Economic Crisis In Indonesia

THE FULL STORY

by
RICHARD MANN

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What caused Indonesia to experience the largest fall in the value of its currency of any country since World War II? Was it Soros-type speculators stampeding herd-like out of the rupiah after a massive collapse of confidence? Was it a calculated plot by an unknown person, group or power to topple President Soeharto ahead of the Presidential elections? Was it Indonesian Government ineptitude? Was it the reckless borrowing by the private sector? Was it corruption, collusion and nepotism? Did the IMF solve the crisis or make it much worse?

Whatever the causes of the unimaginable downward slide of the rupiah, the consequences have been devastating. Growth down from plus 8 percent to minus 5 percent, many projects and factories on standstill, per capita income slashed by nearly 80 percent down to less than US$300, inflation threatening to skyrocket, unemployment up by almost 10 million, companies and banks technically bankrupt. And, as if this was not bad enough, the country was reeling from scarcities caused by the prolonged drought, not to mention health problems caused by haze pouring off raging forest fires.

For 30 years praise had been heaped on the New Order Government for its macroeconomic management. 'Friendly' countries poured in investment dollars which have increased by many magnitudes since President Soeharto's early days. Abruptly, Indonesia found that most of its economic 'friends' were fair-weather companions. Except countries in the immediate region, many a door was firmly slammed on its requests for help. Suddenly, Indonesia, its Government and its President found themselves fighting an economic war against an unseen enemy resistant to every kind of 'medicine.'

Day by day, step by step, blow by blow, this book traces Indonesia's unfolding tragedy - a disaster which some say will take three to five years to correct.

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FOREWORD

This study has been compiled monitoring media coverage of the economic crisis in Indonesia from England, Singapore, Malaysia, Australia and Indonesia itself.

It is the story of how market forces sent Indonesia crashing on its face and it has been told by letting it tell itself, event by event. It will be of particular interest to non-Indonesians by being told largely from what I perceive to have happened within Indonesia. Throughout the crisis, Indonesian and foreign perceptions and reactions were widely different.

What emerges it substantially different from the overall public impression of Indonesia's handling of the crisis and even of its causes.

In the beginning, Indonesia was an innocent and unaffected bystander to the crisis in Thailand. Then it was a bewildered participant as the crisis appeared to roll through Malaysia, Singapore and Indonesia, before turning north to South Korea and, at various times, appearing to threaten China and Hong Kong. Next, its economic managers applied every tried and tested financial mechanism to shore up the falling rupiah - with no effect. Finally, as the crisis turned from somebody else's to Indonesia's very own, the country was caught up in the most savagely destructive economic downturn in more than 30 years. Whatever counteractive steps the Government took, failed dismally and, the greater the failure, the deeper the loss of investor and business confidence and the more severe the economic collapse. In desperation, in January, with the rupiah at Rps 17,000 to one US dollar, the Government turned to the International Monetary Fund (IMF).

Fund directors seized the opportunity to try to bring Indonesia to the path of ideological free market purity, instead of focusing on the causes of the crisis. As bad luck would have it (from Indonesia's point of view), just as Jakarta asked the IMF for assistance, the Fund was extending its activities from simple bailouts to wholesale economic and political reforms, including, by implication, even social reforms. Indonesia couldn't cope with its suggestions and demands, though, as the crisis deepened, it tried harder. The result was not immediate help but a barrage of IMF-led international criticism which threatened to turn one of Asia's success stories into a pariah among nations. Swamped by criticism and bereft of the prompt help it needed, Indonesia's economy slipped further and ever more rapidly downhill on the back of a currency that also slid remorselessly downwards. The few concrete, short- term measures suggested by the Fund, such as tightening liquidity and bank closures only made the crisis very much worse. Eventually, the Government of Indonesia felt compelled to look for other ways to halt the catastrophic fall of the rupiah and turned to the idea of a Currency Board, a solution President Soeharto called IMF-Plus. That didn't work either because by this time foreign currency reserves were too low and the banking system too perilous.

It was probably just as well because the Currency Board would have dollarised the Indonesian economy just at a time when it was important for all prices and transactions to be in rupiah. Malaysia had stuck to Ringgit pricing and seemed much better off. Few of its business operators had been forced to close because they could not pay US dollar denominated rents in the heart of Asia.

By April, there seemed no solution for Indonesia, other than to follow the so far unsuccessful advice of the IMF. It really was the last chance. Everything had been tried. If the IMF's medicine didn't work this time, Indonesia was faced with living through the nightmare of letting its economy's now multiple ailments cure themselves, over time.

At the outset, virtually no one had realised the extent of Indonesia's offshore, foreign currency denominated debt. Of course, they should have, especially the Central Bank. But they didn't. Even when it <u>was</u> realised, both the Government of Indonesia and international 'rescue' agencies like the IMF turned their backs firmly on paying the corporates' bills. The private sector had borrowed far more than it could ever hope to repay in a very short-term and just trying to do so pushed the rupiah constantly down and the dollar equally constantly up. Worse still, the dollar was on a ride to record highs. Loss of confidence in the rupiah led to a stampede out of the national currency and into US dollars. To varying degrees much the same sort of things were happening elsewhere in the region. In the US, for the first time in 30 years, the

Federal Government was budgeting a surplus. There was a dollar drought.

With official backs firmly turned against paying the private debt, the only solution was for the companies to request roll-overs from their creditors and/or for Indonesia to weather the repayment storm while taking whatever prudent steps could be taken to minimise economic and social damage. The creditors were not keen. The crisis continued.

Because the cause of the crisis was late in being understood and everything the Government tried seemed to fail, more and more Indonesians blamed the Government. There was a massive outpouring of frustrations which had built up over many years related to corruption, collusion, nepotism, lack of Western-style democracy, lack of accountability, lack of transparency and an inadequate legal and regulatory structure, especially for banking and business. In fact, all these things had been true for many years, in Indonesia and elsewhere in the region, but everybody had got by and the so-called Asian economic miracle had rolled on. On January 24, discussing the region, Gwynne Dyer wrote in the 'Jakarta Post: "The cozy "Asian way" capitalism that served the "tigers" so well in the first phase of industrialisation (as it served Japan, too, a century before), suddenly ran out of rope. The flood of money from outside exacerbated all its worst tendencies to over-investment and non-accountability - and then exposed it to a scrutiny it could not survive. Crash."

The opening up of economies and the injection of tidal waves of foreign capital with clear expectations of repayment proved too much for Indonesia, with a still-undeveloped legal and regulatory environment and weak institutions. Because society was suffering, the Afinger of criticism was pointed at the Government by virtually all levels of society. The general tenor of the criticism was that the Government was to blame for all the weaknesses and should be changed. Also, people who had grown up in Indonesia knowing only one President especially wanted change and there was widespread resentment at the way the President, his family and his friends appeared to have benefited from a system that now seemed incapable of guaranteeing even the basic needs of the people for employment and food - a situation made infinitely worse by a long drought which had drastically curtailed domestic food production, threatened water supplies and removed any rural safety net from beneath displaced urban workers.

While the crisis worked itself out, a Government which had become unpopular because of its perpceived failure to deliver, faced the prospect of social unrest over escalating prices and loss of income and mounting political criticism from university students. The so-called middle class remained mostly quiet or backed the Government although there were plenty of frustrations and criticisms, particularly among intellectuals, among those who felt that they had been excluded from power and influence and even among the upper sections of the bureaucracy. In a sense, large swathes of the rural populace and the working people were in the classic position of having nothing to lose if they vented their displeasure on hoarders, shopkeepers who were felt to have unjustifiably raised prices or even the Government. But the middle class, though suffering, were as much afraid of the turbulence from this quarter as they were of the crisis itself. This fear went some way toward guaranteeing the stability of the Government. After the March meeting of the People's Consultative Assembly, the election of a 'new' president and vice- president and the swearing in of a new cabinet, the new Government knew that it had to find a way of stabilising the rupiah or perhaps face the prospect of riot or even revolution.

Understanding of the crisis in Indonesia has not been assisted by continuous prejudiced and even inaccurate reporting, particularly but not exclusively by the Western media and by reportage that was demonstrably incorrect. While it was true that the Government had responded with tragic slowness before Christmas, as it sought to understand what wals causing the crisis, in the New Year and particularly after the signing of the January accord with the IMF, Government action came swift and fast. Yet President Soeharto and the Government were still pillo-ried in the media for being reluctant to introduce reforms and for not carrying out the agreement with the IMF to the letter. Even one of the New Order Government's staunchest critics, in the end, was forced to say: "What more could President Soeharto do?"

Many Indonesians felt, that far from going slowly, President Soeharto had "given everything away" in his deal with the IMF, such was the Government's understandable panic that its national economy was about to collapse with devastating consequences. It was this panic that led to the picture of President Soeharto apparently obediently signing the IMF agreement with M'chel Camdessus standing over him like an angry school teacher!

Only when the Indonesian Government realised that the IMF's measures were ideological and long-term, and therefore incapable of solving the immediate crisis, did the New Order Government's relationship with the IMF and other agencies, such as the World Bank, become turbulent. But the facts spoke for themselves. The rupiah refused to stabilise, bank insolvency was rising, corporate debt was increasing, offshore loans could not be repaid, letters of credit were not being honoured overseas and the economy generally was grinding to a halt.

The markets were not influenced, as was public opinion generally, by misinformation from the media, whether innocent or deliberate. The markets saw only unpaid debts and economic collapse, and, as a result, dwindling grounds for even a shred of confidence. After the March election, the Government squarely faced this issue: how to restore confidence by stabilising the rupiah at a reasonable exchange rate to the US dollar so that business could start to function again.

Asia's currency crisis swept through Indonesia stripping bare all its weaknesses and exposing them to ruthless international scrutiny. The crisis sowed doubts in the minds of Indonesians about their readiness for globalisation and sparked a feverish search for scapegoats to blame for all that had apparently gone wrong. Problems mounted on problems. Blame mounted on blame. Some people were afraid. others said they lived in exciting times, rich with the prospect of change and improvement. Indonesians felt sorry for themselves. Foreigners who knew Indonesia felt sorry. How things would turn out only time would te l.

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