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THE BEST OF TIMES AND THE WORST OF TIMES: INDONESIA AND ECONOMIC CRISES[•]

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Abstract:

This paper examines the experience of Indonesia during two major crisis episodes, the 1997-98 Asian financial crisis and the 2008-09 global economic recession. In the first episode, Indonesia experienced a deep economic and political crisis, while in the second the impacts were very mild. The paper examines various explanations of these large differences, focused in particular on the contrasting hypotheses of 'good management' and 'good luck'. The comparative Southeast Asian experience is also analyzed.

Key words: Indonesia, Southeast Asia, crises.

JEL codes: E65, N15, O53.

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1. Introduction

Crises are an ever-present feature of the global economy. The 2008-09 global economic recession (hereafter GER) was the most serious event of its kind since the Great Depression of the early 1930s. Crises can have devastating economic, political and social impacts, disrupting a country's growth trajectory, resulting in greatly increased public indebtedness and causing social hardship. According to detailed historical studies of (public) debt and crises, and their impacts on growth (Reinhart and Rogoff, 2009, 2011), debt/GDP ratios in excess of a threshold of about 90% result in significantly slower growth in the following decade, on average of about four percentage points, albeit with a much lower median contraction. Significantly, they found that the threshold ratio for emerging economies, that lack policy credibility and trust in international capital markets, is much lower, about 60%. They conclude that 'seldom do countries grow their way out of debt.' (p.43)

The effects of crises are especially serious in developing countries, where such a high proportion of the population is either below the poverty line or precariously above it, with considerable 'churning' above and below that line. For example, Suryahadi et al (2011) show that, for Indonesia, while 53.3% of the people who were classified as poor in 2008 moved out of poverty in the following year, almost half the people who were poor in 2009 were not so classified the previous year.

The literature on crises is as diverse and heterogeneous as the phenomenon itself. Crises vary as to their origins, intensity, magnitude, and duration. They range from mild economic contractions followed by swift recovery to deep, systemic events that permanently alter a country's development trajectory. Some are single-country events, mainly home grown (eg, Indonesia in the mid 1960s, The Philippines in the mid 1980s). Others are almost entirely external, such as for most developing economies in 2008-09. In some crises, a mix of external and domestic factors is at work, such as in the Asian financial crisis (hereafter AFC). Some crises principally affect the level of economic activity, while others are associated with, and maybe triggered by, widespread financial collapse and a sharp depreciation of the exchange rate. They may also be associated with – or likewise triggered by – broad and deep political and institutional changes. Recovery paths also vary greatly, from the 'V-shaped' swift return to pre-crisis growth rates, as in Mexico in 1994 (Edwards, 2010, chapter 6) and most of East Asia after 1999 (Corden, 2007; Ito, 2007), to the 'L-shaped' pattern of prolonged decline and stagnation, as in most of the economies of Eastern Europe and the former Soviet Union from the early 1990s (Pomfret, 2002).

But there are common elements too. As Krugman and Wells (2010) note, crises have their origins in excessive debt:

> 'Too much debt is always dangerous. It's dangerous when a government borrows heavily from foreigners – but it's equally dangerous when a government borrows heavily from its own citizens. It's dangerous too when the private sector borrows heavily …'

Moreover, there is a general presumption that the country impacts of a crisis will be milder if several other factors are present. The first is whether a country has historically conservative macroeconomic management, so markets are less likely to mark down its debt, and the government has ample scope for short-run Keynesian macro policy. The second is if the international economy is buoyant, offering the scope for export-led recovery following the boost to competitiveness from an exchange rate depreciation. The V-shaped recoveries in Korea and most of Southeast Asia after 1998 are a good example of this proposition. Conversely, the US has not had this lifeline in the current crisis; in fact the value of its currency rose for a period during 2008-09 owing to the 'safe haven' effect of capital inflows. Third, a resilient financial sector is important, so that financial institutions do not have to be bailed out (hence leading to fiscal stress) and firms may trade through the crisis, taking advantage of the lower exchange rate. A fourth factor is whether there is a swift and coordinated response from major economies (eg of the G20 variety in 2009) and the IMF and donors for country crises. The fifth concerns the domestic institutional capacity to respond to corporate and social distress, in the form of credible central banks, financial regulators, and social providers. Finally, a strong, effective, decisive, 'legitimate' government, able to make quick and tough decisions, can make a major difference. This was absent at the end of the Marcos and Soeharto eras in The Philippines and Indonesia 1986 and 1998 respectively, where economic and political crises interacted and aggravated the situation. More recently, there is also some concern that Thai policy capacity has been partially incapacitated by ongoing political uncertainty.

The fact that there is no universal 'crisis theory' has led researchers to undertake detailed country analysis, drawing on the body of theory related to crises as modified for the particular country circumstances and nuances. For example, in the case of the 1997-98 Asian economic crisis the impacts varied greatly across the region, ranging from mild disruption to deep economic contraction and political turbulence. These diverse effects can be traced to a broad range of country-specific factors, ranging from a number of (predisposing) 'vulnerability indicators' to a set of politico-institutional variables.

In examining crises, Indonesia is a most suitable case study. It has experienced two serious economic crises in its independent history, in the mid 1960s and 1997-98. In addition, there have been two periods where a serious crisis was widely anticipated but successfully averted, in the mid 1980s and 2008-09. As with crises in general, these four events differ significantly in their origins, severity, impacts and recovery trajectories. The first crisis was entirely homegrown, with a moderate growth slow down caused by the loss of macroeconomic stability, reckless economic policies, and deep political impasse. The second was over the period 1981-86, when the sudden fall in global commodity prices triggered the debt crisis in the developing world, especially among the major energy exporters. Indonesia might have been expected to succumb to this crisis, as did the country with which it is most frequently compared, Nigeria. In the event, although its growth slowed significantly, it managed to navigate through this period in a highly effective manner, owing to the government's prompt and comprehensive reform measures.[1]

The third crisis, of 1997-98, was by far the most severe in its economic impact. There was a dramatic growth slowdown, from peak to trough of more than 20 percentage points (that is, comparing the pre-crisis growth rate to that of the major crisis year, 1998). Both the modern banking sector and the exchange rate collapsed. Like the first crisis, the events of 1997-98 resulted in major regime change. And like Indonesia's crisis-affected neighbours, the crisis was essentially V-shaped in nature, with a relatively swift restoration of economic growth. In the fourth case, 2008-09, the growth slowdown was very mild, about two percentage points, but it occurred against a global backdrop of the most challenging economic circumstances since the 1930s.

We focus in this paper on a comparison of the latter two events. These are the most relevant to the modern era of economic development, in which developing economies such as Indonesia are more fully integrated into the world of international capital mobility and fast-acting contagion. Moreover, Indonesia's database is more comprehensive over these two periods, with national accounts available on a quarterly basis. The main question we ask is why and how the economic effects of these two episodes were different in almost every respect: were these differences mainly due to good management or good luck? For broader insights, we also look at the comparative experience of several developing Asian economies over these two periods.

The issue of crisis management is issue is central to understanding Indonesian economic policy making and growth dynamics, and country case studies such as this one contribute to a broader analytical understanding of crises. Our organization is as follows. In section 2 we examine the Indonesian experience during these two episodes, 1997-98 and 2008-09. Section 3 presents some comparative developing Asian experiences, and briefly investigates factors explaining the differences over time and across countries. Section 4 summarizes the main arguments and highlights some key policy lessons.

2. Indonesia during Two Crisis Episodes

The two crises had very different histories. The first originated in Thailand, and spread quickly to neighbouring East Asian economies, including Indonesia. By contrast, the origins of the 2008-09 GER were clearly external to Southeast Asia (Garnaut and Llewellyn-Smith, 2008). That is, it was caused by reckless financial behaviour and the development of obscure financial instruments in the major financial centres of New York, London and elsewhere, compounded by increasingly lax financial regulation, and a low-interest rate environment and, in the US case, East Asian lenders able and

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[1] The best comparative account of this episode remains Gelb and Associates (1988), which underlines how unusually successful was the Indonesian management of the crisis.

willing to fund its huge twin deficits. Once the asset boom began to deflate, particularly in the US real estate and stock markets, financial distress set in quickly, freezing up global financial markets, and resulting in rapidly rising public debt (owing to both automatic stabilizers and corporate and financial bail-outs), and in turn depressing the real economy.

For economies on the 'periphery', like Southeast Asia, there were three principal transmission mechanisms. First, there is a real economy effect, resulting in falling export demand, affecting both price and quantity, exacerbated by rising protectionism in OECD countries. The second is a financial contagion effect, from exposure to financial institutions and assets in the OECD economies. The third is a financial protection effect, that is, the perverse outcome of capital flowing to the jurisdictions considered the best able to protect financial institutions and the funds invested in them (even though the crisis originated in these countries), in addition to the general decline in cross-border capital flows as the global recession set in.

It is therefore necessary to consider both channels, the trade and capital account effects. On the trade side, since these flows fell from late 2008, the more trade-exposed economies would be expected to be most adversely affected. With respect to capital flows, it is likely to be the economies that are running large current account and/or fiscal deficits, or whose financial sectors are most connected to those in the US and UK, or where the prudential management of the financial sector is considered the weakest. There will also be additional factors, especially in the realm of political economy, since as noted crises generally test the capacity of governments and institutions to respond quickly and effectively.

Let us examine the outcomes over these two periods, starting first with the Indonesia. We compare the two events with reference to quarterly national accounts data over 12 periods in Figure 1, and a range of qualitative indicators in Table 1. The national accounts series commence just prior to the onset of the crisis, which for convenience we take as the first quarters of 1997 and 2008.[2] That is, t=1 corresponds to these two quarters. In both cases, Indonesia entered the crises growing strongly, in 1997 with a decade of historically high growth, and three decades of strong performance. In 2008, there had been almost a decade of moderately strong, and increasing, growth.

Figure 1 and Table 1 here

But the outcomes diverged almost immediately. Growth collapsed from Q4 1997, and continued to be sharply negative for the first two quarters of 1998, after which there was an anaemic and erratic recovery for several quarters. The effects on the real economy were dramatic, with a peak to trough growth collapse of about 20 percentage points between 1996 and 1998. If measured as annualized quarterly data, the decline was larger still. This would be

[2] The AFC is generally dated from July 2, 1997 following the collapse of the Thai Baht. The formal date of commencement of the GER is a matter of debate, but the impacts were not felt in Indonesia until Q3 2008.

among the sharpest growth collapses in modern economic history.[3] By comparison in 2008-09, growth slowed from about 6.5% to 4.5%. Importantly also, at the sectoral level, the agricultural momentum was maintained in the latter period, whereas the AFC was accompanied by a serious El Nino-induced drought, although cash crops benefitted from the large exchange rate depreciation. Thus food supplies were unaffected in the latter period, and hence there was less general socio-economic stress, especially for the poor.[4]

The key to this crisis was the capital flight, which commenced in Q3 1997, and accelerated in the next three quarters. This put pressure on the exchange rate where Bank Indonesia, learning from the costly mistake of the Bank of Thailand, quickly let the formerly heavily managed rate float. From a pre-crisis rate of Rp 2,500, the collapse was truly spectacular, bottoming out at Rp 17,500 in early 1998. Neither the banking sector, which had been liberalized in 'big bang' fashion a decade earlier, nor the corporate sector, could withstand a collapse of this scale. Practically all overseas borrowings were unhedged, premised on the assumption that BI could maintain its quasi-fixed rate. The formal banking sector therefore imploded, and much of the modern economy, especially construction and import-substituting manufacturing, came to a halt. This collapse occurred against the backdrop of, and partly caused, rapidly accelerating inflation, which for a brief period verged on hyperinflation.

The crisis was also mismanaged both domestically and internationally. The IMF 'over-managed' the crisis, by demanding fiscal austerity and excessive policy conditionality, in addition to displaying a lack of political sensitivity at key periods. Then President Soeharto, who dominated all aspects of Indonesian government and the military, had already weakened the authority of his gifted team of technocrats and undermined popular support for the regime through egregious family-based corruption. He was subsequently forced to step down from office in May 1998 in the face of widespread street protests.[5]

The events of 2008-09 were different with respect to economic growth, the exchange rate, inflation, and practically every other economic indicator. In the most difficult period, Q4 of 2008, the economy continued to grow. As noted, the crisis originated from outside the region, in western financial capitals. While there was some nervousness in the Indonesian financial market, the

[3] Eichengreen et al (2011) provide some comparative data on growth slowdowns, but Indonesia is not included in their sample of countries.

[4] Agricultural growth was also strong during the 1980s 'near crisis'. The sector was also less seriously affected during the mid 1960s economic and political crisis. Of course, the importance of the agriculture sector declined significantly over this period, and by 2008-09 its share of GDP was about one-third that of the mid 1960s. Nevertheless, food availability remains a sensitive social issue, especially during periods of economic uncertainty and political tension.

[5] For a more detailed account of these developments, see the four-monthly 'Survey of Recent Developments' in the Bulletin of Indonesian Economic Studies over this period.

resulting capital flight was modest and the banking sector remained intact (Rosengard and Prasetyantoko, 2011). The only really threatening period was in late 2008 and early 2009. The Jakarta Stock Exchange fell by about 50% at the end of 2008, and was closed for a period. The growth in bank lending fell sharply, from an annual rate of about 32% before the crisis to 10%. Banking confidence also fell sharply, as illustrated by the fact that outstanding inter-bank borrowing fell from Rp206 trillion in December 2007 to Rp84 trillion in December 2008. Banks therefore sought to repair their balance sheets by pushing up interest rates (Basri and Siregar, 2009). Inflation was kept under control, and the exchange rate was allowed to drift downwards, over this period falling by about 33%. The latter was comparable to the declines in other emerging and commodity-exporting economies, including developed economies like Australia. Moreover, Indonesia had already been operating a floating rate regime for a decade. Thus a decline of this order of magnitude did not have severe financial repercussions, apart from a brief period of market jitters in early 2009. In fact, it helped to cushion the negative impacts of the global economic decline and the short-lived fall in commodity prices.

In addition, as compared to the earlier period, the country was now less vulnerable to a crisis according to the usual key indicators. These include the level of short-term indebtedness and the ratio of the stock of 'mobile capital' relative to its international reserves (Athukorala and Warr, 2002). In turn, the absence of a banking collapse and the modest economic slowdown in 2008-09 resulted in limited fiscal stress, unlike in 1997-98 when public debt suddenly escalated to about 100% of GDP. In fact, the fiscal prudence over the period 2000-08 meant that the government had re-established fiscal policy credibility and it had some scope for expansionary fiscal policies. Similarly, although the road to full central bank independence from 1999 onwards was a rocky one, Bank Indonesia had also established a reasonable degree of credibility in the markets, and it too was able to adopt an expansionary stance in 2008-09.

Indonesia's democratic processes and institutions managed these shocks effectively. National parliamentary and presidential elections were conducted in 2009, and the Yudhoyono administration was decisively returned to office. In 1997-98 the Soeharto regime showed itself to be increasingly out of touch with public opinion. Most of its key economic advisors had been progressively sidelined during that decade, and the business empires of the Soeharto family had become deeply unpopular. Its management of the crisis became increasingly farcical from late 1997.

The one major negative factor in 2008-09 was of course the state of the global economy, in contrast to its buoyant state in the first episode, when it was little affected by the AFC. Thus, in the late 1990s, the increased competitiveness arising from large real exchange rate depreciations greatly boosted competitiveness, resulting in strong export growth and hence an export-led recovery. In 2008-09, such a strategy was not available, although China and India maintained their growth momentum (see Figure 1), and thus the decline in global commodity prices was short-lived.

Why were these outcomes so different, and in particular why did Indonesia navigate the 2008-09 crisis with little difficulty? This is a large and complex issue, but the key in a latter period was a fortuitous combination of ‘good luck’ and ‘good management’. We briefly consider each of these in turn. It is also important to emphasize that the two crisis episodes were inter-related. As is well documented, crises force governments, policy makers and business to review their strategies. Governments attempt to pinpoint and correct policy gaps, such as a loosely regulated banking system or an under-performing central bank. Businesses, banks and households become more risk-averse.

There are several aspects to Indonesia’s good management story over the past decade, that in turn moderated the crisis impacts. The most important is overall good macroeconomic management. As noted, fiscal policy has been remarkably prudent since 2000, with successive administrations able to resist demands for greater spending. This gave the government credibility in managing its public debt, and some room to move in its fiscal stimulus packages in late 2008 and early 2009.[6] Monetary policy was also better managed, with an independent central bank and a more flexible exchange rate. Both these factors were positive elements, although their importance should not be overstated. As noted, BI has had constant political problems during its first decade of ‘independence’, and it has struggled to keep inflation on a par with Indonesia’s trading partners. Exchange rate flexibility also had its limits, with the central bank understandably reluctant to let the rate drift down too far in view of recent history.

A second factor was that the financial sector remained intact. This is a key difference compared to 1997-98. Banks and the corporate sector were not highly leveraged, there was no generalized decline in asset prices, and Indonesian banks had virtually no connection to the troubled assets and financial markets of the US and UK. Although there was some nervousness in Indonesian financial markets, the government quickly extended the deposit guarantee facility, and it had to rescue only one minor bank, Bank Century,[7] while its deposit guarantee scheme was hardly deployed. The government can claim a substantial part of the credit for this favourable outcome, as financial regulation had improved in the wake of the disastrous collapse a decade earlier. But the general increase in private sector caution, aided by relatively small speculative capital inflows prior to 2008, rendered a boom and bust scenario less likely.

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[6] In fact, the government’s discretionary stimulus was quite modest, about 1% of GDP in 2009, considerably smaller than could have been justified by ‘fiscal fundamentals’. The two main constraints were an ability to quickly increase spending, particularly on infrastructure projects, and a reluctance on the part of the parliament to authorize significant increases in expenditure during an election year.

[7] While the bank was a minor one, its rescue had massive political repercussions, resulting in the ‘departure’ – many regarded it as the ‘removal’ – from office in May 2010 of the country’s highly regarded Minister of Finance, Dr Sri Mulyani Indrawati (see Hill, 2010).

Third, the political economy underpinnings were favourable in 2008-09. The government was seen as legitimate, and it had the authority to act, even if its general response was rather timid. There was a general public understanding that, as in the mid 1980s, the principal causes of the crisis were external. And although there were constant allegations of corruption, unlike in the late Soeharto era they were not primarily directed at the president and his family. Moreover, the economics team was regarded as credible.

So much for the good management story. We have already drawn attention to the fact that the above outcomes also contained elements of good luck. In addition there were other fortuitous factors at work. At least three deserve mention. First, Indonesia was much less affected than its neighbours by the implosion in world trade that commenced in late 2008. In spite of the major liberalizations since the mid 1980s, Indonesia is not as globally oriented as its neighbours. Its exports of goods and services are equivalent to about 30% of GDP, much less than Malaysia (114%), Thailand (73%) and even the Philippines (45%). It is of course true that, in the years leading up to the GER, Indonesia enjoyed rapid export growth on the back of high commodity prices. Over the period 2004-08, real export growth averaged 11%, more than double the rate for 2000-04, and one of the highest in East Asia. In fact, gross export growth accounted for 83% of the expansion in GDP from 2004 to 2008. Nevertheless, imports also grew very rapidly, with the result that the contribution of net export growth was quite small.[8]

Second, in addition, Indonesia is a much smaller participant in that part of global trade that contracted the most in 2008-09. This is the so-called ‘fragmentation trade’ in electronics and automotive parts and components as part of global production and buying networks, much of it under MNE auspices. This trade declined the most rapidly as consumers deferred purchases of non-essential consumer goods. As a share of Indonesia’s total exports, parts and components account for about 9%, less than half the share for Thailand and one-quarter that of Malaysia (Athukorala, 2006).

A third good luck factor was the continued strong growth of the Chinese (and increasingly Indian) economy. This country has not only become East Asia’s principal economic locomotive over the past decade but, as a major commodity importer, its economy is highly complementary with Indonesia’s. This growth also sustained the high commodity prices over this period, apart from a brief dip in late 2008. Thus Indonesia’s terms of trade remained at historically high levels throughout.[9] Together with good rainfall, the agricultural sector, which still employs almost 40% of Indonesia’s workforce, remained buoyant in 2008-09, here also in contrast to the experience in 1998.

[8] According to unpublished ADB estimates, over the period 2000-09 net exports accounted for 7.7% of Indonesia’s GDP growth, compared to the median for nine major Asian economies of 10.8% (and 15.2% excluding China).

[9] Although commodity prices dipped over this period, coal export volumes continued to increase in 2009. CPO (palm oil) export volumes declined in 2009, but they were still 50% higher than that of 2007. Copper exports also rebounded quickly in 2009.

The lagged effects of strong commodity prices from the previous three years also contributed to consumption holding up well in 2009 (Basri and Rahardja, 2010).

On balance, therefore, the explanations for these highly divergent outcomes are manifold, economic and political, domestic and international, with no one-size-fits-all explanation. If 'everything went wrong' in 1997-98, the opposite could be said of 2008-09, with good luck just as important, indeed some would argue more important, than good management.

3. Comparative Experiences

What of the experience in neighbouring economies? In fact, the Indonesian story broadly resembled that of low-income economies in general. The IMF (2010) concluded that real per capita GDP growth in 2009 stayed positive in two-thirds of these countries. The main effects of the GER were transmitted not so much through movements in terms of trade and interest rates, as in previous occasions, as through a sharp contraction in export demand, foreign direct investment, and to a lesser extent remittances. Growth was supported by counter-cyclical fiscal policy, a historically unusual outcome for these economies, and a response that was facilitated by prudent macroeconomic policy over the preceding decade. While most of the fiscal stimulus occurred through automatic stabilizers, some additional spending was directed to the social sectors and infrastructure.

Among Indonesia's neighbours, the impact of the GER varied greatly. We focus on the other five major Southeast Asian economies and refer to the quarterly national accounts data over the two periods presented in Figure 1, together with the country economic literature.[10] In the 1997-98 event, the most important determinant of survival was the quality of financial sector management, and the level of indebtedness, public, corporate and financial, and especially short-term debt (Athukorala and Warr, 2002). The more these features resembled the Thai case, the more likely the country was to succumb to the contagion that quickly spread through the region after the collapse of the Thai Baht on July 2, 1977. In 2008-09, as noted, the origins of the GER were very different. In this case, the main explanators of economic crisis were the trade exposure of the economy, the state of the financial sector and its connections to markets in the OECD north, and the scope for quick-acting macroeconomic stimuli.

The crisis impacts were felt immediately in Singapore, where trade is equivalent to about 400% of its GDP. Its economy began to experience negative growth in the third quarter of 2008, and throughout the whole episode it experienced the sharpest economic contraction in its independent history, on a much larger scale than the mild slowdowns it experienced in the earlier recessions of 1998 and 1986. As has traditionally been the case, when

[10] See for example the World Bank's East Asian and Pacific Half Yearly Updates, the special issue of the ASEAN Economic Bulletin, August 2011, and the country literature referred to below.

the global economy began to recover by mid-2009, the country was among the first to resume high growth. Singapore has rather limited economic policy tools with which to respond to a major crisis that emanates from a global economic slowdown. Although the government's fiscal position is one of the strongest in the world, any fiscal stimulus will quickly leak out of the economy through imports. The major monetary policy lever to keep inflation in check is the exchange rate. In the event, the government was able to curb the import leakages of its fiscal stimulus by concentrating its expenditure measures on the labour market, with targeted incentives to induce firms not to lay off their workers, although there were still second-round import leakages (Das, 2010). The country also enjoyed the benefits of its financial safe haven reputation. None of its banks were imperiled during the crisis, while this factor plus the government's deposit guarantees actually attracted funds to the country. There was also scope to ease the labour market pressures by curbing labour inflows from abroad on a limited scale.

A somewhat similar set of factors was present in Malaysia in 2008-09 (Athukorala, 2012). It too is a very open economy, though less so than Singapore, and its merchandise exports are also dominated by electronics. Thus it began to record negative growth from the fourth quarter of 2008. But like Singapore, it has a well-established reputation for credible macroeconomic management. In this respect, its standing was enhanced in 1998 through its decision to eschew the IMF rescue package and to adopt the then unorthodox measure of imposing controls over short-term capital flows. The country's financial sector held up well, supported by government guarantees, while the very large migrant workforce also offered the potential for labour market flexibility. The government adopted an aggressive fiscal stimulus package, which it had room to do with public debt well below OECD norms, supported by buoyant (and partly captive) domestic savings. Nevertheless, public debt is now arguably the country's principal source of macroeconomic vulnerability, as fiscal deficits have been a more or less continuous feature since the AFC. Nevertheless, In the event, Malaysia's 2008-09 slowdown was shallower and of shorter duration than that of 1997-98. However, the recovery in the latter period was less rapid owing to the faltering state of the global economy in 2009-10.

Thailand is also an open economy, although not on the scale of its two southern neighbours, and it likewise has a high exposure to the international trade in electronics and automotive products. Thus its growth fell sharply negative in late 2008. It too has a history of reasonably prudent macroeconomic management, and a substantial migrant workforce. Its financial sector, which triggered the AFC in 1997, had been cleaned up significantly, and survived the GER without duress. Where Thailand was vulnerable, arguably, was in the political stalemate that had persisted through the post-Thaksin era (Siamwalla, 2011). This had had the effect of jeopardizing the country's traditional fiscal caution, and it also rendered more difficult the adoption of quick-response fiscal stimulus measures. In the event, its growth dips and recoveries resembled those of Malaysia in both periods, underscoring the fact that these two economies share many similar structural and policy features.

The Philippines maintained its reputation as the regional exception. Its economic growth was (marginally) positive growth in 2009, while in 1998 the slightly negative growth was as much to do with the agricultural contraction resulting from the El Nino drought as it was to the AFC contagion. It might have been vulnerable in 2008 owing to its higher level of public indebtedness, occasioned in part by congressional blockages of the Arroyo administration budgets. However, three factors explain why growth remained positive. First, the economy is not as trade-connected as the above three economies, while its principal international connection is increasingly remittances, now about half the value of its merchandise exports. Remittances held up quite well in 2009, better than most other types of capital flows. Second, the country's financial institutions remained intact, as they did in 1998. Third, the central bank, BSP, which had been comprehensively reformed and recapitalized in the early 1990s, continued its effective monetary policy management, as it had in 1997-98 and during several political crisis events over the past two decades.

In the case of Vietnam, growth slowed quite sharply in late 2008, as it did in 1998, to about half that of the pre-crisis periods in both cases.[11] In fact, it was the country in Southeast Asia[12] that in 2008-09 might have experienced something like an AFC-type crisis, and for largely similar reasons. That is, the government was attempting to hold on to a fixed nominal exchange rate, in the context of inflation at higher levels than its major trading partners (thus resulting in a real effective exchange rate appreciation), large capital flows (including to a suddenly liberalized stock market), a sizeable asset price boom, and a fragile, state-dominated banking sector (Leung et al eds 2010). However, in its favour, it had tremendous growth momentum, it is not yet as internationally connected as some of its more advanced ASEAN neighbours, the large private capital flows were recent, and agriculture is relatively more important.

4. Summary and Lessons

How countries respond to and manage economic crises is an important indicator of the quality and resilience of the country's institutions, the government's economic management credentials, and the adaptability of the business and household sectors. In this respect, Indonesia is an excellent case study. It has experienced two serious economic crises, in the mid 1960s and 1997-98, while it has successfully avoided two threatening episodes, the mid 1980s collapse in commodity prices and the 2008-09 GER. This paper has examined why and how Indonesia was deeply affected on one occasion, 1997-98, but its growth momentum was little interrupted in 2008-09. Indonesia emerged from the GER in relatively good shape. Its growth was

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[11] Note however that quarterly national accounts data are not available for Vietnam in the earlier period.

[12] The much smaller Cambodian economy did in fact experience negative growth, in part due to its heavy reliance on tourism and textile and garment exports, together with shaky finance and construction booms (Hill and Menon, 2011).

quickly restored to pre-crisis rates, and its macroeconomic prudence has been rewarded. While the outcomes have been different, the two events are certainly connected, in the sense that there were painful lessons learned from the earlier episode. In the financial sector there is now much greater caution and better regulation. The central bank now has greater independence, and it is gradually adopting a framework consistent with modern best-practice of inflation targetting and exchange rate flexibility. The country's traditional fiscal prudence has been restored, after the extremely costly financial bailouts of 1998. More generally, the country now has a 'legitimate' government and political institutions that continued to function more or less as usual during the near-crisis period.

At the same time, the events of 2008-09 illustrate that crisis management is invariably a combination of good management and good luck. If in 1997-98 'everything went wrong', both centrally in response to the crisis and peripherally,[13] in 2008-09 there was good fortune. The global economy slowed sharply, but Indonesia is less exposed to the international economy than its neighbours, particularly in the global production networks of consumer durables. The country's commodity prices remained buoyant, in no small measure owing to the continued strong growth in China over this period. Agriculture held up well. The international institutions and the governments of leading economies were moderately helpful, particularly in offering emergency balance of payments and fiscal support.[14]

Looking forward, the only event that one can predict with certainty is that there will be more crises. Perhaps they will come quickly, with a second GER. Any number of worrying scenarios is possible. For example if the Eurozone problems are not promptly resolved, if a political impasse in the US hijacks that economy's fragile recovery, or if Japan's debt problems become insurmountable. However, although there are recurring themes in the literature on crises, each new event has specific circumstances. Policy makers typically undertake various forms of 'stress test' exercises, although the arsenal of responses is commonly directed towards coping with the last event, akin to 'generals fighting the last war'. To the extent that economic crises spill over into political crises, which is common, their resolution becomes even more complex. Although crisis events cannot be foretold, the two key messages for a country like Indonesia are the importance of prudence and the development of resilient, high-quality institutions for economic policy. Indonesia scores very highly on the former. The reduction in public debt to GDP from over 100% to less than 25% in little over a decade must surely be counted as one of the developing world's most successful fiscal consolidations, even if it came partly at the cost of underinvestment in infrastructure. The financial sector, which has been central to most recent crises, is now more cautious and better regulated. With respect to the latter, the process of institution building, in the Ministry of Finance, Bank Indonesia,

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[13] With respect to the former, that is, bad weather, exceptionally low commodity prices, Soeharto's health concerns, and so on. See Hill (2000).

[14] Notably, however, the regional cooperation and financial arrangements developed in the wake of the AFC, principally the Chiang Mai Initiative, were not employed and are still in the process of development.

the legal system, and independent regulatory agencies, there has been progress, but at a far slower rate. Here is arguably the country's major medium-term economic policy challenge, building high-quality analytical capacity that is insulated from the immediate political processes. This is the surest way for Indonesia to maintain its growth momentum and to withstand the adverse exogenous shocks it will certainly experience in the coming years.

Finally, what of the impacts of these crisis episodes on agriculture and poverty? A well-established empirical observation is that the share of agriculture in output and employment declines over time. Since economic crises result in declining growth rates and possibly levels of GDP, there is typically a reversal in the declining agricultural shares, particularly for employment. The demand for food is less income-elastic, and it therefore holds up better than that for manufactures and services. There are also supply-side effects, principally that labour coefficients in agriculture are more flexible, extended community support networks are stronger, and it is cheaper to live in villages than cities. The exchange rate depreciation that usually occurs during crises boosts the competitiveness of tradable goods, both food and cash crops. These trends were all clearly evident in Indonesia in 1997-98, but as expected only weakly so during the minor growth slowdown of 2008-09. It is important to also note that this reversal in agriculture's declining share, though welcomed in some quarters, is hardly desirable. It signifies regress in the long sweep of economic development, structural change and the transition out of low productivity activities.

Although there is a clear relationship between the levels and rates of change of GDP per capita and poverty incidence, that relationship in periods of crisis is complex, as the Indonesian experience demonstrates. The sectoral impact of crises is one reason for the complexity. As noted, agriculture generally fares better than most other sectors and, since the poor are disproportionately located in that sector, the crisis impacts may be mitigated. Conversely, modern sector activities, especially finance and advanced manufacturing, are often the most adversely affected, and workers in these sectors are generally among the better paid. Conversely, the living standards of the poor are by definition precarious and vulnerable, with few financial assets to fall back on if their earnings decline. It is therefore quite possible that, even though they experience a smaller proportional decline in their living standards than the rich, they fall into poverty (Suryahadi et al, 2011). Several other factors are also relevant: how labour markets adjust (whether primarily through price or quantity, that is falling real wages or increased unemployment); food availability and prices; and the speed and effectiveness of various social safety net measures. It took approximately six years, 1998-2004, for Indonesia's per capita GDP and its poverty incidence to recover to pre-crisis levels. Thus, while the overall relationship between crises and poverty is clear enough, the composition and severity of this poverty requires careful empirical analysis, of the kind presented by other contributors to this volume.

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Table 1: Indonesia in 1997-98 and 2008-09 Compared

Variable	1997-98	2008-09
1. Origins	mix of domestic & external factors	almost entirely external
2. International economy	buoyant	growth deteriorates; highly uncertain capital markets
3. GDP growth decline	about 20% points	about 2% points
4. Exchange rate	collapse, about 80%	modest depreciation, about 33%, then recovery
5. Capital flows	major, prolonged capital flight	modest, brief outflows
6. Trade performance	abrupt swing from current account deficit to surplus	imports and exports contract modestly and briefly
7. Financial sector	deep collapse; major bank runs	remains intact; no major collapses
8. Stock Market	deep collapse	sharp but temporary decline
9. Inflation	temporary loss of monetary control; brief hyper-inflation	moderately high though contained, declining as crisis hits
10. Fiscal policy	from small surplus to significant deficit; huge increase in public debt	from small deficit to larger but still modest deficit, public debt declining
11. Agriculture	drought affected; fear of rice crisis; cash crops respond positively to ER decline	good rice harvest; cash crops remain buoyant
12. Labour market	flexible; main effect through declining real wages	more rigid; but effects minimal
13. Social safety net	rudimentary; very little	quite well developed
14. Political & institutional context	highly unstable; collapse of Soeharto regime; institutional vacuum	political system well developed, stable; 2009 elections proceed
15. International support	limited; major dispute with IMF	closer relations, no disruption to aid flows

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10/03 KELLY BIRD and HAL HILL, 'Tiny, Poor, Landlocked, Indebted, but Growing: Lessons for late Reforming Transition Economies from Laos'

10/04 RAGHBENDRA JHA and TU DANG, 'Education and the Vulnerability to Food Inadequacy in Timor-Leste'

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10/07 PREMA-CHANDRA ATHUKORALA, 'Production Networks and Trade Patterns in East Asia: Regionalization or Globalization?

10/08 BUDY P RESOSUDARMO, ARIANA ALISJAHBANA and DITYA AGUNG NURDIANTO, 'Energy Security in Indonesia'

10/09 BUDY P RESOSUDARMO, 'Understanding the Success of an Environmental Policy: The case of the 1989-1999 Integrated Pest Management Program in Indonesia'

10/10 M CHATIB BASRI and HAL HILL, 'Indonesian Growth Dynamics'

10/11 HAL HILL and JAYANT MENON, 'ASEAN Economic Integration: Driven by Markets, Bureaucrats or Both?

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11/01 BUDY P RESOSUDARMO and SATOSHI YAMAZAKI, 'Training and Visit (T&V) Extension vs. Farmer Field School: The Indonesian'

11/02 BUDY P RESOSUDARMO and DANIEL SURYADARMA, 'The Effect of Childhood Migration on Human Capital Accumulation: Evidence from Rural-Urban Migrants in Indonesia'

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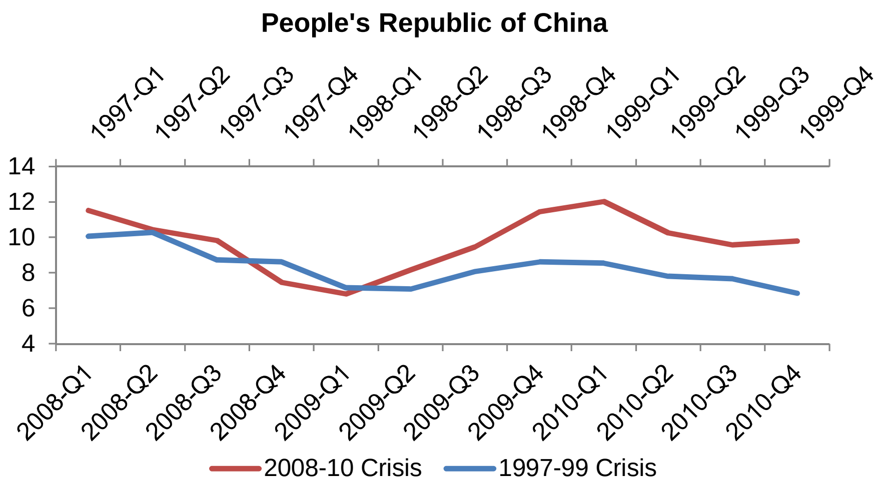
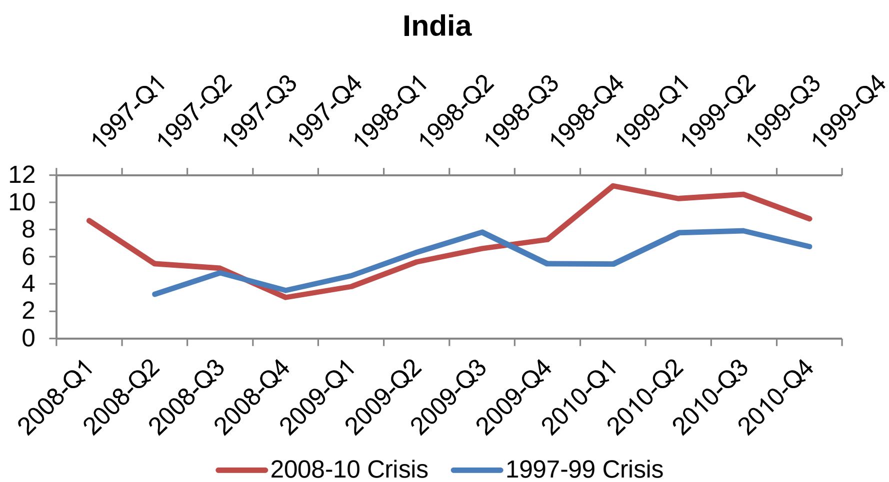
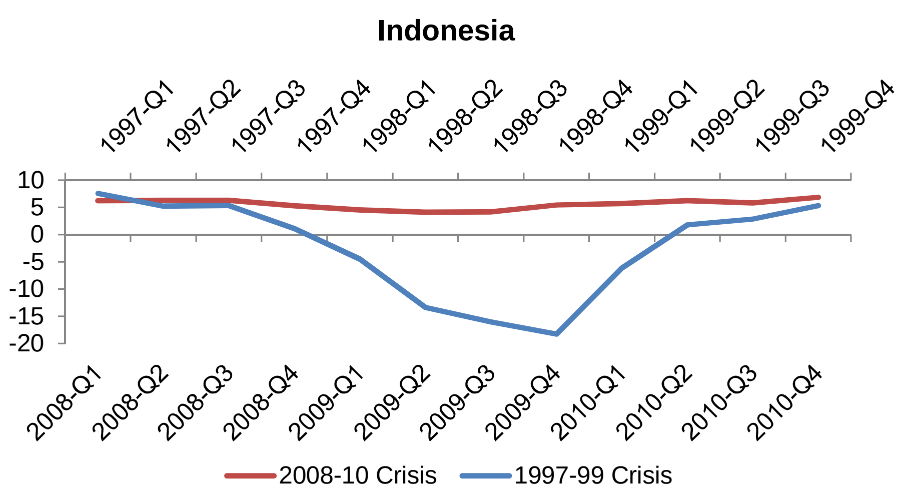
12/03 HAL HILL, 'The Best of Times and the Worst of Times: Indonesia and Economic Crises'

Figure 1: Crisis impacts: 1997-98 and 2008-09 compared







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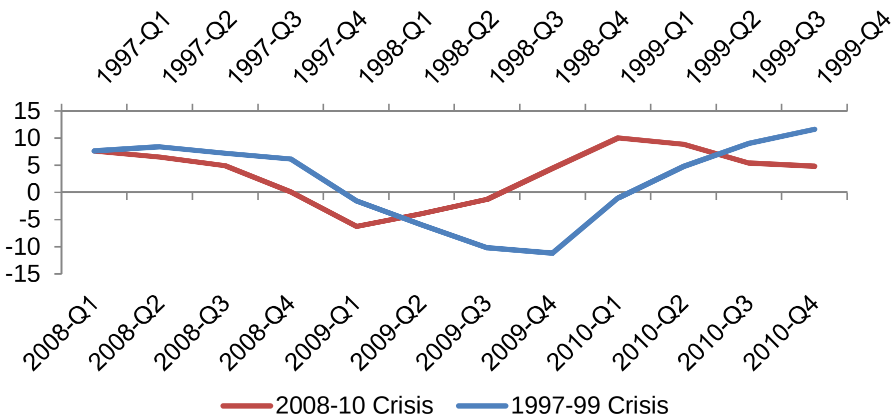

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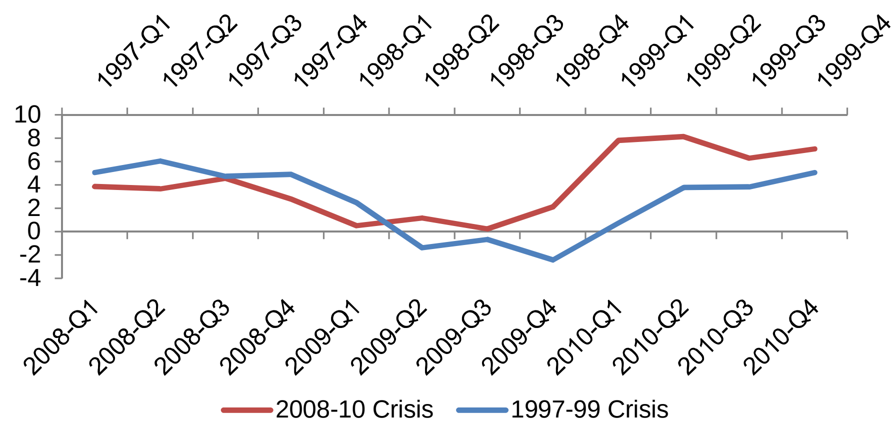

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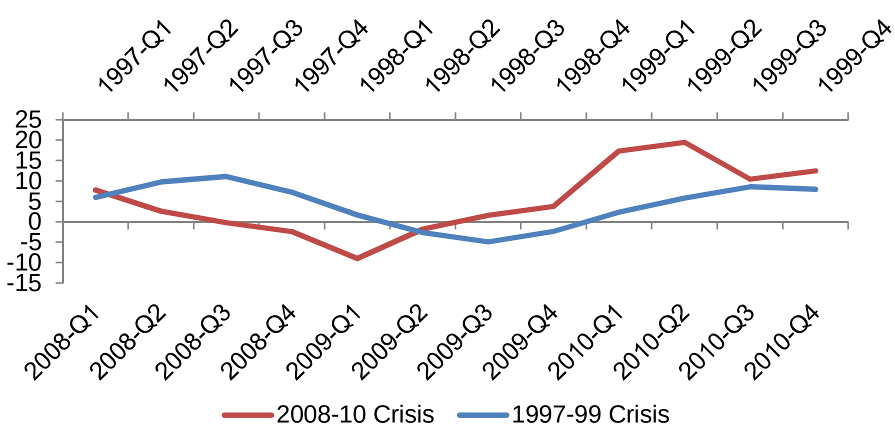

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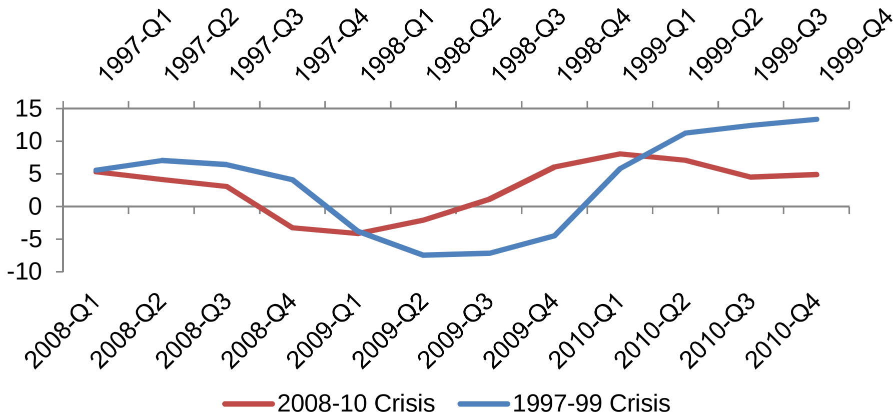

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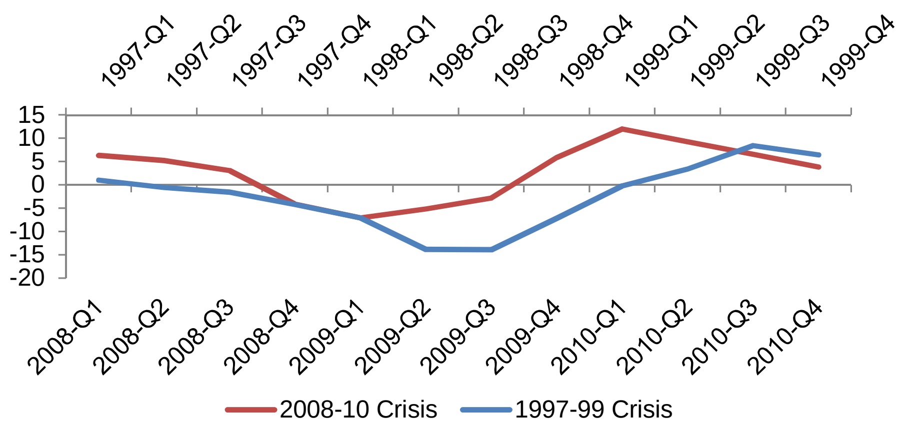

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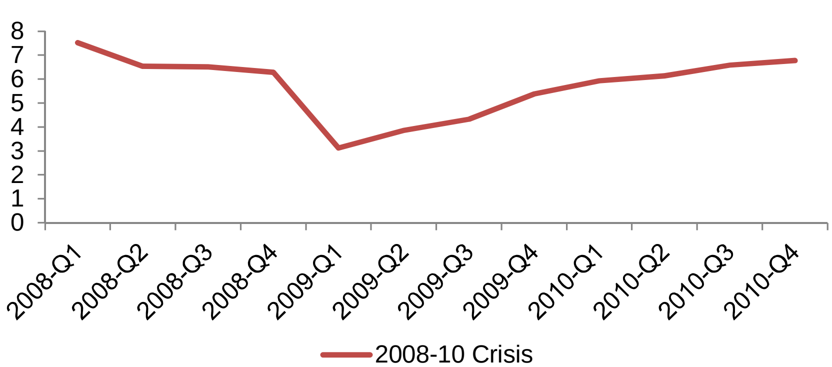

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