Socio-Economic Impacts of the Global Economic Crisis: The Indonesian Story

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ABSTRACT
The 2008/2009 global economic crisis has affected many countries, including Indonesia. This paper aims to examine the socio-economic impacts of the crisis in Indonesia. The paper has two main parts. The first part gives a theoretical explanation of the main transmission channels through which the crisis has affected the Indonesian economy. The second part is the empirical part on economic growth, export, employment, remittances and poverty in Indonesia. One important finding from this study is that unemployment and poverty declined. The paper gives two main reasons: Indonesia has managed to keep a positive economic growth rate (though declined) in 2009, and many laid-off workers from crisis-impacted firms in the formal sector may have been absorbed by the informal sector.

Key words: 2008/09 crisis, economic growth, Indonesia, poverty, unemployment

JEL Classification: E24, F24, F43, I32

I. Introduction
Economic crises in a country can be originated from outside or inside the country. For Indonesia, the 1997/98 Asian financial crisis was mainly from internal sources. It began first with a sudden huge capital flight out of Indonesia (although it was triggered by capital flight which took place earlier in another severely crisis affected country, Thailand). As a direct consequence of the capital flight, Indonesia’s national currency (rupiah) then depreciated against the US dollar (as also happened with bath Thailand) and the national banking sector collapsed and many companies were bankrupted. Whereas, the 2008/09 global economic crisis was mainly from an external source, namely it started as a huge financial crisis in the US and then became a global economic crisis, which affected Indonesia too.

The Indonesian experiences with the two big economic crises in the past 12 years (i.e. the 1997/98 Asian financial crisis and the 2008/2009 global economic crisis) may suggest that the country’s economy is very vulnerable to economic shocks, either from internal sources or external sources, for the following main reasons. First, the Indonesian economy is now more open than before (say, 3 decades ago). Especially since the economic reforms started shortly after the 1997/98 crisis toward more trade, banking and investment liberalization, Indonesia has become more integrated with the world economy.
Consequently, any global economic instability or recession will have a significant effect on the Indonesian economy. Second, though at a decreasing rate, Indonesia is still dependent on exports of many primary commodities, i.e. mining and agriculture. Consequently, any world-price/demand instability for those commodities, particularly agriculture (including crops/plantations) will become a shock for the Indonesian economy. Third, in the past two decades, Indonesia has become increasingly dependent on imports of a number of food items such as rice, food grains, cereals, wheat, corn, meat, dairy, vegetables and fruits, or even oil. Consequently, increases or instabilities of world prices or the world production failures of these commodities will have particular effects on domestic consumption and food security in Indonesia. Fourth, more Indonesian working population, including women, went abroad as migrant workers, and hence livelihoods in many villages in Indonesia have become increasingly dependent on remittances from abroad. Consequently, if any economic crisis hit the host countries (such as happened in Dubai during its financial crisis in 2009) will hit the Indonesian economy too. Finally, as a hugely populated country with increasing income per capita, domestic food consumption is not only high but also keeps increasing. Accelerating output growth in agriculture is therefore a must for Indonesia, and this depends on various factors, including climate, which is an exogenous factor. As Indonesia is located between the Pacific ocean and the Indian ocean in the line of equator, the country is always vulnerable to El Nino/La Nina phenomenon which may cause failures in rice (and other commodities) harvest and therefore will generate a hyperinflation.

With the above background, this paper aims to examine the socio-economic impacts of the 2008/09 global economic crisis in Indonesia. The paper has two main parts. The first part (II) gives a theoretical explanation on the main transmission channels through which the crisis has affected the Indonesian economy. The second part (III) examines empirically the impacts of the crisis on economic growth, export, employment, remittances and poverty in the country.

II. The 2008/09 Crisis and Its Transmission Channels

The 2008/2009 crisis has been called by many economists as the most serious economic or financial crisis since the great depression in the 1930s. In Asia, if not all, most countries, including China, India and Indonesia were also affected by the crisis. The crisis impacted those countries through various channels, i.e. exports, investment (including foreign direct investment/FDI), and remittances. However, the most important channel for most of the affected countries was export. Consequently, the impact of the crisis on exports, productions, workers and their families in those countries was widespread. Retrenchments mounted in many export-oriented manufacturing industries across the region, while working time fell
along with increased downward pressure on wages. In response, millions of workers migrated back to rural areas and shifted to informal and vulnerable employment. In response to the crisis, many of the affected countries in the region, as with many crisis-affected countries in other parts of the world, have reacted with both market-based and regulatory policies to mitigate the negative impacts of the crisis on their economies.

As export was the most important transmission channel for most of the affected countries, therefore, the 2008/09 crisis for those countries, including Indonesia, was primarily a world demand/export market crisis. Theoretically, as illustrated in Figure 1, this kind of shock will affect those countries first through its effects on their domestic firms exporting products which are less demanded because of the crisis. It leads further to less production and employment in these firms and also in other backward as well as forward production related industries/sectors (meso-level effects). The employment reduction causes decline in incomes of many individuals or households (micro-level effects). Lower individuals or household incomes will result further in lower market demands for goods and services and hence production cuts in many industries/sectors, leading to more unemployment and households with lower incomes, and so on.

**Figure 1: The 2008/09 Global Economic (World Demand) Crisis and Its Impact on Poverty**

![Diagram of the 2008/09 Global Economic (World Demand) Crisis and Its Impact on Poverty](image-url)
In large countries like Indonesia which consists of many islands or regions (i.e. provinces, districts and subdistricts), the impact may vary by region, or even the impact in some regions within a country may be more severe than at the national level. For instance, if the decline in average income per person or household in Java island (where most export-oriented manufacturing industries are located) is higher than in the rest of the country, and the proportion of the affected individuals or households in Java is significant large, then total income in Java will decline faster than that in the rest of the country (meso-level effects).

If remittance inflows to Java also decline from foreign countries also affected by the crisis, then the income in Java will drop further. If not only Java but also remittances to other regions in Indonesia drop, than the national income or the economic growth rate will also decrease (macro-level effects). In other words, if only one region in Indonesia is affected by the crisis, and the region’s economy is not significant for the national economy based on gross domestic products (GDP) distribution by region, the effect at the national level may be insignificant, even if the impact for that particular region is significant. On the other hand, if Java is the highest GDP contributor, even a small impact of the crisis on Java will produce a serious shock for the national economy.

Thus, depending on (1) the importance of the affected commodities in Indonesia’s total export; (2) the importance of the firms producing the commodities and other related firms (through backward and forward production linkages) in the economy of the regions where those firms are located of the firms; (3) the importance of the regions’ economy in the Indonesian economy; and (4) the crisis-coping measures taken by the affected firms to mitigate the effect of the crisis, the impact or outcome of the 2008/09 crisis on the Indonesian economy and hence poverty can be large or small. Therefore, in this respect, in analysing the impact of the crisis on Indonesia’s economy and poverty, the main questions that should be taken into consideration are what export commodities have been hit by the crisis, in what regions, how are their linkages with the rest of the economy, and what types of workers and their households are mostly affected?

III. The Impacts

A. Economic Growth

Up to the end of 2008, countries like Thailand, Malaysia, Singapore, the Philippines and Indonesia still show some resilience towards the crisis. However in the first quarter of 2009, they experienced deteriorating economic performance, except Indonesia (Figure 2). Singapore suffered the most and
recorded -8.9 per cent in real GDP growth rate (year-on-year basis) in the first quarter of 2009. This was not surprise at all, given the fact that as a tiny economy, Singapore is fully integrated with the global market for goods, services and finance. Consequently, its economy is fully sensitive to any external economic shocks. The country’s economy then started to recover with positive growth again in the third quarter. Similarly with Singapore was Thailand which has also been seriously hit by the crisis since the third quarter 2008 and the economy contracted by 7.11 per cent in the first quarter 2009. Thailand achieved again positive growth in the last quarter 2009. Malaysia which experienced a slightly positive growth of around 0.1 per cent in the last quarter 2008, also suffered economic contraction by 6.20 per cent in the first quarter 2009. Meanwhile, Indonesia and the Philippines managed to keep positive growth although at declining rates during the crisis period. In the first quarter of 2009, Indonesia achieved 6.2 per cent growth, but in the last quarter it was lower at 5.2 per cent.

While the economy of other countries in the group deteriorated significantly especially during the first months in 2009, Indonesia has not only positive but also slightly higher GDP growth rates during the second and third quarters of 2009. In overall, however, based on data from National Agency of Statistics (BPS), the growth rate of Indonesian economy was at around 4.5 percent, much lower than the growth rate achieved in 2008 (Figure 3). This may suggest that the Indonesian economy was also affected by the world economic recession in 2008/09, but nevertheless the country was able to keep positive economic growth rates during the crisis period.

Figure 2:
Economic Growth Rate in Selected ASEAN member countries, 2008 and 2009 (% change year-on-year)

![Economic Growth Rate in Selected ASEAN member countries, 2008 and 2009](http://web.worldbank.org/WEBSITE/EXTERNAL/COUNTRIES/).
Further as shown in Table 1, besides Indonesia, there were other few countries in the region, such as China, India, Pakistan and Bangladesh which were also managed to mitigate the impact of the crisis on their domestic economy. Interestingly, the table shows that, within the developing world, countries in Asia and the Pacific region performed much better than those in other parts of the world during the crisis. Of course, many explanations can be thought, including that the variation in the impact of this kind of crisis on domestic economy is strongly related to the degree of integration of the particular country with the world economy. Rapidness and effectiveness of crisis-coping policy measures in the particular country may also played an important role.

Table 1:
Economic Growth in the Developing World by Region, 2007-2010

<table>
<thead>
<tr>
<th>Region</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010*</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and Pacific</td>
<td>11.4</td>
<td>8.0</td>
<td>6.8</td>
<td>8.1</td>
</tr>
<tr>
<td>-PRC</td>
<td>13.0</td>
<td>9.0</td>
<td>8.4</td>
<td>9.0</td>
</tr>
<tr>
<td>-Indonesia</td>
<td>6.3</td>
<td>6.2</td>
<td>4.5</td>
<td>5.6</td>
</tr>
<tr>
<td>-Thailand</td>
<td>4.9</td>
<td>2.2</td>
<td>-2.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>7.1</td>
<td>4.2</td>
<td>-6.2</td>
<td>2.7</td>
</tr>
<tr>
<td>South Asia</td>
<td>8.5</td>
<td>5.7</td>
<td>5.7</td>
<td>6.9</td>
</tr>
<tr>
<td>-India</td>
<td>9.1</td>
<td>6.1</td>
<td>6.0</td>
<td>7.5</td>
</tr>
<tr>
<td>-Pakistan</td>
<td>5.7</td>
<td>2.0</td>
<td>3.7</td>
<td>3.0</td>
</tr>
<tr>
<td>-Bangladesh</td>
<td>6.4</td>
<td>6.2</td>
<td>5.9</td>
<td>5.5</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>5.5</td>
<td>3.9</td>
<td>-2.6</td>
<td>3.1</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>5.9</td>
<td>4.3</td>
<td>2.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>6.5</td>
<td>5.1</td>
<td>1.1</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Note: * forecast by the World Bank.

The Indonesian ability to keep positive (though lower) economic growth rates during the crisis period was mainly because of positive growth rates of domestic (demand-side) components of GDP growth,
especially government and private consumptions. Government consumption increased by 18.0 per cent during the first half (H1) of 2009, or almost four times as fast as in 2008. This significant increase was a result of pay increases for civil servants and the election-related spending (parliamentary elections were held in April and presidential elections in July 2009), and an improvement in the disbursement rate of budgeted outlays. While, private consumption which accounted for approximately 60 percent of GDP made the biggest contribution to GDP growth on the demand side during the crisis period (ADB, 2009).

As a comparison, during the 1997/98 crisis the Indonesian economy had plunged into a deep recession in 1998 with overall growth at minus 13.7 per cent (Figure 4). This was much higher than the highest positive economic growth ever achieved during the Soeharto era, or even until the present day. The worst declines were in the construction sector (-39.8 per cent), financial sector (-26.7 per cent), trade, and hotel and restaurant (-18.9 per cent). Other sectors, which had large contractions, were manufacturing (-12.9 per cent) and transport and communication (-12.8 per cent). Mining and other services sectors experienced a contraction of about 4.5 per cent. The agricultural and utility sectors still experienced positive growth at about 0.2 per cent and 3.7 per cent respectively (Feridhanusetyawan, et al., 2000). The crisis also led to a significant drop in income per capita to drop (Figure 5).

Figure 4:
Indonesian GDP Growth rate during the 1997/1998 Crisis

![Graph showing Indonesian GDP Growth rate during the 1997/1998 Crisis](image)

Source: Statistical Yearbook of Indonesia (various years), Indonesian National Agency of Statistics (BPS) (www.bps.go.id).
Figure 5:
Development of Indonesian Income per Capita during the 1997/98 Crisis Period (US dollar).

Source: Statistical Yearbook of Indonesia (various years), BPS (www.bps.go.id).

B. Trade

In the trade area, especially export, the 2008/09 crisis has caused the fall in world demand for manufacturing exports from many developing countries, including in Asia. Indonesian export also declined significantly during the period September/October 2008 and January/February 2009, and then started to recover (Figure 6). But, the recovery of export has been mainly due to the increase in world prices for some primary commodities. While, with respect to manufacturing industry, Indonesian export growth rate until June 2009 was still negative compared to the same period in 2008; although some goods already started to have positive growth rates (Table 2).

Figure 6:
Export and Import Growth in Indonesia, Jan.2008-Jan.2009 (%)
### Table 2

**Export Growth by Selected/Key Manufactured goods, 2008-2009**

(January-June; % change year-on-year)

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Growth Performance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude palm oil (CPO)</td>
<td>-43.66</td>
</tr>
<tr>
<td>Steel, machines and automotive</td>
<td>-24.68</td>
</tr>
<tr>
<td>Textile and garments</td>
<td>-12.39</td>
</tr>
<tr>
<td>Rubber</td>
<td>-44.75</td>
</tr>
<tr>
<td>Electronics</td>
<td>14.08</td>
</tr>
<tr>
<td>Pulp and paper</td>
<td>-23.95</td>
</tr>
<tr>
<td>Wood, including furniture</td>
<td>-26.58</td>
</tr>
<tr>
<td>Food and beverages</td>
<td>-25.83</td>
</tr>
<tr>
<td>Leather, including footwear</td>
<td>-14.14</td>
</tr>
<tr>
<td>Plastic</td>
<td>-19.51</td>
</tr>
<tr>
<td>Tobacco</td>
<td>8.22</td>
</tr>
<tr>
<td>Fertilizer</td>
<td>-26.01</td>
</tr>
<tr>
<td>Gold and silvers</td>
<td>38.30</td>
</tr>
<tr>
<td>Cosmetic</td>
<td>5.69</td>
</tr>
<tr>
<td>Total exports of manufacture goods</td>
<td>26.77</td>
</tr>
</tbody>
</table>

Source: database from Ministry of Trade (www.mot.go.id).

### C. Remittance

Based on World Development Indicator database (www.worldbank.org/data), in the past remittances have proven to be a relatively stable source of private foreign currency inflows (Figure 7) than many other nontrade sources to many developing countries, particularly in Asia. In Indonesia, livelihoods in many villages are very dependents on the continuation of remittances inflows. The remittances are the main source of income in these villages, suggesting a strong negative link between remittances and poverty and income inequality. The remittances also promote human capital development by increasing the capacity
of households to spend on education, health, and nutrition. Therefore, although remittances entail economic and social costs, they are considered by the Indonesian government as a very important engine of economic growth and poverty and income inequality reduction, especially in relatively less developed or poor regions. They not only provide credit-constrained or poor households means to smooth domestic consumption but they can be used as funds for local investment and thus generate local economic activities.

Figure 7:
Remittances to Developing Countries 1990-2008 (US$ billion)

![Figure 7: Remittances to Developing Countries 1990-2008 (US$ billion)](source: World Development Indicators online database (www.worldbank.org/indicator)

According to ILO (2009), the number of Indonesian workers abroad had been on an upward trend until the crisis deepened in mid 2009. In 2007, 697,000 workers legally emigrated in search of employment, while there may have been at least twice that number of illegal migrants. Overall, it was estimated that the number of Indonesian overseas migrant workers, including undocumented migrant workers, stood at 5.8 million in December 2008. Around 65 per cent of them, including many of the female migrants, were domestic workers, deployed in 41 countries. Plantations (especially palm oil) and construction (mainly building and roads) sites are common workplaces for Indonesian migrant workers, i.e. Malaysia and the Middle East, respectively. Some Indonesian workers are employed in the manufacturing sector, especially in the electronic industry (e.g. Taiwan China and Hong Kong China).

Yugo et al (2009) give some estimations showing that total remittances inflows from overseas Indonesian workers declined slightly from approximately US$1.589 billion in the end of first quarter
2009 from US$1.61 billion in December 2008. But, during the same period, the number of Indonesian workers departed overseas increased with 258,000 workers by the end of December 2008 or around 54 percent as compared to the end of September 2008 with 168,000 workers. However, Indonesian workers went abroad in 2008 were less than in 2007 (Figure 8). No further information provided by this study on the main reason of this fact. The question is: was the less number of Indonesian overseas workers in 2008 compared to 2007 mainly because of the crisis? Was the slightly decline in remittances inflows discussed above was also caused by the crisis?

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

D. Employment

According to ADB (2009), unemployment in many Asian developing countries has risen during the 2008/09 crisis, particularly in the more export-dependent economies of Hong Kong, China; Singapore; and Taipei, China. In Indonesia, data provided by BPS show steadily increasing of workers dismissal and homed in the formal sector during end December 2008 and early December 2009 (Figure 9). While, according to ILO (2009) the crisis has prompted a steep fall in the growth of wage employment, which
grew about 1.4 percent during the period February 2008-February 2009, compared to 6.1 percent during the same period in the previous year.

Figure 9: 
Number of Laid off and homed workers in the formal sector, 31 December 2008-4 December 2009

Source: Ministry of Manpower and Transmigration, and BPS (www.bps.go.id/sakernas).

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

**Figure 10:**
Open Unemployment Rate, 2005–2009 (%)

![Chart showing open unemployment rate from 2005 to 2009.](chart)

Source: BPS (www.bps.go.id/sakernas).

As a comparison, Figure 11 shows changes in unemployment rates in other selected Asian developing countries between the third quarter (Q3) of 2008 and the latest. The Philippines (PHI) has the smallest percentage point of change in the group (with the latest data Q2 2009), followed by Thailand (THA) (April-June 2009); Sri Lanka (SRI) (Q1 2009); Republic of Korea (KOR) (May-July 2009); Malaysia (MAL) (Q1 2009); Taipei, China (TAP (May-July 2009); and Hong Kong, China (HKG) (May-July 2009). Whereas, Singapore (SIN) has the highest percentage point of change for the period Q3 2008-Q2 2009.

**Figure 11:**
Unemployment Rates in Other Asian Developing Countries, Q3 2008 and latest (%)

![Chart showing unemployment rates in other Asian developing countries.](chart)

Source: ADB database (www.adb.org/Documents/Books/ADO/Update/figs/)

**E. Poverty**

In ASEAN, although the crisis had serious impacts on the welfare of millions of people in the region (though the impact varied by country), it did not reverse the progress achieved by member countries in
Reducing poverty in the pre-2008/09 crisis. Since 1990, the share of the region’s population living in absolute poverty (less than US$1.25/day) has declined from 55 percent to less than 10 percent of the population. The 1997/98 crisis did have effects on the pace of poverty reduction, but it was only temporary. However, at the time of the 2008/09 crisis, the speed with which ASEAN member countries were able to recover from the crisis was questionable (ASEAN-World Bank, 2009). Even, the World Bank (2009c) estimated that the speed of the process of poverty reduction in the region would diminish (Figure 12), although it may vary by country, depending on a number of factors, including effectiveness of e.g. poverty-reduction policies and fiscal policies in stimulating domestic demand.

**Figure 12:** Poverty Reduction Process in ASEAN During the Crisis Period

![Poverty Reduction Process in ASEAN During the Crisis Period](source: World Bank (2009c).

In Indonesia, based on BPS data, in the aftermath of the 1997/98 crisis, poverty increased dramatically from around 17.47 per cent in 1996 to about 24.23 per cent in 1998, when the crisis reached its climax. However, in 1999 poverty started to decline gradually, though first very slightly, up to 2005. In 2006, due to the high increase in world fuel prices, and as Indonesia has become increasingly dependent on imports of oil, the poverty rate increased again, on average between 1.8 percentage point per year or about 4.2 million people fell into poverty between the period 2005-2006. Only after some
policy adjustments and macroeconomic stabilization, the poverty rate started to decline again in 2007. In relative terms, the poverty rate in 2007 was the same as that before the 1997/98 crisis. However, in absolute terms, the number of those living under the current poverty line was still higher than that in the pre-1997/98 crisis period. Although the difference varies by year, the poverty rate in urban areas is always lower than that in rural areas. According to World Bank’s estimates, the poverty rate is likely to continue to fall, from 14.2 per February 2009 to around 13.5 per cent in early 2010 and 11.4 per cent in early 2011 (Table 3). This suggests that the 2008/09 crisis would not lead to an increase of the poverty rate in Indonesia (as compared to the 1997/98 crisis).

### Table 3:
**Poverty in Indonesia, 1976-2008**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Poor (million)</th>
<th>Percentage of poverty (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Urban</td>
<td>Rural</td>
</tr>
<tr>
<td>1976</td>
<td>10.00</td>
<td>44.20</td>
</tr>
<tr>
<td>1980</td>
<td>9.50</td>
<td>32.80</td>
</tr>
<tr>
<td>1984</td>
<td>9.30</td>
<td>25.70</td>
</tr>
<tr>
<td>1987</td>
<td>9.70</td>
<td>20.30</td>
</tr>
<tr>
<td>1990</td>
<td>9.40</td>
<td>17.80</td>
</tr>
<tr>
<td>1996</td>
<td>9.42</td>
<td>24.59</td>
</tr>
<tr>
<td>1998</td>
<td>17.60</td>
<td>31.90</td>
</tr>
<tr>
<td>1999</td>
<td>15.64</td>
<td>32.33</td>
</tr>
<tr>
<td>2000</td>
<td>12.30</td>
<td>26.40</td>
</tr>
<tr>
<td>2001</td>
<td>8.60</td>
<td>29.30</td>
</tr>
<tr>
<td>2002</td>
<td>13.30</td>
<td>25.10</td>
</tr>
<tr>
<td>2003</td>
<td>12.20</td>
<td>25.10</td>
</tr>
<tr>
<td>2004</td>
<td>11.40</td>
<td>24.80</td>
</tr>
<tr>
<td>2005</td>
<td>12.40</td>
<td>22.70</td>
</tr>
<tr>
<td>2007</td>
<td>13.56</td>
<td>23.61</td>
</tr>
<tr>
<td>2008</td>
<td>12.77</td>
<td>22.19</td>
</tr>
<tr>
<td>2009</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>2010</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>2011</td>
<td>..</td>
<td>..</td>
</tr>
</tbody>
</table>

Note: *= March; ** February *** World Bank’s estimates (World Bank, 2009a).
Source: BPS (www.bps.go.id).

### IV What Made the Difference?

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

The question now is what made the difference? Was that because the Indonesian government’s response this time was more quick or was better prepared than during the 1997/98 crisis, or something else? According to many discussions,1 there are a number of reasons:

(1) from a regional perspective, the Indonesian economy performed well in the years before 2008 (with one of the best growth rates in Asia after the 1997/98 Asian crisis up to 2008, particularly during the period 2005-2008);2

(2) the banking sector remains in good health (which was not the case in the years before the 1997/98 Asian economic crisis), although bank lending growth reduced in line with the slowing economy;

(3) consumer prices kept stable, allowing Bank Indonesia (BI) to loosen monetary policy (which is important to keep consumption growth);

(4) Indonesia’s external position remained sound, the country’s significant external financing obligations are being met, and foreign exchange reserves have risen slightly;3

(5) Indonesia’s public finances are strong (which was not the case during the 1997/98 Asian crisis), allowing policy makers to quickly move to offset the global downturn’s effects on Indonesia with a fiscal stimulus;

(6) also based on the experience of the 1997/98 crisis, cautious policies by Indonesia’s government4, banks,5 and corporations,6 over the past decade have resulted in low debt levels and limited

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2 Although sustained high rates of annual economic growth over several years is not a guarantee that a country will not experience a big crisis in the near future. Until early 1997 Indonesia had annual growth rates of on average 7 per cent. But, unexpectedly, by the end of that year, the Indonesian economy was hit by the biggest crisis, at least since its independence in 1945.
3 According to Zavadjil (2009), BI had built-up adequate foreign exchange reserves, equivalent to almost 200 per cent of short term debt on a remaining maturity basis, which provided a good cushion against capital outflows in the second half of 2008. With these reserves, BI was not only able to intervene in the market to limit the fluctuation of the rupiah, and thus prevent a major decline in confidence, but, the rupiah was also free to fluctuate to absorb the impact of the capital outflows.
4 Zavadjil (2009) explains that careful fiscal management policies adopted by the Indonesian government in the post-1997/98 Asian economic crisis period reduced the public debt ratio to around 33 per cent by the end of 2008, which was amongst the lowest in the G20, and had the prospect of further decline. Consequently, the government was in a position to increase the deficit from roughly 0.1 per cent of GDP in 2008 to as much as 2.5 per cent in 2009, raising the growth rate by 0.5-1.0 percentage points according to IMF estimates. Moreover, as he argues, if global economic conditions deteriorate again, Indonesia has the option of pursuing more stimulus.
5 Indonesia’s banks were able to maintain ample liquidity and capital buffers. In 2008, the capital adequacy ratio was around 17 per cent (compared with the Basel requirement of 8 per cent). Also, banks hold about 23 per cent of their assets in BI paper or government bonds, considerably above international norms. Thus, the overall loan to deposit ratio was about 75 per cent, i.e.
refinancing needs. This served the country especially well in late 2008 and early 2009, when liquidity tightened around the world;

(7) compared with some Asian countries, Indonesia is a relatively “closed economy”;\(^7\)

(8) consumers kept spending despite the fact that banks tightened credits in late 2008. Much of this spending might also related to the election related activities; and

(9) based on the experience of the 1997/98 Asian crisis, this time the Indonesian government was more quick and more active in response with appropriate measures to the crisis, e.g. by providing the stimulus through fiscal and monetary policies.

Specifically, the Asian Development Bank gives its own reasons that made Indonesia more resilient than other countries during the 2008/09 crisis (ADB, 2010b):

(1) the impact of a spike in risk aversion was muted by steady policy responses in Indonesia and the stabilising impact of co-ordinated global counter-measures on global financial markets;

(2) the income impact of the fall in commodity prices was mitigated by the fact that the preceding years had seen record high prices for these same commodities, allowing rural households to build up a savings buffer to help them smoothen out consumption spending;

(3) because the global recession was of relatively short duration, the effects of the financial crisis were avoided;

(4) the government’s good housekeeping of previous years provided it with the space to take swifter and more effective policy responses than in previous episodes of external shocks; and

(5) the balance sheets of the banking, corporate, and household sectors were much stronger.

V. Concluding Remarks

The 2008/2009 global economic crisis started first in 2007 as a financial crisis in the US and then some months latter spread worldwide. The crisis has affected many countries, including Indonesia. While many other countries in the region started to show a significant deceleration in their economic growth in the first quarter of 2009, the economic growth rate in Indonesia begun to fall only in the last quarter of 2009. However Indonesia has managed to keep its economic growth rate above zero in 2009, though it was

banks were mainly financed by deposits rather than the interbank market and/or foreign loans which proved much more unstable sources of funds during the crisis (Zavadil, 2009).

\(^6\) The bulk of Indonesia’s corporations were in relatively good shape, in line with the rest of emerging Asia (Zavadil, 2009). This was very different with the 1997/98 Asian crisis. Currency and maturity mismatches were one of the key causes of the 1997/98 crisis.

\(^7\) In his study, Djaja (2009) shows that the share of Indonesia’s exports to GDP was 29.4 per cent in 2007. The figure in the next three quarters of 2008 was 30.0 per cent on average. About 85 per cent of goods and services produced by Indonesian economy were used domestically in 2005, while only about 15 per cent went to foreign buyers. This indicates that Indonesia is not so strongly integrated with the rest of the world, at least from an export point of view. With such low exports, a sudden drop in world income and hence in world demand for Indonesian exports will not affect significantly domestic production.
much weaker as compared to its economic growth in 2008, or lower than the average growth since the country had recovered from the 1997/98 Asian financial crisis.

This study comes with two main important findings. First, despite many laid-off workers in the formal sector were reported, the official (open) unemployment has not increased significantly. Even, by August 2009, the rate declined compared to the level by February 2009. The most possible reason for this was that most (if not all) of the laid off employees ended up in economic activities in the informal sector, either as low-paid workers or owners of micro or small businesses. This reason is said most likely due to the fact that Indonesia does not have a social security system as the one known in the West which provides unemployment benefits to those who have no jobs. Thus, for the laid off employees from the formal sector who were engaged in informal economic activities, they did that just as a means for them to survive. The informal sector has proved to be very important during the crisis as the last resort for them.

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

References