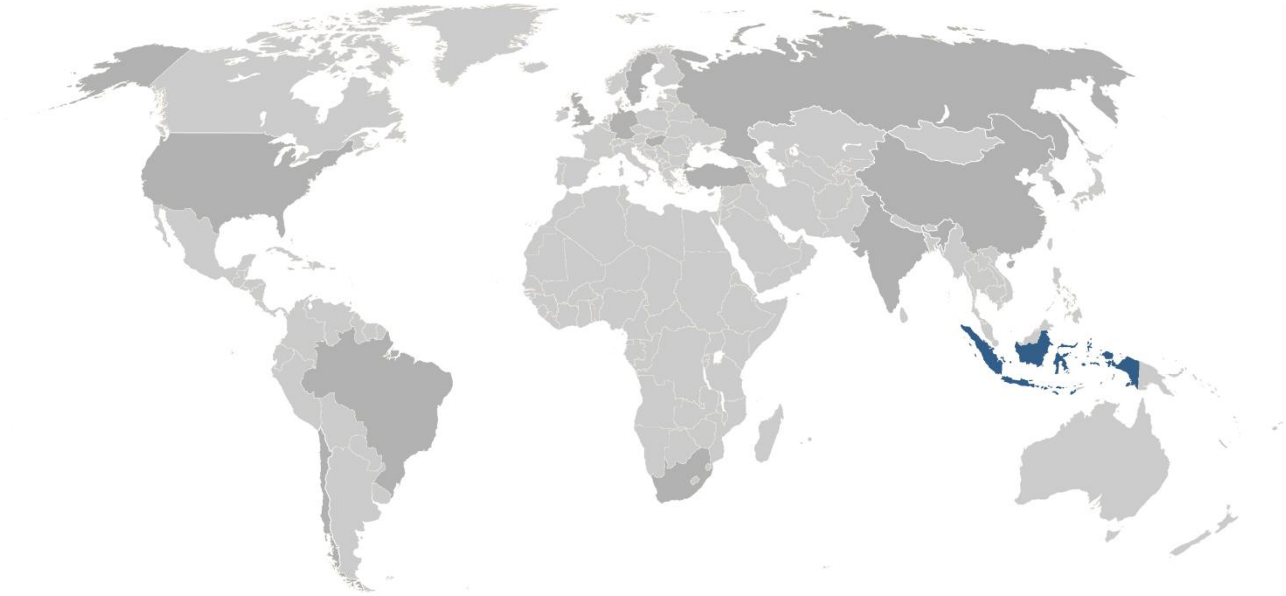
Managing the Crisis |

Indonesia Country Report

Patrick Ziegenhain



This report is part of the study *Managing the Crisis* which assesses 14 governments' response to the global economic and financial crisis between September 2008 and September 2009 on the basis of a standardized set of criteria.

Please cite as follows: Patrick Ziegenhain, *Indonesia Country Report*. In: Bertelsmann Stiftung (ed.), *Managing the Crisis. A Comparative Assessment of Economic Governance in 14 Economies*. Gütersloh: Bertelsmann Stiftung, 2010.

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1. Risk Exposure at the Outset of the Crisis

- What was the structure of demand (e.g., share of private/state consumption, gross capital formation, exports and imports in GDP/GNI)?
- To what extent was the economy exposed to macroeconomic imbalances (e.g., foreign debt, trade or fiscal imbalances)?
- Was/is the financial system primarily bank- or market-based?

Economic structure and macroeconomy

After years of stable growth, recovering from a severe economic crisis in 1997, the Indonesian economy was hit by the global economic downturn in 2008. After the Asian crisis and the subsequent regime change in Indonesia, the country began a process of democratization. In 2008, economic growth was driven primarily by strong domestic demand, which accounted for 57.2 percent of GDP, followed by exports, gross capital formation (23.9%) and government consumption (8.1%).[1] Given that 85 percent of goods and services produced in Indonesia are consumed domestically, Indonesia's economy is considered to be relatively closed in terms of foreign trade dependency.[2] Like other Asian emerging economies, Indonesia had shown a considerable trade surplus for several years before the onset of the crisis. This changed by the second quarter of fiscal 2008, when imports of capital goods, raw materials and consumer goods grew faster than exports, which slowed as a result of decreasing global demand and the global rise in commodity prices. Indonesia's surplus dropped from $32.7 billion in 2007 to $23.3 billion in 2008. In 2007, exports accounted for 24.3 percent of GDP ($118 billion) and imports for 19.7 percent of GDP ($85.3 billion).[3] In 2008, Indonesia shipped $139.3 billion worth of exports (a year-over-year growth of 18%) and $116 billion worth of imports (year-over-year growth of 36%).[4] The current account surplus decreased from $10.5 billion in 2007 to $0.6 billion in 2008. However, it remains unclear whether this trend will continue in the long term, once the contraction of global demand halts or reverses itself.

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[1] Bank Indonesia, "2008 Economic Report on Indonesia," 2008, 7, http://www.bi.go.id/NR/rdonlyres/7538502C-0522-4BE5-A798-5B1AD29B1792/16522/LPI2008ingg.pdf (accessed October 19, 2009).
[2] ILO, "Impact of the Financial and Economic Crisis on Indonesia – A Rapid Assessment," 2008, 2, http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/meetingdocument/wcms_101594.pdf (accessed October 21, 2009).
[3] Bank Indonesia, "2008 Economic Report on Indonesia," 2008.
[4] DB Research, "2009 Key Economic Indicators: Indonesia," http://www.dbresearch.de/servlet/reweb2.ReWEB?rwdspl=0&rwnode=CIB_INTERNET_EN-PROD$RSNN0000000000019946&rwsite=CIB_INTERNET_EN-PROD (accessed October 23, 2009).

The absence of major macroeconomic imbalances can be attributed on the one hand to the aggressive reform programs driven in recent years by Indonesia's central bank, Bank Indonesia, and on the other hand to responses by the government and the IMF to the 1997 crisis. As the markets for bonds and stocks are still not fully developed, the Indonesian financial system is primarily bank-based.

- What was the government's economic record (e.g., growth, unemployment rate, inflation and fiscal position) prior to the crisis?
- What was on the economic agenda prior to September 2008 (e.g., anti-inflation, efficiency-oriented, redistributive, supply vs. demand-side policies)?

Policy priorities prior to crisis

After the deep economic plunge around 1997 – 1998, Indonesia's GDP growth rose steadily throughout the following decade, from 5.4 percent in 2000 to 6.3 percent in 2007. By 2004, real GDP per capita had returned to pre-financial crisis levels. Poverty levels (i.e., those living on less than $1 per day) have fallen in recent years from 17.8 percent to 16.6 percent of the population, and unemployment has decreased from 10.3 percent to 9.1 percent.[5]

Coming into office in 2004, the administration of President Susilo Bambang Yudhoyono (widely known as SBY) set a broad range of economic reforms into motion, significantly accelerating the recovery process after the Asian crisis. His guiding economic principles, which he regularly repeated, were "pro-growth, pro-job, pro-poor."[6] The government showed remarkable progress in rehabilitating public finances, bolstering domestic demand and improving the country's investment climate. By increasing fixed fuel prices three times, and passing a major tax reform, the debt-to-GDP ratio was reduced from 57 percent in 2004 to 33 percent in 2008, and the budget deficit to 1.8 percent of GDP in 2008. Although at 8.4 percent, the unemployment rate is still the highest in Asia, and about 32 million people (14.2% of the population) still live on less than 70 cents a day, poverty was reduced by 2.5 percent, per capita income nearly doubled to $2,237 in 2008, and consumer spending rose to an annual growth level of five percent.[7] In 2008, foreign investment in Indonesia rose at the fastest pace in Southeast Asia to a total of

[5] World Bank, "Indonesia: Economic and Social Update," April 2008, http://siteresources.worldbank.org/INTINDONESIA/Resources/Country-Update/ecsos.update.apr2008.pdf (accessed September 29, 2009).
[6] Susilo Bambang Yudhoyono, "The Government Statement on the Regional Development Policy, 2008, http://www.indonesia.go.id/en/index.php?option=com_content&task=view&id=7701&Itemid=701 (September 16, 2009).
[7] Arijit Ghosh and Daniel Ten Kate, "Indonesia May Be 'Superstar' as Yudhoyono Wins Vote (Update2)," Bloomberg.com, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=aFNLgbILj_Kw (accessed September 22, 2009).

$8.3 billion, almost double the amount attracted in the entire decade before SBY took over.[8] But although anti-corruption legislation was implemented and the legal framework was improved, widespread corruption and red-tape bureaucracy continue to restrain the country's full potential for growth, and demand further action.[9]

- How stable was the executive branch in the years/months prior to September 2008 (e.g., credibility/legitimacy of leaders/parties in government, cabinet stability/reshuffles, parliamentary/electoral support)?
- How much room did fiscal conditions provide for a major stimulus (e.g., budget surpluses/deficits, conditions for issuing additional treasury bonds)?
- How much room was there for monetary policy initiatives (e.g., pre-crisis level of interest rates, required reserve ratios, flexibility of foreign exchange rate regime)?

Executive, fiscal & monetary capacities to respond to downturn

The Indonesian government under President Susilo Bambang Yudhoyono was in a very stable position in the years prior to the beginning of the financial crisis in September 2008. After his success in the 2004 direct elections, the president organized a grand coalition with nearly all parties represented in the national parliament.[10] This informal coalition included such heterogeneous forces as the radical and more moderate Islamic camp as well as rather secular parties, including Golkar, the former state party of the preceding authoritarian regime. All these parties were given ministerial positions in the SBY administration. Therefore, the president's leadership was never seriously challenged in the time prior to or during the crisis in 2008 – 2009.

Due to the restrictive fiscal policy of the post-Asian crisis years, fiscal conditions had eased significantly, so the Indonesian government had sufficient scope of action when the new financial crisis emerged. Nevertheless, spreads on long-term bonds rose significantly after the Lehman Brothers collapse, reflecting the cautiousness of domestic and foreign investors who had not forgotten the severe devaluations in the financial market during the 1997 crisis.[11] In addition, the budgetary dependence on the revenues of state-owned enterprises (SOE) could have limited response capabilities, when the budget contributions from SOEs' sales declined or the firms themselves had

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[8] Tom Wright, "Indonesia's President Looks Ahead as Vote Nears," Wall Street Journal, 2009, http://online.wsj.com/article/SB124682860201597129.html#mod%3Dtodays_us_nonsub_page_one%26articleTabs%3Darticle (accessed September 22, 2009).

[9] Transparency International, "Indonesia Corruption Perception Index 2008 and Bribery Index," http://www.ti.or.id/en/publication/84/tahun/2009/bulan/01/tanggal/21/id/3845/ (accessed September 29, 2009); World Bank/IFC, "Doing Business 2010 – Indonesia," http://www.doingbusiness.org/Documents/CountryProfiles/IDN.pdf (accessed September 29, 2009).

[10] The only exception was the nationalist PDI-P (Democratic Party of Indonesia-Struggle) led by Megawati Soekarnoputri.

[11] Helmi Arman, "Why long-term yields are still high and what can be done?" The Jakarta Post, http://www.thejakartapost.com/news/2009/08/14/why-longterm-yields-are-still-high-and-what-can-be-done.html (accessed October 20, 2009).

to be bailed out.[12]

The fall in commodity prices as a result of the global economic downturn removed significant pressures on the country's monetary policy, which in recent years had largely been concerned with containing inflation.[13] However, Bank Indonesia (BI) increased interest rates through November 2008, as the consumer price index continued to rise due to second-round effects of the mid-2008 oil price hike and the decline in subsidies for oil and gasoline prices. Thus, bolstering liquidity by decreasing interest rates was not possible without risking higher inflation until the end of the fourth quarter. However, in December 2008, Indonesia even showed a slight deflation of 0.4 percent, caused by lower fuel prices and overall weakening demand.[14] The foreign exchange reserves totaled $59 billion, or 13.5 percent of GDP in September 2008, far larger than the short-term foreign debt repayment obligations (which totaled $31.8 billion, or 64.1% of reserves).[15] Consequently, Bank Indonesia had sufficient ability to supply the banking sector with direct liquidity as well as to intervene in the foreign exchange market to stabilize the national currency, the Indonesian rupiah.

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[12] For further information see Miko Kamal, "Corporate Governance and State-Owned-Enterprises: Is it on the Right Track?" Macquarie University Law Working Paper No. 2008-30, 2008, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1311030 (accessed October 22, 2009).

[13] Bank Indonesia, "Monetary Policy Review," September 2009,http://www.bi.go.id/NR/rdonlyres/47709E5A-9EA3-4231-94DC-C26CAB4D982A/17751/MPRSeptember2009.pdf (accessed October 22, 2009).

[14] The Coordinating Ministry for Economic Affairs Republic of Indonesia, "Trade and Investment News," December 30, 2008, http://www.embassyofindonesia.org/ina-usa/economy/pdf/Trade&InvNews-30Dec2008.pdf

[15] Bank Indonesia, "Financial Stability Report," September 2008, http://www.bi.go.id/web/en/Publikasi/Perbankan+dan+Stabilitas+Keuangan/Kajian+Stabilitas+Keuangan/fsr_1108.htm (accessed October 23, 2009); DB Research, "Key Economic Indicators: Indonesia," 2009, http://www.dbresearch.de/servlet/reweb2.ReWEB?rwdspl=0&rwnode=CIB_INTERNET_EN-PROD$RSNN0000000000019946&rwsite=CIB_INTERNET_EN-PROD (accessed October 23, 2009).

Exposure to specific market and trade risks

- To what extent has the country been exposed to global financial market risks, particularly contagious/toxic financial instruments (e.g., open capital account, floating or pegged/fixed currency)?
- How important was/is the financial sector for the national economy? What was/is the extent of interdependence between the financial sector and real economy?
- To what extent was the economy integrated into regional/global trade flows? How dependent was the economy on foreign demand for manufactures and commodities?
- Did property, equity or other markets display excessive growth and a bubble-like situation prior to September 2008?
- In what condition was the banking sector (e.g., size/structure of banking sector, non-performing loans, capital adequacy ratios of major banks, if available)?

As a result of the 1997 crisis, Indonesia's financial sector remains partially restricted to foreign financial investment.[16] There have been no major investments by Indonesian banks in subprime mortgage instruments reported so far. Therefore, only a few Indonesian banks, on the whole rather small institutions, suffered from serious liquidity problems at the outbreak of the global financial crisis in 2008. Nevertheless, according to then-Bank Indonesia Governor Boediono, Indonesian banks did have some problems associated with derivative products, even if this impact was relatively small compared to other countries, especially in the developed world.[17] A larger risk was represented by the high numbers of small and medium-sized enterprises (SMEs) in or near distress, combined with corporations' high dependency on foreign financing sources.[18] A significant devaluation of the floating Indonesian rupiah, combined with a domestic credit crunch, would have caused severe damage to the Indonesian economy. Due to high interest rates following the 1997 crisis and a serious lack of confidence in domestic banks, foreign finance accounts for 47 percent of corporate finance, bank lending for 40 percent (up from 34% in 2003) and equity issuance—which is concentrated on a small number of companies, mainly SOEs—for 10 percent.[19]

Although the Indonesian stock market was one of the world's best performing exchanges in 2007, no excessive growth in any sector was identifiable, a fact mainly attributable to the strict financial market oversight by the central bank and its subordinate institutes, which were established after 1997. Al-

[16] For further information on the restriction of foreign financial investment see Republic Indonesia, Ministry of Finance, "Information on foreign investment," http://www.kanwilpajakkhusus.depkeu.go.id/infoInvestment.asp (accessed September 2, 2009)

[17] Vivanews, "Boediono, Governor of Bank Indonesia: Surviving the Global Economic Crisis," http://en.vivanews.com/news/read/31623-surviving_the_global_economic_crisis (accessed October 2, 2009).

[18] IMF, "Country Report No. 09/231," 2009, 7, http://imf.org/external/pubs/ft/scr/2009/cr09231.pdf (accessed October 16, 2009).

[19] IMF, "Country Report No. 08/298," 2008, 37, http://www.imf.org/external/pubs/ft/scr/2008/cr08298.pdf (accessed October 16, 2009).

though the real estate market experienced some price growth in 2007 – 2008, this did not develop bubble-like characteristics.

As a result of the consolidation and restructuring process initiated after the 1997 economic collapse, the Indonesian financial sector was generally solid and well-performing at the outset of the current crisis. Banks accounted for 79 percent of total sector assets, and the 15 major banks possessed about 70 percent of total bank assets. The sector's gross non-performing loan (NPL) ratio declined from 4.6 percent to 4.1 percent in June 2008 (year-over-year), the lowest rate since 1997, at the same time showing continuing significant credit growth (31.6% year-over-year). The capital adequacy ratios (CAR) of the five major banks were between 13.5 percent and 15.8 percent, clearly over BI's threshold of eight percent, but already had dropped by as much as 6.4 percent compared to 2007.[20]

Structural or policy advantages and disadvantages

- Did policymakers/executive agencies have any experience in handling financial crises? Did this experience play a role in the 2008-09 policy response?
- Were there independent regulatory institutions or prevention/response schemes in place to contain financial risks?
- Were there internal veto players (e.g., federalist powers, courts) or international obligations that thwarted swift action on the part of the government?
- Have executive powers been extended in times of crisis? Has this been based on formal or informal mechanisms?

As previously mentioned, at the outset of the current financial crisis, Indonesia had just recovered from the severe economic crisis of 1997 – 1998, during which GDP growth had slumped by 13.1 percent. To prevent any such similar economic collapse, the Indonesian governments had introduced stricter financial market regulations and oversight, establishing an independent and powerful central bank, and defining clear monetary and fiscal policy goals. This prevented severe damage and made a quick and effective response possible. The experience gained in the 1997 crisis led to a higher awareness of macroeconomic risks and to the creation of state-owned regulatory institutions such as a deposit insurance corporation (Lembaga Penjamin Simpanan, LPS) and a capital market and financial institutions supervisory agency (Badan Pengawas Pasar Modal, BAPEPAM).[21] Thus, the government was able to react more appropriately to the 2008 economic turndown than would have been the case without this previous experience.

[20] Bank Indonesia, "Financial Stability Review," September 2008, http://www.bi.go.id/web/en/Publikasi/Perbankan+dan+Stabilitas+Keuangan/Kajian+Stabilitas+Keuangan/fsr_1108.htm (accessed October 23, 2009).

[21] Reza Y. Siregar and William E. James, "Designing an Integrated Financial Supervision Agency," ASEAN Economic Bulletin 23.1, 2006: 98-113, http://www.adelaide.edu.au/cies/papers/0405.pdf (accessed September 19, 2009).

The national government's crisis response measures met practically no resistance from potential veto players with the power to intervene. Indeed, there was broad nationwide consensus on the extent and nature of the response programs. As the country is a democracy, other levels of government were involved, but showed little resistance to the national government's management. Executive powers have not been extended during the crisis. In December 2008, the Indonesian parliament even voiced some concerns over a new financial safety net (JPSK), proposed as a regulation rather than a law. Some lawmakers said this might give the government a "superior" power, leading to moral hazard.[22] However, the competencies of the central bank to intervene in the financial market were put on a broader legal basis than before the 2008 crisis through implementation of a government regulation.[23]

- How strongly has the national economy been hit during the period under review? Where has it been hit most severely thus far (e.g., growth rate, production, trade, employment)?

Initial impact of economic downturn

Indonesia felt the effects of the worldwide crisis mainly in its export sector, when global demand and commodity prices slumped. Growth rates in this sector were expected to fall to an estimated level of -1 percent to 5.1 percent in 2009, from their former level of 7.8 percent. GDP growth estimates were revised downwards to between four percent and five percent for 2009.[24] After an initial round of layoffs and the return of oversea workers, the country's employment rate actually rose in February 2009 by 2.4 percent.[25] The increased employment rate was mainly caused by remarkable growth rates in the agricultural sector.[26] Therefore, the expected drastic increase in unemployment did not manifest.

As happened globally, capital was withdrawn from emerging markets. The Indonesia Stock Exchange (ISX) Index dropped by 51.2 percent by the end of 2008, with its steepest dive in share prices seeing a 22.17 percent loss

22 Aditya Suharmoko, "RI holds financial 'crisis simulation'," The Jakarta Post (Online), December 20, 2009, http://www.thejakartapost.com/news/2008/12/20/ri-holds-financial-039crisis-simulation039.html (accessed October 2, 2009).

23 Government Regulation No. 62 of 2008 concerning Amendment of Government Regulation No. 1 of 2007 concerning Income Tax Relief for Investment in Designated Business Lines and/or Designated Regions, http://www.esdm.go.id/prokum/pp/2008/PP%2062%202008.pdf (accessed October 2, 2009).

24 ILO, "Impact of the Financial and Economic Crisis on Indonesia – A Rapid Assessment," Bangkok 2008, http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/meetingdocument/wcms_101594.pdf (accessed September 21, 2009).

25 World Bank, "Indonesian Economic Quarterly," September 2009, http://siteresources.worldbank.org/INTINDONESIA/Resources/Publication/280016-1235115695188/5847179-1243851359474/6164739-1252905807195/report.Sep09_eng.pdf (accessed September 24, 2009).

26 Central Bureau of Statistics, "Economic Growth in Indonesia Second Quarter 2009," http://www.bps.go.id/eng/brs_file/eng-pdb-10agu09.pdf (accessed 20 October 2009).

over a three-day period on October 6 – 8, 2008. Market capitalization decreased in this period by 46.2 percent.[27] Other financial markets also saw heavy outflows, especially the Government Securities and Bank Indonesia Certificate (SBI) market. The Indonesian government temporarily decided to close the stock market for three subsequent days, between October 8 and October 10, to halt the flurry of selling.[28]

Liquidity in the Indonesian banking sector threatened to dry up, as mistrust between the banks grew and the spreads on the overnight interbank market rose drastically, exacerbating the problems of rapidly withdrawn foreign capital. Nevertheless, due to high CAR values and the banks' relatively minor commitments to toxic investments, no significant institution came into trouble. A few smaller banks struggled, including the financially distressed Century Bank, which had IDR 15 trillion ($1.5 billion) in assets. The bank failed to settle IDR 5 billion ($500,000) in interbank claims on November 13, 2008, officially because of technical problems. The institute was nearly immediately put under the control of the state-owned Indonesia Deposit Insurance Corporation (LPS), thereby preventing systemic risks to the whole banking sector. In accordance with the tightening liquidity, the rate of growth in credit volumes dropped from 36.6 percent in the third quarter of 2008 to 26 percent in the fourth quarter of that year.[29]

[27] Ira S. Titiheruw and Raymond Atje, "Payment System in Indonesia: Recent Developments and Policy Issues," ADBI Working Paper Series No. 149, September 2009, http://www.adbi.org/working-paper/2009/08/31/3323.payment.system.indonesia/(accessed October 19, 2009).

[28] Nancy-Amelia Collins, "Indonesia Keeps Stock Exchange Closed," Voice of America, October 9, 2008, http://www.voanews.com/english/archive/2008-10/2008-10-09-voa22.cfm?moddate=2008-10-09.

[29] World Bank, "Indonesian Economic Quarterly," September 2009, http://siteresources.worldbank.org/INTINDONESIA/Resources/Publication/280016-1235115695188/5847179-1243851359474/6164739-1252905807195/report.Sep09_eng.pdf (accessed October 19, 2009).

2. Agenda-Setting and Policy Formulation

- When did state organs (e.g., government, central bank) begin setting a crisis response agenda? How long did it take to adopt the first crisis measures?
- Who were the driving forces (e.g., government, central bank, foreign actors, media, trade unions, employers` associations) in getting stabilization/stimulus policies started?
- Were these measures launched as executive orders or parliamentary laws? How closely did constitutional bodies (e.g., executive, legislative, central bank) cooperate?
- What kind of role did sectoral or regional lobbies play in policy formulation?

Agility and credibility

The government was aware of the crisis as early as August 2008. At that time, President SBY referred to the imminent dangers, but also outlined the opportunities offered by the crisis in terms of development and connected these with his administration's course of reform.[30] In mid-October, after the turmoil at the ISX, the government issued a new regulation giving the government and central bank a stronger legal basis to handle market crises, including for decisions on how and whether to bail out troubled banks.

The regulation in lieu of law establishing a financial system safety net (Jaring Pengaman Sistem Keuangan, JPSK) was passed in order to protect the financial system from possible crises, and complemented a pair of 2004 regulations on the deposit insurance agency (LPS) and the central bank. It allows the government and the central bank to inject liquidity and give incentives both to banks and to non-bank financial institutions. To avoid misuse of funds, as took place with Bank Indonesia Liquidity Assistance (Bantuan Likuiditas Bank Indonesia, BLBI) in the late 1990s crisis, BI can assume the authority ordinarily wielded by shareholders to replace bank officials, and can put banks under special supervision. If regulators cannot solve outstanding problems, a Financial System Stability Committee (Komite Stabilisasi Sistem Keuangan, KSSK) comprising the finance minister and senior central bank officials will provide loan facilities or temporary capital injections to failing institutions. The committee also has the power to replace banks' management or even shut them down completely. Emergency funding for failing banks or other institutions can be drawn from special non-tradable government bonds or directly from the state budget.[31]

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[30] Susilo Bambang Yudhoyono, "Government Statement on the Regional Development Policy," 2008, http://www.indonesia.go.id/en/index.php?option=com_content&task=view&id=7701&Itemid=701 (accessed September 16, 2009).

[31] Ministry for Economic Affairs of the Republic of Indonesia, "Trade and Investment News," 2009,

Both Bank Indonesia and the government served as driving forces in the quick response to the crisis, each within the sphere of its own competences. This relatively smooth process was aided by the close relationship between President SBY and BI Governor Boediono. The measures taken in response to the crisis included executive orders, such as the crisis response guidelines, as well as laws such as the government's budget expansion and the stimulus package of 2009, which had to be discussed and ratified by parliament. According to Article 23 of the constitution, which concerns budget law, the government can allocate new spending not included in the budget, or shift spending between programs or government agencies to protect the economy, only if certain conditions are met. Under the 2009 budget law, the government is allowed to exercise its emergency budget authority if 2009 economic growth falls at least one percentage point below the six percent target, if macroeconomic indicators fall 10 percent short of the assumptions used for the budget, or if there are massive runs on one bank or multiple banks and the yield on government bonds rises by 300 basis points within one month.[32]

The special clause gives the government broad political leeway to take immediate action without having to go through protracted political deliberations in the national parliament. However, the parliament's supervisory function has been preserved, due to the 2009 budget law's clear-cut definitions of the conditions under which the government might exercise its special authority to take emergency measures.

In general, the power of regional lobbies has grown remarkably during the decentralization process initiated following the 1998 regime change. Their influence on national policy-making in nationwide, macroeconomic matters is limited, however.

- Did policymakers actively consult domestic and/or foreign experts outside of government?
- Did the government actively seek collaboration with other governments or international organizations?
- Did the government participate in multilaterally coordinated rescue efforts?
- Was the government curtailed in its response through IMF support programs?

Consultation with external experts and openness to international collaboration

The Indonesian government concentrated on its own national response to the global financial crisis, but continuously discussed its impact with regional and international organizations. Particularly in 2009, multinational organiza-

http://www.indonesia.go.id/en/index.php?option=com_content&task=view&id=7718&Itemid=718 (September 28, 2009).

32 The Jakarta Post (Online), "Budget geared for crisis," November 4, 2008, (September 16, 2009), http://www.thejakartapost.com/news/2008/11/04/editorial-budget-geared-crisis.html (accessed September 19, 2009).

tions were active in providing financial support for the implementation of the stimulus package.

At the annual meeting of the Asian Development Bank's (ADB) Board of Governors in Bali in May 2009, the ADB agreed to approve a $1 billion loan to Indonesia in order to help the country in the wake of the global financial crisis. It was one of the largest single loans the ADB has ever provided to Indonesia.[33] The loan was provided under Indonesia's Public Expenditure Support Facility Program, allowing Indonesia to reduce the government's costs for borrowing from the market. The ADB stated that the financial crisis had significantly hindered Indonesia's ability to access funds from credit markets. In addition, economic recessions in several of Indonesia's major trading partners have also negatively affected demand for Indonesian exports, and hindered investment inflows.[34]

Additionally, the World Bank's Board of Executive Directors granted a unique $2 billion Public Expenditure Support Facility for Indonesia, including a deferred drawdown option in March 2009. According to the World Bank, the Indonesian government was given the opportunity to use these funds if market liquidity conditions worsen and government access to international or domestic financial markets is insufficient.[35]

Indonesia also took part in the so-called Chiang Mai Initiative. Created by the ASEAN+3 (China, Japan, South Korea) countries in 2005, the initiative provides a rescue fund which can be tapped by governments in case of severe economic disturbance. The initiative is designed to provide an alternative to financial aid by other international institutions, thus offering more independence and relieving members from having to undergo externally imposed adjustment programs. But so far, no withdrawal of funds has been possible, as the financial contributions of each country to the fund have only recently been determined.

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[33] Asian Development Bank, "ADB Approves $1 Billion Loan to Help Indonesia Maintain Social Expenditures Amid Financial Crisis," 2009, http://www.adb.org/media/Articles/2009/12904-indonesian-poverties-reductions (accessed September 30, 2009).

[34] Asian Development Bank, "Indonesian Public Expenditure Support Facility Program," http://pid.adb.org/pid/LoanView.htm?projNo=43009&seqNo=01&typeCd=3 (accessed September 30, 2009); Asian Development Bank, "ADB Approves $1 Billion Loan to Help Indonesia Maintain Social Expenditures Amid Financial Crisis," 2009, http://www.adb.org/media/Articles/2009/12904-indonesian-poverties-reductions (accessed September 30, 2009).

[35] World Bank Press Release, "World Bank Supports Proactive Indonesian Response to Global Financial Crisis," 2009, http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/INDONESIAEXTRIL-LION/0,,contentMDK:22088969~menuPK:50003484~pagePK:2865066~piPK:2865079~theSitePK:226309,00.html (accessed September 30, 2009).

Indonesia may play a greater part in the global economy as a member of the G-20, which replaced the G-8 as the main forum for global economic coordination, reflecting a shift in power from rich countries to emerging markets. At the G-20 summit in London in April 2009, world leaders fell short of agreeing on a coordinated plan for a global stimulus package. Indonesian President Yudhoyono said that Indonesia had been guided by three main goals in the G-20 summit: ensuring coordinated, effective and concrete action between developed and developing nations; pressing for reform to the global financial architecture; and ensuring that any global action agreed upon in the summit would benefit Indonesia's national economy.[36] The London summit's direct and immediate impact for Indonesia was limited; however, as the country did not want to access the additional, rather substantial financial resources that G-20 leaders agreed to mobilize, primarily through the IMF.[37] Nevertheless, Indonesia did to some extent participate directly in multilaterally coordinated efforts aimed at addressing the global financial crisis.

3. Policy Content

- How large is the stimulus package as expressed as a percentage of GDP (including compensations to those hit particularly hard by the crisis through social/labor policies)?
- The stimulus is spread over a period of how many years?

Scope of stabilization and stimulus policies

To dampen the impact of the global financial crisis on the domestic economy, Indonesia launched a stimulus package worth $6.3 billion (IDR 63 trillion), approximately 1.4 percent of GDP.[38] The parliament added an additional $200 million (IDR 2 trillion) to the budget proposed by the government when approving the program at the end of February 2009. The stimulus was designed to be spent in 2009, starting in March of that month.

[36] Website for the 2009 London Summit (2009), http://www.londonsummit.gov.uk/en/global-update/cp-indonesia/ (September 30, 2009).

[37] Hadi Soesastro, "After the London G-20 Summit," 2009 http://www.csis.or.id/scholars_opinion_view.asp?op_id=707&id=14&tab=1 (accessed September 30, 2009).

[38] Unless other sources are cited, all data concerning the stimulus package passed in February 2009 are based on: Ministry of Finance of the Republic of Indonesia, "The 2009 Revised Budget Fiscal Stimulus Programme: Mitigating The Impact From The Global Crisis and State Budget 2008 and 2009," March 2009, http://www.bi.go.id/NR/rdonlyres/AE350D5E-BCB8-4AA4-BE29-9FB44C66B04B/15743/APBNPenyesuaian_2009_ENGLISH1.pdf (accessed September 30, 2009).

The stimulus package was supplemented by an expansion of income tax relief for eight industries (e.g., the aircraft and chemical industries) passed in December 2008, and by an increase in subsidies by almost 33.5 percent to mitigate the impact of the crisis on consumers and businesses.[39] Subsidies for food, fertilizer and rice seeds were budgeted at $3.2 billion (IDR 32 trillion), and credit subsidies for businesses $2.1 billion (IDR 21 trillion). Another $1 billion (IDR 10 trillion) was reserved as emergency assistance for various other businesses.

At the time of writing, it was unclear whether there would be a further stimulus program in 2010, as the economic situation had improved significantly. At the least, the government expects to see slower budget expansion in 2010, with a reduced budget deficit of $9.8 billion (IDR 98 trillion), or 1.6 percent of GDP.

Targeting and coverage of policy tools

- How is stimulus spending distributed across sectors? How and to what extent is the financial sector supported (e.g., through loans, guarantees, capital injections)?
- Which industrial and structural policies (e.g. corporate tax cuts, subsidies, company bail-outs) can be observed?
- What kinds of measures target the expansion of public spending on infrastructure? Which ones are designed to sustain business and consumer spending?
- Are policies in support of businesses adequately targeted and delineated (e.g., at creating employment, supporting competitive firms)?

Indonesia’s stimulus package had three goals. Policymakers sought to keep the private consumption growth rate above 4 percent, improve the competitiveness and resilience of Indonesian companies, and mitigate the effects of layoffs by means of labor-intensive infrastructure projects. The financial sector was not covered by the stimulus package. Financial sector support was a central bank objective, but after the turbulence in October 2008, the sector had no need of a separate rescue program such as the United States Troubled Asset Relief Program (TARP). The few struggling banks were covered by the ongoing process of consolidation within the banking sector.

The portion of the stimulus package addressing private consumption accounts for $2.6 billion (IDR 25.9 trillion), and includes a major income tax rate reduction, an increase in the tax-free band, and subsidies on cooking oil, biofuels and generic medicine. Civil servants’ salaries were also increased.

The package addresses the corporate sector with $3.6 billion (IDR 36.9 trillion). In addition to a two percent corporate tax reduction, a further five percent reduction is offered for companies listed on the stock exchange. This

[39] Ministry for Economic Affairs of the Republic of Indonesia, Government of Indonesia, “Evaluation of the Economy in 2008 and Outlook for 2009,” January 2009, http://www.indonesia.go.id/en/index.php/content/view/116/id/index.php?option=com_content&task=view&id=7757&Itemid=718 (accessed September 19, 2009).

step is aimed at encouraging medium-sized enterprises to list their shares on the stock exchange, since the Indonesian stock market is still focused on very large companies. There are also tax and non-tax subsidies aimed at easing companies' financial situations, and at stimulating the geothermal energy sector, oil and gas exploration, and expansion in the water supply. Infrastructure projects concentrate primarily on developing rural regions, expanding water and energy supplies, enhancing public infrastructure, and increasing agricultural efficiency.

The stimulus certainly eased the financial situation of business in general, and the tax cuts were broadly welcomed. However, the extent to which programs were able to stabilize distressed companies or actually create new investment and jobs remains difficult to evaluate. The fact that employment levels were already rising in February 2009, the month the stimulus package was passed by parliament, makes coming to a concrete conclusion even harder. Nevertheless, the stimulus definitely had a positive psychological impact on the economy. The central bank's early actions also helped to calm the financial sector, thus contributing to relieve tension in the economy.

- Are stimulus measures influenced/limited by pre-crisis development strategies (e.g., industrial policies) or have novel/additional (e.g., environmental) policy objectives been inserted?
- Is the response to the crisis grounded in a broader developmental perspective (i.e., crisis as development opportunity) or predominantly short-term political constituency logic?
- Do stimulus policies address prevailing structural deficits and future growth potential?

Development as an objective of stimulus policies

To some extent, the stimulus package included efforts to fight regional disparities, a general objective of the government's developmental policy. However, in this regard it is difficult to distinguish between new programs and previously planned projects. In addition, the amount of money earmarked for this issue, keeping the vast scale of the Indonesian countryside in mind, leaves doubts as to the effectiveness and efficiency of the spending's developmental aspect.

The subsidies on biofuels and tax subsidies for the geothermal industry appeared to be more of a more symbolic gesture than a policy with significant developmental impact. Thus, there are developmental aspects to the stimulus package, but the direct effects are questionable. In addition, only 14.2 percent of the funds for infrastructure had been disbursed by September 2009, according to the National Development Planning Agency (Bappenas).[40]

[40] ASEAN Affairs (Online), "Indonesia: Stimulus no Longer Necessary to Boost Investment," September 29, 2009.

- Has the stimulus included "buy national" clauses? Have import-restricting mechanisms been newly established or re-established?
- Has the country's executive/central bank manipulated the exchange rate or intervened in the foreign exchange market (if so, in which direction)?
- Have there been measures to prop up export industries (e.g., tax rebates, direct export subsidies)?

National bias and protectionism

Despite some nationalistic demands by various politicians and political parties, the stimulus package did not contain any distinctive "buy national" clauses or import-restricting measures.[41] However, there have been some cuts in export quotas aimed at stabilizing prices, as in the rubber industry, which was hit severely by the slump in prices for raw materials. In addition, $100 million (IDR 1 trillion) was provided by the stimulus package to the Indonesian export insurance agency Asuransi Ekspor Indonesia (ASEI) in order to increase the supply of export guarantees.

As previously mentioned, a rapid devaluation of the rupiah would have endangered the financial conditions of SMEs, especially in the export sector, since a higher exchange rate for the U.S. dollar would have increased the costs of foreign debt settlement. Therefore, at the peak of the crisis in November 2008, the central bank issued a regulation requiring Indonesian citizens and companies wanting to buy more than $100,000 in foreign currency to produce documents asserting the existence of underlying transactions as well as taxpayer registration numbers.

Indonesia, as Boediono then reaffirmed, nevertheless continued to uphold its free foreign exchange regime.[42] The temporary measure was designed to regulate foreign exchange flows and minimize foreign exchange speculation or the purchase of foreign currency in the absence of underlying transactions. The regulation also addressed a greater concern, that big depositors would convert their savings into foreign currencies for transfer to banks in Singapore or Malaysia, as these countries provide a blanket deposit insurance guarantee on all deposits at their banks, while Indonesia guarantees only to the first $200,000 (IDR 2 billion) in deposits.[43]

The central bank also intervened several times in the foreign exchange market, seeking to stabilize the currency by selling currency reserves. The rupiah came under speculative attacks for several weeks in October and November 2008, sometimes falling to as low as IDR 12,000 to the U.S. dollar, a depreciation of almost 15 percent.[44]

[41] The Jakarta Post (Online), "Nationalistic tunes," November 5, 2009.
[42] The Jakarta Post (Online), "Regulating forex flows," November 17, 2008, (accessed September 29, 2009)
[43] Ibid.
[44] Ibid.

- Which labor market policies have been enacted (e.g., unemployment" benefits, rise in public-sector employment)?
- Which social policies have been included (e.g., expansion of support, additional investment in health and education system)?
- Which measures have been taken to support purchasing power (e.g., consumer checks, tax cuts, cash transfers)?

Social protection

As mentioned above, stabilizing and increasing private consumption was one of the main purposes of the stimulus package. The primary means to this end included a flat five percent income tax reduction and the addition of new tax brackets. By reducing the costs for cooking oil, a particularly significant portion of lower-income households' expenditures, as well as paying subsidies for the purchase of generic medicine and expanding the tax-free band, the stimulus package softened the effects of the increasing poverty associated with the economic crisis. In addition, salaries and other payments to civil servants generally belonging to the middle-income group (i.e., military staffers, police, retired government personnel and teachers/lecturers) were increased.

4. Implementation

- Does the government actively communicate and justify the rationale/goals of its stimulus policies to the public?
- Over time, how has the public responded to the government's management of the crisis (e.g., consumption/investment trends, public opinion polls)?

Political communication

President SBY was not forced to defend or justify his stimulus policies to the public in any systematic way, since they generally met with a positive response. In general, economic experts and the general public approved the administration's economic measures. Members of the Indonesian parliament suggested even more public spending, and after consultations with the Ministry of Finance passed an augmented stimulus package on February 24, 2009. Due to this parliamentary intervention, the total amount of the package was increased by $200 million (IDR 2 trillion).[45] Paskah Suzetta, the chairman of the National Planning Agency (Bappenas), argued that it would have made more sense if the stimulus package had focused more specifically on supporting purchasing power rather than taking on a supply-side orienta-

[45] Kilas Berita, "Stimulus Fiskal Bekal Indonesia Hadapi Krisis Global," February 25, 2009. http://www.kilasberita.com/kb-finance/ekonomi-a-moneter/16208-stimulus-fiskal-bekal-indonesia-hadapi-krisis-global (accessed September 29, 2009).

tion.[46] In the same line was the criticism of vice-presidential candidate bowo Subianto, who frequently argued that the stimulus package benefited the business community and not ordinary people.[47] Additionally, some ments of the business community complained about the slow disbursement of stimulus funds, particularly those designated for infrastructure projects.[48]

Compared to other countries, there was no broader public debate on the contents of the stimulus package. Rather, the president used the measures to underline the generally good economic performance of his administration as he campaigned for the June 2009 presidential election. The successful management of the economic crisis was one of the major reasons for SBY's reelection. During the parliamentary and the presidential election campaigns, respectively held in April and July 2009, opposition candidates refrained from criticizing the SBY administration's policies, focusing on other topics instead.

Most Indonesians were less affected by the global economic crisis than were residents of other countries, and regard their personal future rather positively. In a survey by Nielsen's Global Consumer Confidence Index, which tracks consumer confidence, major concerns and spending habits among 25,140 Internet users in 50 countries, Indonesian consumers were the most optimistic worldwide in the first half of 2009, followed by counterparts in Denmark and India. While global consumer confidence in general has plummeted to a record new low, Indonesian confidence remained steadfast.[49] However, private consumption levels remained almost flat throughout 2009.[50]

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[46] Evaluasi terhadap efektivitas kebijakan stimulus fiskal 2009," June 4, 2009, http://indonesiafile.com/content/view/1535/39/ (accessed October 22, 2009).
[47] Berita Sore, "Stimulus Ekonomi Untungkan Pemodal," April 14, 2009, http://beritasore.com/2009/04/14/stimulus-ekonomi-untungkan-pemodal.
[48] The Jakarta Globe (Online),"Government Slammed for Slow Disbursement of Stimulus," June 22, 2009, http://thejakartaglobe.com/business/government-slammed-for-slow-disbursement-of-stimulus/313786 (accessed September 22, 2009).
[49] Nielsen, "Global Consumer, Confidence, Concerns, and Spending – A Global Nielsen Consumer Report, 1st Half 2009," http://id.nielsen.com/site/NielsenGlobalConsumerConfidenceReport1stHalf09.pdf, (September 22, 2009).
[50] World Bank, "Indonesian Economic QuarterlIndonesia File, "y," September 2009, http://siteresources.worldbank.org/INTINDONESIA/Resources/Publication/280016-1235115695188/5847179-1243851359474/6164739-1243851879653/Full.Report.en.pdf (accessed September 30, 2009).

- How large has the time lag been between adoption and implementation of selected major stimulus components?
- What are the reasons for delay in implementation (e.g., legal barriers, insufficient capacities, corruption)?
- Have sectoral or regional interest groups influenced the workings of policy implementation in any way?

Modes and time frame of implementation

The disbursement of funds for infrastructure projects experienced massive time lags. By September 2009, only 14.2 percent of the funds thus ear-marked had been spent.[51] This can be attributed to delays in the tendering mechanism and a lack of general preparedness on the part of public servants, particularly at the local level. Local officials are reluctant to spend public money because they fear that unintended misuse of this money would lead to their prosecution for corruption.[52] As of this writing, there was no reliable data on the disbursement of the other funds associated with the stimulus package. However, delays in implementation are to be expected, particularly in infrastructure programs. This is due to problems typical of emerging, less-developed economies such as flawed infrastructure and a lack of capabilities on the part of local government officials.

- Beyond emergency stand-by programs with the IMF, has the government collaborated with other governments or international organizations in implementing its response to the crisis?

International or regional cooperation

Like most other countries affected by the economic crisis in 2008, Indonesia reacted with a specific set of national policies. However, there were regular meetings with important international organizations such as the ADB, the World Bank and the G-20 group, through which the national government coordinated its efforts with other bilateral and multilateral partners. These multilateral organizations facilitated the financial implementation of the stimulus package.

[51] ASEAN Affairs (Online), "Indonesia: Stimulus no Longer Necessary to Boost Investment," September 10, 2009. http://www.aseanaffairs.com/indonesia_news/investment/indonesia_stimulus_no_longer_necessary_to_boost_investment (accessed September 19, 2009).

[52] Hundreds of mayors and local councilors have been arrested and accused of corruption in recent years. Concerning the economic stimulus package, the SBY administration has announced strict supervision of fund expenditures.

5. Funding, Tax and Monetary Policies

- Has the government initiated tax reductions/incentive schemes?
- Have these been aimed at the private and/or the corporate, domestic or the foreign sectors?

Tax policies in support of stimulus/ stabilization

Indonesia's stimulus package consists of a major tax reform for both the private and corporate sectors. The SBY administration had been developing a comprehensive tax reform since coming into office in 2004. In the beginning of 2008, some first important reforms were passed into law. As a reaction to the global financial crisis, further tax reform was initiated in two steps. As described under "targeting and coverage of policy tools," a first step in November/December 2008 included income tax relief for eight industrial sectors. In a second step, flat tax cuts, an expansion of the tax-free bands for lower-income taxpayers, and broader tax reductions for companies listed on the local stock exchange were passed as part of the economic stimulus package in February 2009. The tax reforms were introduced on the one hand in order to stimulate private consumption and bolster purchasing power, and on the other hand to lower corporate expenditures and ease companies' financial situation.

- What kind of policies did the central bank contribute to the national crisis response? Which unconventional measures were used to fight the crisis?
- If an independent national monetary policy is not feasible, were there substituting measures in the country's exchange rate policy?

Monetary and currency policies in support of stimulus/ stabilization

As in most other countries affected by the global economic crisis, the Indonesian banking sector faced a collapse in the overnight interbank market due to dramatically increasing spreads and stringent credit conditions. To ease the liquidity situation, BI started to decrease interest rates after the consumer price index decline in the fourth quarter of 2008. However, this measure had almost no immediate effect, as banks continued to increase spreads until they were up to five percent higher than the official interest rates. Along with other central banks around the world, BI started in mid-September 2008 to offer additional short term facilities, and doubled the number of auctions per week. Along with the previously mentioned restrictions in the foreign exchange trade, the BI promoted acquisitions and mergers with the aim of banking sector consolidation. Furthermore, the limit on the balance position for short-term foreign loans was loosened in order to reduce demand for U.S. dollars, and the term for foreign exchange swaps was lengthened from seven days to one month, effective October 15, 2008.[53]

Unlike other states in the region, Indonesia did not allow its currency to fall against the dollar in order to make exports more competitive amid slumping global demand. Rather, Indonesia sought to prevent the kind of drastic devaluation against the dollar experienced in 1997, when the rupiah slumped by up to 80 percent. According to the BI, a rupiah depreciation would not have significantly bolstered export performance, as the export slide simply reflected lack of demand elsewhere. Such a step would rather have been counterproductive, as Indonesia's foreign debts, including government ones, are primarily denominated in U.S. dollars.[54]

Credibility of funding mechanisms

- Relative to conditions at the outset of the crisis, does stimulus funding have a solid foundation in monetary policy or in bond/credit markets?
- Is the program part of the normal budget/integrated into the budgetary cycle, or is it financed primarily from sources outside of the formal budget?
- Is there cross-level burden-sharing between center and regions (e.g., debt issuance, fund transfers)?
- Is financial aid given to banks/companies/households in a discretionary way or based on well-defined formulas (e.g., conditionalities)?
- Did the government make credible commitments to terminate its expansionary fiscal and monetary policies under (what kind of) post-crisis conditions?

Indonesia's stimulus package was in part financed by using $5.1 billion (IDR 51.3 trillion) of unused funds from the 2008 budget, and by additional loans worth $4.5 billion (IDR 44.5 trillion), borne solely by the central government. The expenses for the government were high, as five-year yields on government bonds skyrocketed to almost 23 percent in October 2008, the highest value in the region. In February 2009, Indonesia completed the largest Asian debt sale in five years by selling $3 billion in sovereign bonds in a dual-tranche transaction aimed at funding the stimulus package. The yields were 11.75 percent on a $2 billion, 10-year offer and 10.5 percent on a $1 billion, five-year offer. These were higher than expected, and both more than 8.4 percentage points higher than corresponding U.S. Treasury bonds.[55]

[53] Ministry for Economic Affairs of the Republic of Indonesia, "Trade and Investment News," 2009. http://www.indonesia.go.id/en/index.php?option=com_content&task=view&id=7718&Itemid=718 (September 28, 2009).

[54] Aditya Suharmoko, "Indonesia not to let rupiah fall to help export," The Jakarta Post (Online), March 23, 2009, http://www.thejakartapost.com/news/2009/03/23/indonesia-not-let-rupiah-fall-help-export.html (accessed September 19, 2009).

[55] John Aglionby, "Indonesia sells $3 billion in debt at discount," The Financial Times Online, February 27, 2009, http://www.ft.com/cms/s/0/b7e3698a-047d-11de-85e9-000077b07658.html?nclick_check=1 (accessed September 18, 2009).

The budget for the stimulus package is integrated with the state's 2009 general budget, in accordance with Article 23 of the constitution, which allows for the supplementary expansion of the state's budget in case of severe macroeconomic circumstances. The government's fiscal policy will also be expansionary in 2010, but to a smaller extent than in 2009. As of this writing, there were plans for a $6.1 billion stimulus package for 2010, but it was questionable whether it would pass parliament in this size if the economy were indeed to recover and inflationary pressures to rise.[56] SBY also made commitments in his electoral campaign to spend $10.4 billion (IDR 140 trillion) in infrastructure projects in the coming years. But this measure is due to a general process of structural development rather than to a specific stimulus package. The BI stopped cutting interest rates in September 2009, maintaining the interest rate at 6.5 percent, as inflationary pressures are forecast to return in early 2010. Another step was to increase banks' minimum reserve requirements from five percent to 7.5 percent, after having lowered the requirements from nine percent to five percent in late 2008 due to the tightening liquidity.[57] Both measures indicate that BI is ending the expansive monetary policy of recent several months, and returning to fighting inflation as the core of its policy.

As Indonesia still suffers from rampant corruption and opaque patronage networks, the disbursement of funds and other aid, especially associated with infrastructure programs, was likely abused to some extent for personal advantage. The most prominent known example is the bailout of Century Bank in November 2008. Instead of the $70 million (IDR 700 billion) approved by parliament, the bank received over $677 million (IDR 6.76 trillion). At the time of writing, it remained unclear whether the extent of the bank's distress was heavier than originally communicated or massive self-enrichment was at work.[58]

On the other hand, government showed resistance to typical patterns of government patronage when the government, and particularly Finance Minister Sri Mulyani Indrawati, refused to bail out the sprawling conglomerate owned by the family of Aburizal Bakrie, a very influential politician and minister from the Golkar party. By November 2008, the Bakrie empire was valued at one-tenth of the $8.2 billion it had been worth in June of that same year and

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[56] The Jakarta Post, "Investment to do well without stimulus," September 9, 2009, http://www.thejakartapost.com/news/2009/09/09/investment-do-well-without-stimulus.html (accessed September 29, 2009).

[57] Global Times, "Indonesian central bank increases reserve requirement to 7.5 percent," September 29, 2009, http://business.globaltimes.cn/world/2009-09/473241.html (accessed September 22, 2009).

[58] Patrick Guntensperger (2009), "Bank bailout scandal rocks Indonesia," Asia Times (Online), September 17, 2009, http://www.atimes.com/atimes/Southeast_Asia/KI17Ae02.html (accessed October 19 2009).

could no longer guarantee the loans it had previously received from the government. In the end, private investors came to the rescue and the taxpayer was spared.[59]

6. Feedback and Lesson-Drawing

- Have there been revisions or additions to the original policy packages or a sequence of distinct stimulus policies in response to unexpected new developments?

Policy feedback and adaptation

As of the time of writing, the Indonesian government had approved just a single economic stimulus package, and was expected to slow its expansive fiscal policy as the economic situation improved. Due to positive indications for an economic recovery in 2010, no revisions or additions to the original stimulus package were made. Even before the passage of the March 2009 stimulus package, a series of tax reforms and subsidy increases had been implemented by the government in December 2008. As described under "credibility of funding mechanisms," an additional, smaller package to support the Indonesian economy is possible in 2010. However, it is increasingly difficult to determine which parts of the SBY administration's economic policies are now attributable to the global financial crisis and which are not.

- Has major institutional reorganization/capacity-building been undertaken in financial supervision?
- Do we find new institutions that were not in place prior to the crisis (e.g., bad banks)?

Institutional restructuring

The Indonesian government did not set up any new institution or supervisory body specifically designed for the implementation of the economic stimulus package. However, existing institutions such as the Indonesia Infrastructure Fund Facility (IIFF) got a more important role, since their funding levels were substantially increased as part of the stimulus package's infrastructure components. As of the time of writing, the Asian Development Bank (ADB) had agreed to provide up to a quarter of the funds required (IDR 1 trillion) to fund the infrastructure projects. The remaining IDR 3 trillion may be provided by the World Bank and the German Development Bank (KfW), according to Bambang Susantono, the deputy to the coordinating minister for the economy in charge of infrastructure.[60]

[59] The Economist (Online), "Bakrie's bounce back. Business in Indonesia," January 8, 2009.
[60] Summary of Business Monitor (2009), "Indonesia Infrastructure Report Q2 2009," http://www.reportbuyer.com/countries/asia_pacific/indonesia/indonesia_infrastructure_report_q2_2009.html (accessed September 29, 2009).

In the banking sector, no new institution such as a bad bank was necessary to deal with the crisis.

7. Tentative Economic Impact

- What do major economic performance indicators tell us about the short-term effectiveness of the crisis response (e.g., growth rate, unemployment rate, industrial output, private consumption, consumer/producer confidence, inflation, exports, bank balance sheets, credit squeezes)?
- How has the political logic of crisis management (i.e., crisis as an opportunity to broaden political support) worked out for the major decision-makers so far? How has the reputation of major government leaders at the center of the crisis response evolved (e.g., based on polls, election results, backing within their political party)?

Economic and political effectiveness of the crisis response

Along with China and India, Indonesia is one of the few countries in the region that showed overall positive economic growth during the crisis. The impact of the global economic downturn peaked in the fourth quarter of 2008, when Indonesia recorded a decline of 3.8 percent in GDP, compared to a 16.9 percent fall in Singapore.[61] In the first quarter of 2009, the Indonesian economy grew by 1.62 percent quarter-to-quarter (a figure just marginally lower than the average quarter-to-quarter growth of the recent years) and 4.32 percent year-over-year.

The ability to find the bottom of the economic crisis so quickly was enabled by the country's strong domestic market and its relatively low dependence on external trade. Growing by 5.4 percent in the first half 2009, private consumption was the main driver of economic recovery. A good harvest and significantly lower levels of inflation bolstered consumption, particularly in the rural regions.

Another considerable contributor to economic recovery was the service sector's 5.9 percent growth, which accounted for 2.4 percent of the GDP growth in the first half 2009. As previously mentioned, the crisis had no negative effect on employment; on the contrary, employment rose by 2.4 percent in February 2009, although few of the new jobs generated were in the formal sector. Exports are forecast to drop by 18.3 percent in 2009, and to bottom out in the second half 2009. Nevertheless, exports contracted less than imports, increasing the trade surplus by 21 percent in the first half of 2009. Investment expenditure grew slightly by 0.9 percent, constrained by the 10.1

[61] Fxstreet.com (Online), "Singapore Q4 2008 GDP a record –16.9% and is expected to shrink by 5% in 2009," January 21, 2009, http://www.fxstreet.com/technical/market-view/start-the-day/2009-01-21.html (accessed October 23, 2009).

percent drop in machinery and equipment expenditure. The financial market remains in good health, with the ratio of non-performing loans (NPLs) declining in June to 3.94 percent after reaching four percent in April and May.[62]

At the time of writing, it was quite difficult to measure the economic effectiveness of the stimulus package, as critical indicators for the third quarter of 2009 had not yet been published. The relatively low increase in private consumption and corporate investment indicate that the tax reductions and subsidies included in the stimulus package provided more stabilization than real boost for the Indonesian economy. In addition, the slow pace of disbursement of the funds for infrastructure projects makes it doubtful whether the construction sector received any major impetus to growth.[63] Only $0.3 billion (IDR 2.88 trillion) of the IDR 11.55 trillion earmarked for the infrastructure spending package for 2009 had been spent as of the end of September. Thus, the multiplier effects produced most powerfully by infrastructure programs have not yet been fully applied.[64]

Nevertheless, policy-makers' crisis management dampened the initial impacts of the global downturn and had positive effects. In particular, the central bank's measures to deepen liquidity and stabilize the financial sector at the height of the crisis can be seen as adequately timed and measured.

The global financial crisis offered a good opportunity for the SBY administration to display its economic capabilities. The Indonesian people had traumatic experiences with the economic crisis of 1997, which not only led to massive capital loss but also to political unrest and mass demonstrations, ultimately resulting in the resignation of long-term President Suharto. Therefore, the population's fears that a similar shock would take place this time around proved to be unjustified. The SBY administration's reputation for economic competence grew steadily in 2009. As economic questions are of utmost importance in developing countries such as Indonesia, the overwhelming reelection of President SBY with an absolute majority of the votes in the first of two possible rounds of the presidential elections in July 2009 was a logical consequence. In order to underline his administration's economic competence, the president picked central bank Governor Boediono as

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[62] Unless other sources are cited, the statistics for 2009 mentioned here are based on: World Bank, "Indonesia Economic Quarterly," September 2009; and ADB, "Asian Development Outlook 2009 Update," 2009, 135, http://www.adb.org/Documents/Books/ADO/2009/INO.pdf (accessed October 19 2009).

[63] ASEAN Affairs (Online), "Indonesia: Stimulus no Longer Necessary to Boost Investment," September 10, 2009, http://www.aseanaffairs.com/indonesia_news/investment/indonesia_stimulus_no_longer_necessary_to_boost_investment (accessed September 29, 2009).

[64] The Jakarta Globe, "Unspent Stimulus a Wasted Opportunity," October 21, 2009, http://thejakartaglobe.com/opinion/unspent-stimulus-a-wasted-opportunity/336884.

a running mate, who accordingly became vice president after the elections.[65]

- Is there early evidence that the structure of the economy will change (e.g., greater role of the state, changes in sectoral shares in GDP)?
- Could old structural imbalances be aggravated? Can we already identify new structural imbalances? Have previously existing imbalances been tackled?

Structural distortions

As the stimulus package still has not yet shown its full potential in bolstering the Indonesian economy, and complete disbursement of the infrastructure funds might not be reached until mid-2010, the inflationary pressure expected in early 2010 might increase rapidly. The government's forecast of roughly five percent inflation in 2010 is thus rather unrealistic.[66] The size and shape of the stimulus program for 2010 is unclear, as the government could risk exacerbating inflation if it continues an expansive monetary policy. That would constrain private consumption and export profits, the two main contributors to Indonesia's economic growth. In such a case, the central bank would be forced to take measures to reduce liquidity, basically by increasing interest rates, which would be damaging to the overall economy at this moment.

It is also unclear whether the shift in the country's trade balance, from surplus to a slight deficit due to increased relative levels of imports, will continue in the long term. The stimulus certainly bolstered purchasing power, and the cuts in import duties may lead to a further increase in imports. However, this development could shift if the global economic situation improves significantly, and if commodity prices—particularly that of oil—continue their pre-crisis pace. Therefore, no major change in the economic structure is likely.

[65] The Jakarta Globe (Online), "Indonesia May Spend $6.1b On Fiscal Stimulus in 2010," September 17, 2009, http://www.thejakartaglobe.com/business/indonesia-may-spend-61b-on-fiscal-stimulus-in-2010/330516 (accessed September 22, 2009).

[66] Aloysius Unditu and Novrida Manurung, "Bank Indonesia Keeps Rate Unchanged as Inflation Risks Increase," Bloomberg.com, October 5, 2009, http://www.bloomberg.com/apps/news?pid=20601068&sid=amiLy6gsSGUE (accessed September 18, 2009).

8. Concluding Remarks

The global financial crisis of 2008 – 2009 did not affect Indonesia as acutely as it did many other countries in the world. The impact was comparatively minimal because macroeconomic preconditions were relatively good (foreign debt had been reduced, financial transaction regulations had been established, and the banking sector was solid), because the central bank took decisive and fast actions at the beginning of the crisis, and because the Indonesian government passed an adequate economic stimulus package that favored recovery. Another reason was the importance of the large domestic market, as domestic demand accounts for two-thirds of GDP. Although Indonesia remains vulnerable to sharp falls in the prices of commodities such as coal and palm oil, export declines are not as difficult to weather as for neighbors such as Malaysia or Singapore, which are more export-oriented.[67] Thus, both factors—the good shape of the domestic economy and the county's low exposure to the world economy—contributed to the country's resilience in the face of global economic downturn.

By intervening in the foreign exchange market, the Indonesian central bank prevented major damage to the national economy. The fiscal stimulus and massive political spending related to the legislative and the presidential elections in mid-2009 greatly contributed to boosting domestic consumption at a time when demand from the international market contracted by around 30 percent. By the second half of 2009, Indonesia had already recovered from the temporary economic setback of the global financial crisis, and growth-rate expectations were rising. Indonesia was among the few countries that managed to achieve robust growth in 2009. The national economy could consequently benefit from the global financial revival.

The successful management of exchange rate policy in late 2008 and early 2009 raises the question "whether Indonesia would fare better with a more genuinely floating exchange rate and a much lower level of international reserves," as asked by some noted economists.[68]

A major challenge to further economic development is the relatively low rate of foreign investment in the largest Muslim country of the world. Former central bank governor and now Vice President Boediono stated that "the im-

[67] The Economist (Online), "So far so good. Indonesia's economy and the election," January 8, 2009.
[68] Mudrajad Kuncoro, Tri Widodo and Ross H. McLeod, "Summary of 'Survey of Recent Developments'," 2009, http://rspas.anu.edu.au/economics/bies/docs/srdsummaryv45no2.pdf (accessed September 29, 2009).

portant key … is how to convince the people that Indonesia is a safe and comfortable place for business and investment. Investors should be assured that our macroeconomic [environment] is well-managed in a sustainable way, and that our banking sector remains steady and solid."[69]

[69] Vivanews, "Boediono, Governor of Bank Indonesia: Surviving the Global Economic Crisis," February 19, 2009, http://en.vivanews.com/news/read/31623-surviving_the_global_economic_crisis (accessed October 2, 2009).

Study Context

The Bertelsmann Stiftung has a long tradition of assessing the quality of governance and devising evidence-based policy strategies for decision makers.

The **Transformation Index (BTI)** monitors political management, democratic quality and economic development around the world. The BTI encompasses all 128 developing nations and countries in transition that have a population of more than two million inhabitants, and have not yet attained fully consolidated democracy and a developed market economy.

The **Sustainable Governance Indicators (SGI)** offer a complementary focus on the OECD member states. The SGI evaluate the sustainability of political action in 15 different policy fields (from economy, labor, and education to environment, research and development), the quality of democracy and questions of strategic management capability in each of the 31 OECD countries.

The study *Managing the Crisis* is a joint initiative of the two projects.

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