percent 4. Response towards banking: closure of 16 banks, which then led to rushes. 5. Policies focused on structural reform by carrying out economic liberalization, getting rid of monopolies and official licensing. 6. Exchange rate regime: managed float. Economic players not used to exchange rate risk changes and had not carried out hedging.	1. Monetary policy: the Bank of Indonesia's interest rate was reduced by 300 basis points from 9.5 percent to 6.5 percent. Liquidity was relaxed. 2. Fiscal policy: a stimulus policy was implemented. The budget deficit was enlarged and taxes were lowered. 3. Banking health: prudential banking regulations were relatively tight. NPL less than 4 percent, LDR 77 percent, CAR around 17 percent. 4. Response towards banking: deposit insurance increased from Rp100 million to Rp2 billion per account 5. Safeguarded relatively open trade regime. 6. Exchange rate regime: flexible. Economic players had become used to exchange rate risk changes.

Adopted from Basri and Rahardja (2010).

Indonesia's experience during the AFC in 1998 made it clear that disruption and instability in the financial sector could lead to a severe crisis of confidence. At that time, Indonesia suffered from bank runs due to such a loss of confidence. Indonesia's experience showed that the cost of allowing such a situation to happen was much higher than the cost of preventing such a loss of confidence in advance. Based on this, in 2008, Indonesia strongly supported immediate efforts to restore confidence in the financial sector. The Minister of Finance Sri Mulyani Indrawati and the Governor of Bank Indonesia Boediono coordinated in order to be able to deal with the crisis. In order to monitor the situation in the financial sector, the government and the Bank of Indonesia set up the Financial Sector Stability Committee. Unlike the crisis in 1998, in 2008 the government was more focused on anticipating the needs and actions of the financial sector and avoided destabilizing structural adjustments. The government and the Bank of Indonesia also prepared the Financial Sector Safety Net as a crisis protocol regarding measures that had to be taken in facing this financial crisis. The focus of control for the crisis centered on efforts to monitor developments in the financial sector (including banking, capital markets, the bond market, and insurance) as well as to keep a close watch on the balance of payments. Several stress tests were carried out to examine areas of potential stress within the banking sector as well as to examine the balance sheets of publicly listed companies so as to be able to anticipate the effect on debt of any depreciation of the rupiah against the dollar. There was concern at that time regarding balance sheets and risk premiums: if depreciation worsened the balance sheets of banks and corporations, then the premium risks for the state would also go up.

Key areas for action in 2008 included:

- Ensuring the existence of liquidity in the system. The Government of Indonesia (GOI) and the Bank of Indonesia (BI) took measures to ensure liquidity.

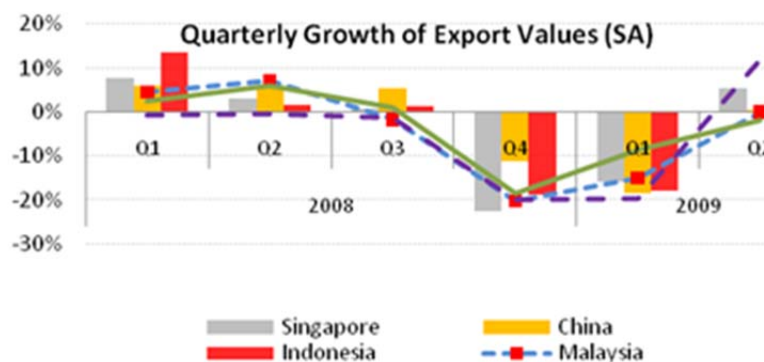
- Maintaining confidence in the banking sector by providing guarantees. The GOI and BI increased the ceiling for the guarantee on deposits from Rp100 million to Rp2 billion per account (The political economy of this decision will be discussed further in Section 3).
- Mitigating the impact of the financial crisis on the poorest segments of society by providing a social safety net.
- Lowering interest rates. Unlike 1998, the Bank of Indonesia responded to the 2008 crisis by lowering interest rates. The 50 basis point cut announced in the second week of January 2009, and two more 50 basis point reductions in the first week of February and March 2009, were steps in the right direction. The Bank of Indonesia cut the rate from 9.5 percent in November 2008 to 6.5 percent by the end of 2009. Nevertheless, as argued by Basri and Siregar (2009), despite the Bank of Indonesia's low interest policy, the banking sector continued to face high borrowing costs due to the agency cost problem. Banks remained unwilling to lend to each other until early 2009. Although the effectiveness of monetary policy was limited to boosting the economy, the low interest rate policy also succeeded in reducing the probability of default by Indonesian companies, which in turn helped to minimize the impact of the financial crisis on the real economy.
- Counter-cyclical policy through fiscal expansion.[5] The Minister of Finance unveiled a stimulus package for 2009 worth around Rp73.3 trillion (or around US$6.4 billion) to boost the economy amid the threat of an economic downturn. The package contained three major categories: income tax cuts, waivers of tax and import duties, and subsidies and government expenditures. In line with Keynes (1936), the aim was to stimulate spending by households and corporations, with the

5. For detail of the analysis, see Basri and Siregar (2009).

result that around 60 percent of the Indonesian fiscal stimulus was allocated to cover reductions in income taxes.

These factors cited above make it clear that in 2008 Indonesia survived the GFC in large part due to good economic policies and economically appropriate measures. All the same, Indonesia benefitted as well from a measure of good luck due to the structure of Indonesia's exports. Basri and Rahardja (2010) argue that the structure of trade is very important in explaining the difference between the 1998 crisis and the 2008 crisis. The sharp decline in exports during both crises was not something experienced just by Indonesia. A similar decline was experienced by many countries, including China, Singapore, Malaysia, and Thailand. In fact, the large export contractions that occurred suggest that the force of the global economic crisis hitting the Indonesian economy was in fact relatively the same for both crises. Figure 4 shows how countries such as China, Malaysia and Singapore experienced contractions in export growth of around 30 percent in the fourth quarter of 2008 and the first quarter of 2009.

Figure 4. All Were Screaming Mayday



At the same time it is important to discuss why this relatively sharp drop in exports had such a limited effect on the Indonesian economy. I argue that the effect on the

Indonesian economy was limited because the contribution of exports to the Indonesian economy was relatively small compared to countries like Singapore, Thailand and Malaysia. The total share of Indonesian exports against GDP was never much more than 29 percent, a figure far smaller than that for other countries such as Singapore (234 percent), Taiwan (74 percent) and Korea (45 percent).

Figure 5. Export to GDP ratio for seven Asian countries

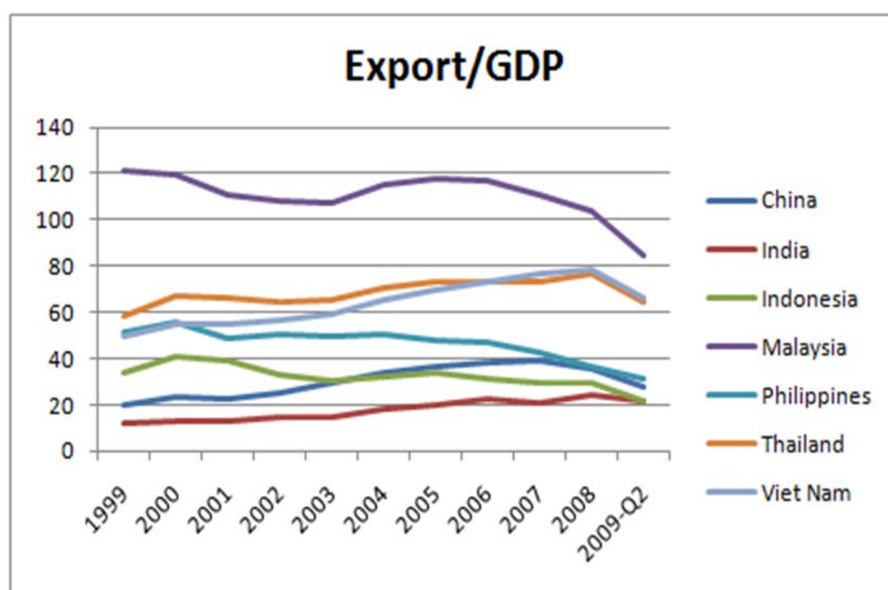


Figure 5 shows the Export/GDP ratios. Consistent with our argument, Indonesia, together with China and India are all countries with a relatively low export ratio to GDP. Thus, Indonesia's relatively small export share quickly spared the country from some of the worst trade-related effects of the GFC. The Indonesian economy survived the GFC thanks to strong domestic demand. However, as Basri and Rahardja (2010) show, the relatively strong growth in consumption during the crisis period was a lag effect from the relatively strong exports in the previous three years. This was more a case of good luck compared with the elements of the rather deliberately planned economic policy strategy noted above.

Furthermore, Kimura (2005) indicates that Indonesia was far less integrated in East Asia's production networks. As a result, the effects of the global crisis on the Indonesian economy were also limited. Yet, clearly, this was not something that had been planned. Indonesia certainly would have preferred to have a larger portion of exports within its economy. But several supply side obstacles (Soesatro and Basri 2005; Basri and Patunru 2008) had already made Indonesia less competitive, thereby limiting the growth of its exports. As a result, as indicated by Basri and Patunru (2008), the Indonesian economy became more dependent on the non-tradable sectors and exports experienced extremely slow-moving growth. In other words, one thing that reduced the effects of the global crisis on the Indonesian economy was the good luck that came from the relatively small portion of its economy that was dependent on exports compared to its neighboring countries.

The other element of "luck" from which Indonesia benefitted was the continued strong growth of the Chinese economy. Continued Chinese growth drove the demand for commodities amd that demand remained high during the GFC. In addition, the good rainfall during 2008 also boosted agricultural production, including agricultural commodities (Basri and Hill 2011).

Thus it seems clear that Indonesia came out of the 2008 crisis so much better that it did from the crisis ten years earlier in large part due to good policies, but in several important economic areas it simply benefitted from a measure of good luck. That being said, however, Indonesia's successful escape from the worst effects of the 2008 GFC had a great deal to do with Indonesia's politics behind the economic policy making process itself.

3. The Political Economy of Crisis Management

The most important difference between the 1998 and 2008 crises for Indonesia lies in the areas of political economy. The political turmoil that led to the downfall of Soeharto caused

the 1997 economic crisis to become far worse, while ten years later, Indonesia enjoyed a large measure of confidence in the government.

From the beginning of the 1997-98 crisis, confidence in the Soeharto government decreased quickly. Because of this there was much pressure to carry out political reforms, including widespread calls for democracy (Bresnan 2005; Schwarz 1999; Aswicahyono and Hill 2002). Political problems such as the lack of transparency and loss of confidence in the government had all exacerbated the crisis (Fisher 1998). In the 1998 crisis, the IMF came on the scene only after the Indonesian government had tried several unsuccessful measures of its own to avoid such intervention. When first questioned about IMF involvement in the crisis, then Minister of Finance, Marie Muhammad, stated that IMF assistance would be purely technical (Soesastro and Basri 1998a, 1998b), indicating the degree of doubt felt by the Indonesian president at that time. At first the government believed it would not need to accept IMF money and that consultation alone would be a potent enough symbol to restore trust in the economy. On the other hand, some in Indonesia welcomed IMF involvement as an opportunity to get rid of crony capitalism, corruption and collusion. IMF's symbolic gestures proved fruitless and consultations with the IMF turned into negotiations. The deal struck with the IMF on October 31, 1997 amounted to US$43 billion, comprising US$38 billion from the IMF and US$5 billion from domestic sources. The government only released the main points of the agreement with no details. This first agreement had four main targets: 1) efforts to restore the soundness of the financial sector, 2) fiscal policy changes, 3) monetary policy (including exchange rate policy), and 4) structural adjustment policies. The structural policy package included tariff reductions, and flour, soybean and garlic deregulation.

Then in early November the government liquidated 16 banks. The first IMF package was showered with criticism. For example, Sachs (1997) questioned the tight monetary policy, asking why tightening the government budget was necessary when the

crisis originated in the private sector. Sachs also wondered why the IMF didn't focus more on short-term policy, such as policies designed to improve the financial sector, rather than on long-term policy such as policies involving structural change.

In addition, it was apparent that the Soeharto government was reluctant to implement this package. Take the case of Bank Andromeda (one of the banks closed down by the Bank of Indonesia), which was reincarnated several weeks after its closure as Bank Alfa—a clear indication of just how unserious the Soeharto government was about economic reforms. In the eyes of the market, the Indonesian government appeared neither committed nor consistent about repairing the economy. Similarly with the deregulation of soybeans and garlic: though everything was clear on paper, many knew how things really stood, and the situation continued to worsen.

At the time when the first IMF package was implemented, the exchange rate ranged between Rp3,000 and Rp4,000 to the US dollar. There was still a good window of opportunity to repair the economy, since rupiah exchange rates were still within a feasible range. But the ambiguous government attitude, compounded by news of Soeharto's ill health in December 1997, pushed the rupiah down still further. Finally, on January 15, 1998, a second Letter of Intent was signed between the Indonesian government and the IMF, the contents of which focused even more on structural changes than the first agreement had. In this letter the Indonesian government agreed to cancel government facilities and official support for the national car and aircraft programs, and to revoke the monopoly enjoyed by the Clove Marketing Board.

The market was still skeptical about this agreement, and when the nomination of B.J. Habibie as the Golkar vice-presidential candidate was announced, the rupiah plummeted to below Rp17,000 to the US dollar. This drop cannot be completely blamed on the political news, but must also be seen as reflecting reactions to the government's hesitation in actually implementing the IMF package.

The skepticism of the market proved to be justified, as the government issued statements that the monopoly of BULOG (Board of Logistics) would continue, as would the national car and aircraft programs. Soeharto even stated that the IMF agreement was at odds with the constitution—further proof of his government's reluctance to move seriously to implement IMF conditions. Economic and political analysis concluded that the government's argument and justification were simply rationalizations for the perpetuation of crony capitalism and favored interest groups. From an economic and political perspective, policy making involves a process of bargaining among interest groups. President Soeharto's argument that the IMF package smacked of liberalism and thus conflicted with the constitution was thus only an effort to justify the maintenance of existing rent seeking activities.

Indonesian economic history makes it hard to distinguish any one consistent vision or ideology guiding economic policy. Close observation of conditions during the 1970s makes it hard to say that development at the time was market oriented. The structure of exports, for example, did not typify industrialization in line with the concept of comparative advantage—a pure characteristic of free market principles. At that time, capital-intensive goods comprised a larger share of exports than did labor-intensive items and protective barriers were relatively high. Only after 1985 did the structural changes set in motion by deregulation lead to labor-intensive exports outstripping capital-intensive ones.

But this pattern did not persist for long. In practice, the 1990s saw a reversal of economic policy, one in line with the strengthening of crony capitalism and an emphasis on strategic industries. In other words, the ideological debate within Indonesian economic policy had not yet reached any kind of mature equilibrium. What actually happened was no more than a process of economic decision-making that could be considered "rational" in so far as policy choices were most advantageous to the legitimacy of the New Order

government. ‘Advantageous’ here means choices of the lowest economic and political cost. In the 1970s, when oil dollars were available and the nationalist faction was ascendant, non-market and protectionist economic choices like those of a socialist, command economy were relatively ‘cheap’ compared to pro-market policies because the government had to accommodate pressure from then strong interest groups to garner political support. But by the mid-1980s, the price of oil had fallen below US$10.00 a barrel, thereby limiting funds available to the government. In addition, technocrats were gaining an increased political role. The result was to make the continuation of non-market policy choices relatively more expensive than pro-market options with a more liberal bent.

The same phenomenon was in evidence during the 1998 crisis. Pressure from the IMF and demands for deregulation had made pro-market policy choices ‘cheaper,’ and we can see the results in the IMF-mandated reforms of October and in the signed letter of intent. But subsequently the price of reform became intolerable since it touched the interests of the rent-seeking crony capitalists and the self-proclaimed ‘nationalists.’ It was then that officials began to speak of the inappropriateness of the IMF package for the spirit of the Indonesian economy, the argument being that the IMF-proposed reforms would carry Indonesia in the direction of ‘liberalism.’

The above analysis makes it clear that Indonesian economic policy did not follow any single, unified ideological direction during the AFC. What happened was no more than a tug-of-war between interest groups mobilized around two different policy predispositions. When the role of the interventionist group increased in importance, the cost of the pro-market policy became too high, and policy choices moved towards government intervention. Then, during an era of crisis when the role of the pro-market group came into the limelight, the cost of government intervention became too high and policy choices moved in a pro-market direction. In short, there was nothing particularly profound or ‘philosophical’ about Indonesia’s framework for economic policy. What happened was

only an effort to uphold the legitimacy of the regime using the most convenient ideological rationale. And this negotiation between competing policies gradually destroyed trust in government consistency. That situation held sway right up to the third IMF package, launched when the rupiah exchange rate stood at Rp8,000 to the US dollar.

Soeharto stepped down on May 21, 1998, ushering in a sequence of political shifts that had a major impact on the implementation of the IMF package leading in June 1998 to a fourth package. Unfortunately, the situation was by that time extremely serious: the exchange rate having risen above Rp10,000 to the US dollar. At this level, some 70 percent of the companies listed on the Jakarta Stock Exchange had to confront ratios of dollar debt to total assets of 50 percent or more (Soesastro and Basri 1998a, 1998b). Basri and Hill (2010) argue the crisis was mismanaged both domestically and internationally. The IMF 'over-managed' the crisis by demanding extreme fiscal austerity and excessive policy conditionality while also displaying a lack of political sensitivity at key periods. President Soeharto, who began to lose full control, was increasingly suspected of corruption, collusion and nepotism with his family business partners.

Thus, Indonesia faced a combination of negative forces – the loss of confidence in the government due to uncertainties about economic reforms; a drop in the core political support for Soeharto because of uncertainties about the political situation; and eventually an ever greater need for the government to provide capital support as outflows from Indonesia escalated, which eventually caused the economy to collapse.

Conditions were quite different in the political economy when the GFC struck in 2008. Then, unlike the 1998 crisis, support for the government was relatively solid. The government was considered both legitimate and capable of controlling the situation. The general public also understood what had happened in the global economy. It was completely aware that the so-called Lehman Crisis was made in the USA. And, as pointed out by Basri and Hill (2010), although corruption was still one of the key problems in the

Yudhoyono administration, corruption charges were not directly aimed at the President. In addition, the government's economic team was also regarded as credible. Political support and a high level of confidence in the government's handling of the crisis can be seen in the news stories in the mass media. In 1998, although the media was not brave enough to criticize the government, the news that got out was usually negative, to say the least. In the 2008-2009 crisis, even though the press was very critical of the government, support for government policies in the handling of the economic crisis was generally quite positive. For example, the largest newspaper in Indonesia released an article regarding the government policy of issuing an emergency law about the Financial Safety Net[6] and the media also reported that many economic analysts considered government policy to have been correct in dealing with the crisis by creating the Financial Safety Net.[7] In short, unlike 1998, in the 2008 crisis, the government was supported by the media, and this helped sustain public confidence in the economy.

One example of how effectively economic policy functioned during the 2008 crisis was the government's decision to help Bank Century. But additionally, effective economic policy was not without periodic political clashes. The Financial System Stability Committee (KSSK), which was set up by the Finance Minister and the Governor of Bank Indonesia, was convinced that the collapse of Bank Century would have a systemic risk for the entire economy given the fragility of the economic situation at that time as seen by the fact that the rupiah had fallen by 30 percent. Furthermore, both the bond market and the capital market had fallen sharply, capital outflows were substantial and there was a shrinking in inter-bank borrowing, as was noted above. In such situation, the collapse of any major bank or financial institute could generate panic. Thus, even though Bank

6. See http://otomotif.kompas.com/read/2008/10/16/16551346/Atasi.Krisis.Pemerintah.Keluarkan.Perppu.JPSK (Kompas, October 16, 2008)
7. See http://nasional.kompas.com/read/2008/10/17/1513493/Ekonom:.Langkah.Pemerintah.Tangani.Krisis.Tepat. See also Koran Tempo (November 23, 2008).

Century was relatively small and its interconnectedness to financial markets was low, the government, and in particular the Bank of Indonesia, was concerned about the psychological impact of even small market players. The Bank of Indonesia's concerns were based on Indonesia's experiences during the 1997-1998 crisis, when the closure of 16 banks – which only controlled 2.3 percent of total banking assets – turned out to have a very negative effect throughout the financial market, including large cash withdrawals by customers in other banks. This in turn rippled from the banks into other sectors.

In addition, to safeguard market confidence, as noted above, both the government and the Bank of Indonesia implemented deposit guarantees. However, unlike other countries such as Singapore, Australia and Malaysia, the Indonesian commitments were far short of blanket guarantees. The Vice President, Jusuf Kalla, declined such blanket guarantees for fear of creating a problem of moral hazard. The government and Bank Indonesia decided only to implement deposit guarantees to a maximum of Rp2 billion. Had there been any instability in the banking sector in Indonesia this might have generated a migration of banking funds from Indonesia to countries where blanket guarantees were in force. The risk of systemic risk became larger because the guarantee was limited. Ultimately worries about such a risk contributed to the decision by the Minister of Finance and the Governor of the Bank of Indonesia to bail out Bank Century in November 2008.

However, the decision to bail out Bank Century generated considerable divisions among the parties. These started when the President- and Vice President-elect (SBY-Boediono) started to form their cabinet several months before the actual bailout (i.e., in August 2009). At that time, some political parties, especially the Golkar Party, which was led by businessman Aburizal Bakrie, charged that steps taken by Indrawati and Boediono to bail out Bank Century were wrong because they were based on incorrect information and that the decision would cause the state to suffer financial losses. In addition, politicians suspected that the funds to save Bank Century were being diverted to

the coffers of the Democrat Party and to election campaign funds for President SBY-Boediono.

The Golkar Party, even though it no longer dominated Parliament, already had more than 40 years in politics in Indonesia. It therefore usually is in the best position to take over Parliament. This bailout issue was then used by the opposition as a way to take over the government. Golkar, the Prosperous Justice Party (PKS), and the United Development Party (PPP), all of whom opposed the bailout of Bank Century, were also government coalition parties. Several political analysts attributed this opposition to their effort to strengthen their bargaining positions in terms of seats in the Yudhoyono-Boediono Cabinet (Haris 2010). Subsequently, media and several political analysts considered this move to be aimed at creating pressure for Boediono to step down. They saw this move as being in connection with efforts carried out by the Coordinating Minister for Economic Affairs, Hatta Rajasa (who was then also chairman of the National Mandate Party [PAN]), and Aburizal Bakrie to become Vice President if Boediono were to be impeached.[8] Bakrie and Rajasa themselves denied these charges.

Apart from this, politicians who opposed the bailout of Bank Century charged that the efforts to save the bank were politically rather than economically motivated and would simply help the owners of this bank because of their funding support for the campaign to elect President Yudhoyono and Vice-President Boediono. Yet, when Indrawati and Boediono presented this bailout plan in October 2008, almost all parties, including the Golkar Party, supported this policy. Ironically, several months later when the new Cabinet was just being selected by President Yudhoyono after he had won the 2009 general election, and Indrawati had been re-appointed as the Minister of Finance, political parties changed their points of views about her again becoming Minister of Finance and began criticizing

8. See Rakyat Merdeka, December 17, 2009. http://www.rakyatmerdeka.co.id/news/2009/12/17/85258/Hatta-Rajasa-&-Ical-Bakal-Gigit-Jari. Metro TV News.com, February 5, 2010; Radar Lampung, February 6, 2010; Indo Pos, February 7, 2010.

the policies being taken. Parliament called for Indrawati to resign. This despite the fact that ministers are responsible to the President and only the President can remove them. The ensuing political pressure continued when the cabinet was being appointed during October 2009, when protesters almost every day demanded the resignation of both Indrawati and Boediono. Up until today, the Anti- Corruption Committee (KPK) has never found any evidence of corruption or flow of funds from Bank Century to pay for the Yudhoyono-Boediono campaign. The KPK even stated that there was no proof of corruption or graft related to the Bank Century bailout.[9]

In May 2010, Indrawati resigned as Minister of Finance because she was appointed to the position of Managing Director at the World Bank. Many analysts, including Hill (2010), have connected Indrawati's resignation with the political pressure related to the bailout of Bank Century in 2008. Indrawati's resignation is difficult to separate from the political tensions between her and Bakrie, Chairman of the Golkar Party. In an interview that was published in the Asian Wall Street Journal,[10] Indrawati stated that those tensions between herself and Bakrie could be traced to 2008 when she opposed the extension of the closure of Indonesia's stock exchange amid a run on companies controlled by Bakrie. In addition, Indrawati was trying hard to examine the tax records of three coal mines belonging to the Bakrie family – Bumi Resources, Arutmin Indonesia and Kaltim Prima Coal – with a total of Rp2.1 trillion in tax arrears. Aburizal Bakrie himself denied that there were any personal problems between himself and Indrawati, and as regards the tax case he was of the opinion that this had no direct connection with him since it was a company problem and he asked politely that this be settled through the courts. Indrawati's resignation was then considered by many as potentially jeopardizing the process of economic reform in Indonesia if it led to a re-strengthening of the business and political

9. See Jakarta Post (December 9, 2010).
10. Asian Wall Street Journal (December 10, 2009).

strength of the Bakrie family. Indrawati was considered by many to have been the champion of reform and main pillar of stability for Indonesian macroeconomics.

What was interesting was that after Indrawati resigned as Minister of Finance, practically all of the protests against her and Boediono suddenly stopped and the issue of Bank Century was no longer a dominant issue in the media. One can see that the Bank Century issue was more about political pressure on Indrawati to leave the Cabinet than about government economic policies.

Despite the particular case of Bank Century, political support and confidence in government policy direction was strong and helped the government manage the GFC. In fact, the political tension between government and political parties really began after the GFC had largely passed, a point I will discuss below.

4. Key Challenges

The economic crisis in 1997 was followed by political changes that provided both challenges and opportunities for the Indonesian people to undertake structural reforms that had often been neglected by past administrations. The crisis had revealed the fundamental weaknesses in Indonesia's institutional design as shown by its failure to regulate and facilitate economic activities. The institutional inability to promote policy consistency and to curb rampant moral hazards and other opportunistic behavior was the primary factor behind the collapse of the financial system in Indonesia at that time. Furthermore, unlike other Asian countries that also suffered from the economic crisis in 1997, the collapse of the financial system in Indonesia was soon followed by the collapse of its political regime.

Ten years later, institutions had been strengthened, authority was restored to government, and political life was significantly democratized. In regard to integrity, the independent status of the Supreme Audit Institution, as well as the establishment of the

KPK, provided good institutional fundamentals, although they still needed to be strengthened.

Still, Indonesia needs further reforms before it can be considered substantively democratic. In addition, despite the continuation of macroeconomic stabilization, there is growing concern about the actual implementation of reforms. In the past few years, Indonesians have complained about how ineffective government policies have been. Many good policy recommendations failed to be implemented simply due to ineffective institutions.

Basri and Hill (2011) argue that Indonesia has been moving from one person authoritarian rule towards a vibrant, sometimes unpredictable democracy in the space of just two years, and against the backdrop of deep economic crisis. At the same time, looking forward, Indonesia has a number of hurdles it must still clear. Five of these seem particularly noteworthy: 1) demography; 2) government-party relations; 3) corruption; 4) decentralization; and 5) infrastructure development.

The demographic issue in Indonesia holds both promise and problems. Ten years after the AFC, Indonesia started to enjoy relatively high economic growth. The Indonesian economy has been entering an expansion period thanks to a demographic dividend from which Indonesia will benefit until 2025. This is an important reason why Indonesia is seen as having the economic potential to make it a member of the BRIC (Brazil, Russia, India and China) group of rapidly advancing countries. Indonesia's population is relatively young with income rising rapidly. Until 2025, Indonesia will have a lower dependency ratio of the elderly than most Asian countries. This will enable Indonesia to close the gap faster with developed countries. Indonesia is placed to become one of the important players in the global economy, particularly in Asia. Countries with youthful populations like Indonesia will tend to have higher consumption rates than those with aging populations. High demand supports growth, as consumption accounts for 65 percent of the Indonesian economy. Data

shows that the new middle class (spending $4 per capita per day or $1,400 per year) grew from 5.7 percent (2003) to 18.2 percent (2010) or approximately 30 million people. As one can easily imagine, this new middle class will lead to a spike in demand for durable consumer goods such as motorcycles, cars and homes. This will enable consumption to continue to be strong in Indonesia into the future. This is why consumer-oriented companies have a good outlook in Indonesia. In addition, Indonesia has both energy and commodities. Global demand for commodities and energy will continue to rise into the future. And with more expensive natural gas and oil, many crops will also become a source of energy. Given these conditions, countries that can produce both of these products have a strong future. These factors contribute to explaining why the Indonesian economy has been doing relatively well in the last few years even during the GFC.

What about after 2025? Indonesia is entering its youthful productive era, but must work to ensure that it has sufficient savings for the future. If demographic projections are continued through 2050, the Indonesian picture is not so sunny. Mason, Lee, and Russo (2000) shows that Indonesia will face an aging population by 2050. This means that after 2020-2030, the aging population will continue to rise quickly. After that, the potential for high growth will decline. Therefore, Indonesia must take advantage of the current demographic bonus to ensure a period of expansion. If not, the country will enter a period of slow economic growth without the chance to accumulate savings. Given such a scenario, the Indonesian economy cannot be satisfied with growth of 6.5 percent. It needs growth above 8 percent for the period leading to 2030.

To take advantage of Indonesia's temporary demographic bonus and to grow at a rate of about 8 percent per year, Indonesia must improve the quality of its human resources. This includes health and education, two areas where, unfortunately, Indonesia is lacking. To close the gap, it is essential that Indonesia invests in quality education and health care. Hausman and Rodrik (2002) emphasize the importance of new product innovations. Woo

and Hong (2010) have stated that Indonesia must emphasize the role of a science-based economy. Indonesia tried in the past to leapfrog ahead, but failed, largely because the country attempted to enter high-technology sectors by producing airplanes. What the country really needs are advances in agriculture, for example new varieties (including agro biotechnology), new approaches to water and environmental management, as well as mechanization, improvements in animal husbandry and infrastructure that supports agriculture.

Unfortunately, the country's export products and markets remain primitive with very little advancement in these fields. Basri and Rahardja (2011) show that primary exports still center around outdated products and markets. An analysis of export growth between 1990 and 2008 shows that the major increases in Indonesian exports involved the same products sold to the same markets. New discoveries accounted for less than five percent of the increase. Basically, there was no substantial introduction of new products for new markets. The country's economic future will be very uncertain if there are not advancements in this area.

A second big problem concerns government-party relations. In the current Indonesian political system, both the President and Parliament are directly elected by the people. Indonesia's political system is basically a multiparty presidential system. The president's party has thus far not enjoyed a majority in Parliament. As a result, the role of political parties is becoming all the more dominant, so much so that the cabinet must have "rainbow coalitions." A president has to be realistic enough to see that his/her cabinet reflects political equality. He/she cannot be based simply on the meritocracy of technocrats.

As we discussed above, the case of Bank Century resulted in tensions between the government and Parliament. The Bank Century case disrupted several of the government's policies. This tension is part of Parliament's efforts to gain stronger bargaining power in

relations with the government. To deal with this, *Sekretariat Gabungan (*the Joint Secretariat of Coalition Parties [JSCP]) has been set up by the President himself. JSCP is an association of the coalition parties that support the government: the Democrat Party, the Golkar Party, the National Mandate Party (PAN), the National Awakening Party (PKB), the Prosperous Justice Party (PKS) and the United Development Party (PPP). The Chairman of the Secretariat is none other than Aburizal Bakrie. Setting up of the JSCP was meant to guarantee better coordination between the government and political parties.

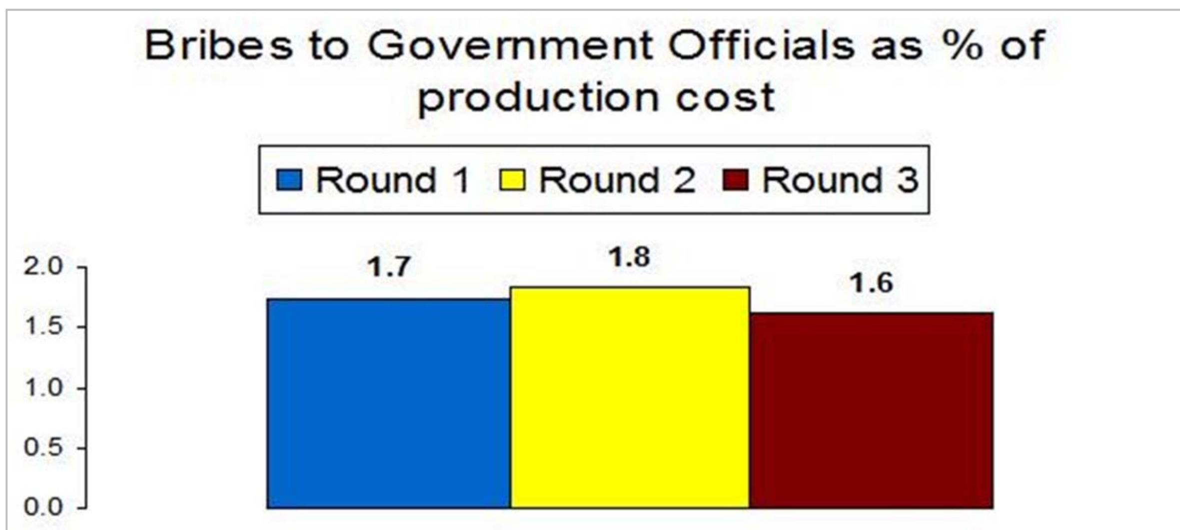
The JSCP has started to play a role larger than any single political party and will create difficulties for economic reformers. However, it will not be strong enough to stop the reform process. The JSCP is not a monolithic, coherent organization. It might in fact weaken the bargaining position of any coalition party in negotiations with the government. In addition, the role of the media and civil society seems stronger today and criticism from officials and NGOs is now continually directed at the JSCP. A free press and open information put pressure on the JSCP to not take a position or make a decision that only profits a particular entrepreneur. Nevertheless, if a common interest develops among the parties, then the JSCP will have a strong bargaining position with the government. Reform measures that implicate many private interests of politicians are likely to be challenged and become more difficult to implement. Good governance could well be the victim and the JSCP could be an impediment to efficient national management of the economy.

A third future difficulty will concern corruption. Eradication of corruption will take a long time to complete, but progress has been made. Basri and Hill (2010) pointed out that many corruption cases have resulted in legislators and senior officials being fined and imprisoned as a result of actions initiated by the KPK. Thanks to the separation of powers among the executive, legislative and judiciary branches, a significant increase in influence has occurred in the judiciary system. Unlike the Soeharto era, the judiciary system is now autonomous. Corruption, however, remains pervasive in the courts creating uncertainty in

both the legal system and in the business climate (Butt 2009). While it is true that the KPK has won some notable victories, resistance to its efforts to combat corruption has continued from opponents of the reforms.

Corruption is also still pervasive at the local level. However, LPEM (2006) argue that there has been a decline in harassment visits and bribes in some regions (Figure 6). The study reports that such a decline suggests that the on-going anti-corruption campaign might be having an impact at the local level.[11] Furthermore, competition between regions might also be reducing the costs of doing business in the regions. Unfortunately, national agencies such as Tax and Customs do not face similar competitive pressures with the result that inefficiency and rent seeking in national institutions continue to be major obstacles (Basri and Patunru 2006). While democracy has brought greater accountability and transparency, it has not of itself directly reduced corruption (Basri and Hill 2011).

Figure 6. Bribes to Government Officials as % of production cost



Source: Based on survey of manufacturing firms (520 firms) in major cities in Indonesia, conducted by LPEM-FEUI (2006)

11. It is also possible, however, that local government officials have had sufficient experience with the new environment so that corruption becomes more institutionalized.

The fourth problem that Indonesia has to deal with is the issue of decentralization. Decentralization, for example, has created incompatibilities between centralized government policies and the role of local government. As the power of local governments goes up, centralized government policies, including central government expenditures, become less effective. Indonesia has yet to find an appropriate mix of incentive and dis-incentive mechanisms in the new democratic era. Basri and Hill (2010) argue that there is a principal-agent problem in which the agent (local government) does not obey the principal (central government) because the local government is now directly elected by its own constituencies. As a result, the central government is less able to enforce rewards and penalties on the local government. Although the amount transferred by the central government to the regions is quite significant, it does not necessarily improve the infrastructure or lower poverty incidence in the regions. Basri and Hill (2010) also point out that despite the many benefits of decentralization, the system is still a work in progress and that, owing to local capture, the political market place is not yet able to weed out poorly performing sub-national governments.

The fifth and final problem is that Indonesia's long-term economic development must confront the problem of infrastructure. In an archipelago such as Indonesia, transaction costs, especially in logistics, are relatively high compared with continental countries. This has been well documented by various research reports. The price of commodities such as sugar, flour and cement in eastern Indonesia (Nabire) are three times higher than in Java. This large price difference reflects the high costs of logistics due to the poor distribution system (Basri and Rahardja 2010). For instance, inefficiencies at Indonesia's numerous harbors make transport costs more expensive, especially for export-oriented and import-based industries (Patunru et.al 2007). The cost of transporting goods from Warsaw to Hamburg, a distance of 750km, is only half the cost of sending goods from Makassar to Enrekang in Sulawesi, a distance of only 240km (Carana 2004).

The cost of logistics in Indonesia amounts to 14 percent of total production costs, far higher than, say, Japan where it is only five percent (LPEM study 2005). The combination of over-lapping regulations and high domestic transportation costs reduce Indonesia's overall trade competitiveness (LPEM-Asia Foundation 2009).

Given these cost differentials, tackling the high cost of logistics may be the key to unlocking the door to prosperity for Indonesia's many regions. Trade logistics—the capacity to integrate domestic economies and connect domestic economies with international markets through the dispatch of goods—is an extremely important factor in realizing a country's economic growth potential. Thus, Indonesia can only achieve higher growth if the government addresses such logistical issues and infrastructure deficiencies. Despite some inroads, progress is very slow. Obstacles include land clearance, complicated and drawn out bidding processes, and lack of coordination among government authorities responsible for infrastructure matters. Such issues as logistics and transaction costs are serious constraints against integrating the domestic economy. Indonesia must avoid becoming inward-looking but should equally hesitate to commit fully to the regional production network. The right choice is to maintain openness along with a minimum structure for the domestic economy while addressing barriers to logistics and transactions.

Infrastructure and other costs are undermining the competitiveness of Indonesian businesses regardless of ownership or trade orientation. In contrast, advocating more liberalization per se would be difficult because businesses might suffer immediate losses and benefits remain elusive. Hence focusing the reform agenda on addressing issues designed to raise competitiveness and enhance the integration of the domestic market could win greater support from stakeholders.

Conclusion

Compared with the Asian financial crisis of 1997/98, the impact of the 2008 global crisis on the Indonesian economy was relatively limited in spite of the fact that the effects of the latter crisis were much larger than the 1998 crisis in terms of magnitude. This chapter argued that at least four differences divide the two crises: the origin of the crisis, the exchange rate regime, policy responses and the overall political economy situation. First, in 1998 the economic origins of the crisis were both domestic and external, while the 2008 crisis was almost entirely external. Second, prior to the 1997/98 crisis, Indonesia applied the fixed exchange rate system but replaced it with the free floating system after the crisis. Third, economic policy responses were different. Besides the change in the exchange rate system policy mentioned above, the Indonesian government implemented extremely tight monetary and fiscal policies in 1998 but more relaxed policies in 2008. In 2008, the government also adopted a more flexible and prudent policy concerning banking and trade than in 1998.

In addition to these good policies, this chapter argued that “good luck” in trade conditions played an important role in the 2008 crisis. Due to the delay of Indonesia’s integration into the global and regional networks of production, its trade dependence was lower than other Southeast Asian counties. In consequence, impacts through trade shrinkage of the global financial crisis were much smaller for Indonesia.

While highlighting all those factors, this paper focused primarily on the role of Indonesia’s domestic political economy during these two crises. The political turmoil leading to the downfall of the Soeharto regime caused the 1998 crisis to become far worse, while a larger measure of confidence Indonesians had in their government helped it handle the 2008 crisis in a calm and positive manner. Lest it leaves an unduly optimistic picture of Indonesia’s political and economic future, however, the chapter closes with an assessment

of several major hurdles that Indonesia must deal with in the coming years: demography, government-party relations, corruption, decentralization, and infrastructure.

Ten years after the 1998 crisis has not made Indonesia safer from another financial crisis, but the ability of Indonesia to manage the economic crisis in 2008 at least shows that the country learned a number of lessons from what went wrong in 1998. The 1998 crisis helped the country to survive the 2008 crisis. Problems continue to remain for Indonesia's longer term economic development but the country is clearly in a far stronger position to move forward than it was a decade ago.

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Abstract (in Japanese)

二つの危機の物語−インドネシアの政治経済

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要約

　2008 年のグローバル経済危機は多くの国々に経済的打撃をもたらした。インドネシアも明らかにこの危機から影響を受けており、輸出の成長は著しく減退した。しかし、インドネシア経済に対する危機の衝撃は、シンガポール、マレーシア、タイなど同じ地域内の他の国々と比べると、限定的であった。この状況は、なぜそうだったのかという疑問を浮かび上がらせる。ただし、この危機はインドネシアにとって初めての金融危機というわけではなく、すでに 1998 年のアジア金融危機で同国は非常に深刻な影響を受けていたのである。そうするとむしろ興味深い論点は、2008 年のグローバル金融危機は、規模自体は 1998 年よりもはるかに大きかったにもかかわらず、なぜその効果は相対的に限定されたものであったのか、という問題である。本論文は 1998 年と 2008 年の危機には少なくとも四つの違い——危機の起源、為替相場制、政策的対応、全体的な政治経済状況——があったと論じる。さらに、貿易構造が 2008 年危機の際には重要な役割を果たしたことも指摘する。インドネシアがこのグローバル金融危機を乗り切ったのは、良い政策と好運という二つの要因のおかげである。本論文は、そうした全ての要因を取り上げるが、とくに二つの危機の間の国内政治経済の役割に焦点を当てる。そして、結論では、インドネシア経済の将来について過度に楽観的な見通しを立てることにならないよう、今後数年間にインドネシアが取り組まなければならない幾つかの主要な課題について評価を行う。

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