

*USAID Responses to Financial
Crises and the Poor:
Indonesia, 1997-1999*

Robert Aten, Ph.D.

Acting Chief Economist, ANE
Technical Support Office

Asian Crisis and Response

- 1996-97 Japanese bank declines in lending to Thailand, Indonesia, and elsewhere because of partially successful Japanese policy reforms
- Next, the Thai financial crisis, followed by international transmission to Indonesia & beyond
- Indonesia initially considered stable, and few expected the adverse response that occurred
- Stiglitz-IMF apparently still disagree over what happened. USAID Indonesian economist views

1997 Indonesian Circumstances

- Economic policy reforms incomplete in 1997
- Private sector had borrowed too much abroad in hard currencies. Repayment in rupiah planned.
- IMF invited in by Indonesian government. IMF closed 16 banks – too few or too many
- President Suharto became ill. Played games over the exchange rate. Suharto withdrew after re-election – encouraged by economic team
- Exchange rate collapse implied flight of capital/investor exit. The Indonesian private sector could/would not repay dollar foreign debt

What Happened Next

- Poor in the Indonesian economy relied on non-tradeables. Crisis especially affected tradeables
- Overvalued real estate in Jakarta. Major West Java based manufacturing issues
- Initial IMF views limited: small staff & too much based on Latin America experiences where gvt. budget balance was a major problem
- IMF initially failed to consult USAID economists. US meetings with embassy only
- Later USAID activities supporting the poor complemented IMF activities

Analytics & Expenditure Response

- In 1997, USAID had planned to phase down/close out economics and other programs because of Indonesian success
- USAID responded strongly to the 1997-1999 financial crisis. USAID program became almost 3x higher (roughly \$50 M - \$ 130M)
- Core USAID increases increased analytics (e.g., macroeconomics, banking, trade), support for the poor, electoral support, and a constructive GOI response to the increased tradeables costs (exchange rate depreciation)

Areas of Response

- Analytics: North Sulawesi, Central Java, anti-poverty, government budget/taxation, agriculture, reduction of gasoline subsidies, decentralization, support for specific tradeables and trade policy
- Funding: Increased analytics, added food aid, added drug costs, restructuring of private debt (JITF), banking system reform (IBRA), environmental protection
- World Bank & IMF often had the lead, but USAID rapid responses critical/complementary

Poverty Alleviation

- Food aid in Maluku, lesser Sundas, West Kalimantan. Drug costs reduced in Java
- Impacts of crisis on selected poor groups (e.g., farm laborers, factory workers). Strengthened microfinance in conflict areas, e.g., West Kalimantan
- Helped GOI carry out relevant analytics regarding adverse tradeables impacts on the poor. Encouraged gvt. transit support

Trade Policy

- Protectionist impulses strong but largely irrelevant. Previous protection eliminated (clove monopoly)
- Efforts to prevent exports to increase available domestic supply to reduce domestic prices (palm oil, other tree products)
- Sugar and rice struggles went on. Tie in to food aid issues. Role of military.
- Indonesia role in WTO telcoms deal.

Parliamentary Support

- Indonesia became Presidential democracy during period. Has implications for role of parliament.
- Democracy support. Economic support for parliament. USAID support helped Parliament understand decentralization, move beyond rubberstamp role without damaging economy. Advice, tng.

Food Aid Again

- Millions were too poor to feed themselves adequately before the financial crisis, especially in poor crop years. Little hunger vs. big hunger.
- Continuing conflict situations (Borneo)
- But many more pushed into absolute poverty by the financial crisis.

Gasoline/Oil Subsidies

- The State-owned oil company long sold gasoline at subsidized rates. In the wake of the crisis, this subsidy increased enormously and was brought on budget. An opportunity cost issue.
- Raising gasoline prices hurt the middle class.
- The principal transportation issue was the difficulty of passing along the costs of repair parts, etc. in vehicles (buses, etc.) principally used by the poor.
- USAID assistance encouraged the GOI to be more flexible in its regulation of these businesses

Jakarta Initiative Task Force

- A World Bank initiative started in 1998 to help the private sector restructure business debts owed abroad that became impossible to repay after depreciation
- USAID provided about half the TA and training
- Small debtors handled successfully as a group
- Large debtors recalcitrant
- Tax and other subsidies used to help reach agreement
- Successfully wound up in 2003 with most debts restructured

Indonesian Bank Restructuring Agency (IBRA)

- Central bank kept banks themselves from borrowing abroad, making bad decisions.
- Banking system collapse anyway because private sector borrowed abroad
- Correct IMF/GOI decision made to save banking system because needed for recovery support
- IMF/GOI decisions probably tried to save too many banks.
- USAID heavily engaged. Will discuss as sidebar later

Decentralization

- Nation-state too centralized for effective management. Many groups seeking splintering of state.
- Crisis exacerbated tensions/conflict, as not sufficient funds to continue finances. Finance for military heavily involved, particularly as military businesses failed during crisis.
- USAID/Germans/World Bank provided substantial leadership to Indonesian process
- Decentralization largely achieved successfully. Nation-state nearly preserved (except East Timor)

Conclusions

- Too ambitious a set of reforms proposed by donors initially for the Indonesian political process to absorb (IMF/WB lead)
- Critical importance for economic recovery of senior Indonesian economists supported by Indonesian analytics (University of Indonesia, and decentralized university support) (USAID lead with TA)
- Continuing political balance between reformers and economic nationalists prevented sufficiently rapid and comprehensive reforms from being achieved (Core Indonesian problem still)