ASSESSING THE IMF FUNDING PROGRAM IN INDONESIA WITH REFERENCE TO 1997'S ASIAN FINANCIAL CRISIS

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Abstract

Asian Financial crisis of 1997 started from Thailand and violently spread to Indonesia. As a result foreign speculative investors pulled out their investments fully from the country and sucked US dollar liquidity by causing severe depreciation of the Indonesian currency 'Rupiah'. Private sectors, however, where most of the domestic borrowings were in the low interest rates and their profits were in Rupiah-their debts suddenly increased as per the US dollar get valued quickly, thus, heavy Rupiah depreciation leaved many companies virtually bankrupt. For the short term relief, these companies desperately sold Rupiah and buy US dollar, this caused Rupiah value to drop-out more from RP 2,600 per US $ in 1997 to RP 14,800 per US $ in January 1998. Efforts made by the central bank to defend Rupiah floating by selling Dollar in International market had not much result oriented, but, at other side the drained Indonesian foreign exchange reserves and enforcing government to free-float the currency sought liquidity from the International Monetary Fund (IMF).

This paper attempts to present an overview that caused Indonesia to get economically hit by the 1997's Asian Financial Crisis, its drawbacks and shortcomings under the International Monetary Funds' prescribed policies that further may or may not influence the Indonesian economy. The aim of this paper is to clearly focus on the role of International Monetary Fund in 1997's financial crisis towards Indonesia. This would also be taken in to consideration that as the study focused Asian Financial Crisis, statistical

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data has been calculated about crisis and post crisis period i-e from 1997 up to 2003. For Indonesia, 2003 is that year where she had been repaid its entire external loan outstanding to IMF. No any loan disbursements have been found from IMF to Indonesia the year after.

Keywords: Financial crisis, international market, foreign exchange

Introduction

The Indonesian archipelago possesses a striking array of economic and geographical assets and farming an arc between different countries via Asia and Australia. Indonesia has 13,677 islands. It controls seaways on its Indian, Middle East and East African ocean sides. Its territory lies between Japan, China and the West Coast of the United States.

Indonesia possesses some of the most remarkable sights in South East Asian region-endowed with a phenomenal array of natural resources along with variety of cultures. She has become the magnet of entrepreneur from the Western side, wayward adventures and inspired artists as well as a stemming ground for proselytizing mission arise un-scrupulous traders. Indonesia has also been witnessed for her running by Dutch and Japanese armies; surveyed, drilled dig up and shipped off by foreign mining companies, poked and prodded by anthologists over the time. In the eve of World War II, Indonesia was a Dutch colony, with the end of the war and Japanese occupations in 1945, a group of nationalists proclaimed struggle and after number of year's struggle and negotiation sovereignty was formally transformed in 1949. From the period she has been politically captured by her own renowned presidencies (Ricklefs, 1993).

Till to mid-1990's, borrowings from the international financial institutions had served as the backbone of the development financing in Indonesia by providing resources to cover the savings-investment gap. Whereas, external financing increased sharply in

response to the rapid expansion in the private sector and the new banking deregulatory policies that followed by the adoption of free exchange regime in the Official Regulation No. 2 of 1982. In comparison of 19970's US$2.7 billion debt, the national debt stock mounted up to US$ 14.87 billion in 1980, US$ 63.95 billion in 1990 and US$ 107.83 billion in 1995. Thus, soaring debt burden from 1980 to 1995 was driven primarily by the private sector borrowings. Key indicators to debt such as debt GDP ratio and debt service ratio remained up to the manageable limits.

The turning point faced by Indonesia was the economic crisis that started taking its toll at the end of 1997. Generally known as the 'twin crisis' began with the contagion effect from the attacks on the Thai bhat which further triggered steep depreciation in the Indonesian Rupiah. Losses sustained by the currency and plunged Indonesia in the historic debt crisis. By the end of 1980 country's foreign debt stood at US$ 159.9 billion. The economy had contracted 13.1 percent as well as the income per capita was down from US$1 1,050 to less than US$ 600 per annum. As a result, Indonesia became quickly reclassified as a severely indebted low income country (Goeltom, 2007).

The International Monetary Fund (IMF) has been considered as world's specific funding agency which has significant impact over the world's most low, middle and sustained economies. Currently IMF is working along with 188‡ (IMF, 2013) member countries across the world. IMF's core responsibility is to provide loans to countries experiencing balance of payment problems. The financial assistance is being made by IMF in a sense to boost up the international reserves, strengthen the payments for imports and revise the condition entities for strong sustained economic growth in order to stabilize the national currency. The loaned amount that a country can borrow according to its access limits –simply varies according to

‡ Data taken on 31st May 2013

the type of loan but is authentically a multiple of country's quota.

Indonesia is commonly known as 'the land of Islands', joined International Monetary Fund program in 1954. At first the relationship remained on its peak but slowly and gradually the relationship between the Fund and Indonesia changed drastically on effect of the rise of new order government in mid 1960s. The time witnessed the highly competitive series of stabilization programs, like, after the oil shocks of 1970s, support of Indonesian balance of payments, technical assistance programs and the routine IMF surveillance. These programs lasted only from 1980s to 1990s. Moreover, this relationship got patchy especially when the economic crisis hit East Asia in 1997.

Causes of the Indonesian Financial Crisis and the IMF Program

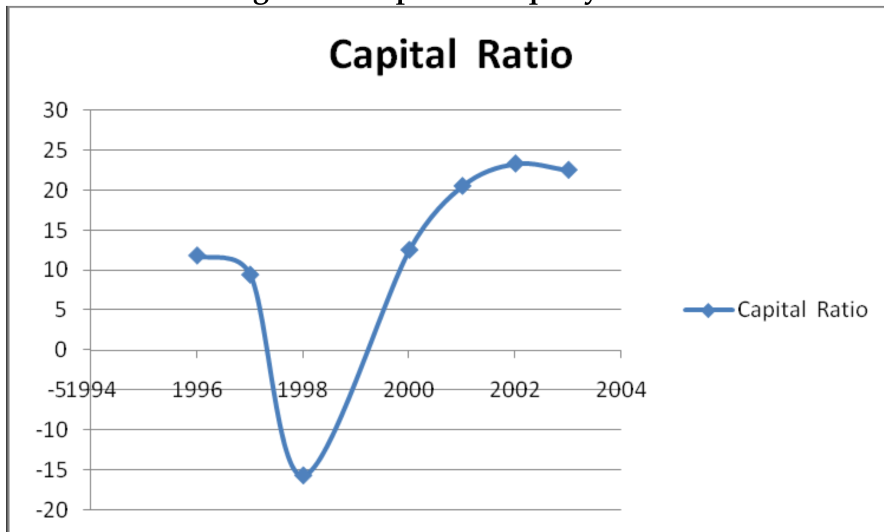
Before the crisis of 1997, Indonesia had fascinated with the strong macroeconomic indicators like surplus budget, healthy and sustained economic growth rate, and adequate stability in prices, monetary aggregates and exchange rates. With this effect she used to get interests to make investments particularly in to the short term assets and may have been focusing indications of fragility in the corporate and financial sectors. Particularly, there had been a build-up of unhedged short-term foreign currency borrowings by the Indonesian stake holders and corporate persons, as well as misallocation of credits through foreign lendings. However, policies to take up the underlying weaknesses had been ignored during the economic boom periods. Whatever the cause, the financial crisis brought devastation in Indonesia's real economy (see Table 1).

Table 1. Key Macroeconomic Indicators, 1990-2003

	Average% 1990-1996	1996	1997	1998	1999	Average 1999-2003
GDP Growth (%)	8	7.82	4.7	-13.13	0.79	3.38
Aggregate Investment Growth (%)	10.55	14.51	8.57	-33.01	-18.2	1.48
Public Investment Growth	-0.7	-1.59	33.39	80.88	-31.4	-26.12
Private Sector Investment Growth	41.97	20.18	1.41	-43.41	-1.3	21.45
Current Account Balance in BOP (% OF GDP)	-1.28	-1.88	-1.15	1.09	1.52	1.48
Capital Account Balance in BOP (% of GDP)	2.04	2.66	0.59	-1.03	-1.2	-0.91
Private Capital Flows	199.46	12.27	-102.94	-3996.45	-28.34	-222.92
Public Capital Flows	-44.63	-255.36	-651.72	246.22	-46.31	54.42
Public Sector Balance(% of GDP)	-0.01	-0.06	-0.15	0.07	-0.01	0.01
Inflation Rate (%)	8.4	5.12	10.31	77.63	1.92	7.78
Interest Rate (30 days SBI in %, end of period)	14.13	12.88	20	38.44	12.51	13.18
Exchange Rate (RP/USD, end of year)	2173	2383	4650	8025	7100	8900
% of Appreciation (Depreciation)	-332.72	-3.25	-95.13	-72.58	11.53	-18.59

Source: Bank Indonesia Statistics, 2004

Figure -1: Capital Adequacy Ratio



Source: Bank Indonesia, 2004

The crisis triggered a turning to the impact on the banking system by destabilizing internal system that quickly degenerated in to a vicious cycle, whereas, the early loss of confidence led to bank runs and most of the banking system became technically insolvent.

Behind these macroeconomic statistics there had been the human dimension for sure of the crisis, such as steep fall in consumption, deterioration in living standards and a concomitant rise in poverty. In this regard, the financial crisis reversed Indonesia's decades –long track record of steady poverty reduction. According to estimates, the poverty level mounted dramatically from 11.3 percent in 1996 to 23.6 percent in 1999 (Goeltom, 2007).

Financial Sector Reform

The weaknesses in the financial sector subjected to a huge devastation of the year 1997 crisis, these flows were mainly concerned with governance in the corporate, financial and government sectors but affected hugely over Bank supervision

policy skills. Likewise, the major financial reforms adopted by Indonesia and strongly recommended by IMF are mentioned here.

Bank Restructuring and Stabilization Program

During the first few months of the crisis when there was intense outflow of capital which resulted in the sharp depreciation (up to 30%) called for lightening of monetary policy. However, the mixture of depreciation in Rupiah along with high interest rate led to the huge corporate defaults. Bank faced a two-fold burden of surging interest rates on funds concomitantly by soaring non-performing[§] loans that threatened their solvency. It was under these pressing circumstances that the Government of Indonesia signed its first letter of intent to the IMF on 31 October 1997.

The first and foremost conditionality imposed for the financial sector was the closure of 16 small private banks considered insolvent. The closure implemented in the early November 1997 triggering immediate panic throughout the banking system. In anticipation of huge pressure in the foreign exchange market, the government and the IMF arranged a first line of defense to be used in foreign market intervention and second line of defense as Stand-by Facility (John, 2005).

Bank Restructuring

The IMF got herself intensely involved in the establishment and functioning of the Indonesian Bank Restructuring Agency (IBRA). IMF imposed conditionality was extensive performance criteria and

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[§] A non performing loan is a loan that is in default or close to be in default. A loan is non-performing when its interest payments and principles are past due by 90 days or more, or at least 90 days of of interest payments have been capitalized, refinanced or delayed by the government, or payment less than 90 days overdue. But there are other good reasons to doubt too that payments will be made in full. The specific explanation is dependent upon the loans, particular terms and conditions

structural bench-marks. While IBRA was responsible for following key tasks:

1. Nursing of problems bank transferred from BI (Bank of Indonesia).
2. Resolution of the assets and liabilities of closed banks through the Asset Management Unit.
3. Corporate restructuring.
4. Selling the assets of closed banks to recover funds from the government.

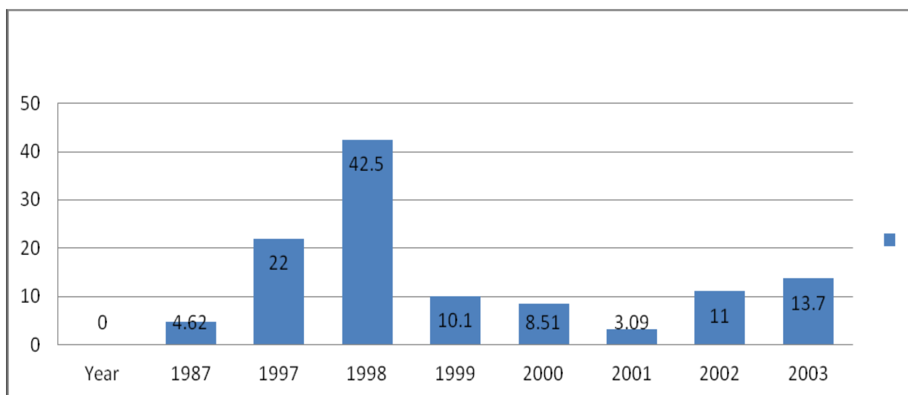
Adequacy of IMF Funding

In the Indonesia's case, IMF access was set at US$10 billion (490% of quota) in which principal amount came from the bilateral donors as well as well as international development banks (the world bank, & the ADB provided US$ 4.5 billion and US$ 3.5 billion respectively), another US$ 4 to 5 billion was committed on bank Indonesia's resources, if needed, where they found itself result oriented. The IMF used to show itself as the front-man of the country. Within the first two years, about US $ 8.7 billion were disbursed. Initial research has found that IMF financing's inadequacy was not the main reason of ruining crisis of Indonesia but the miss judgments of crisis management (specially of October 1997 and January 1998), the failure occurred at the start of crisis when due to lack of comprehensive bank restructuring strategy, it lead towards the expending liquidity in order to keep weak banks afloat.

Moreover, the crisis became political then, which magnified the critical conditions of crisis management and concluded that the deterioration of Indonesian economic activity is totally unrelated to the actual amount of financing.

The key problem was the inadequacy in program management implementation as well the prescribed rapid increase of liquidity. Consequently, these technical failures got into the intense political crises that further devastated the business confidence. From the technical perspective level, the main foresight was the failure to be counted for the high volume of undisclosed short term interbank lines of credit, essential for import financing. Trade financing then remained un-rolled and caused to exacerbate the crisis. Even though, the financial rescue package was not the major problem which took the crisis deeper in Indonesia, but it's being understood that in some cases, no doubt, official financing support had been insufficient and delayed (IMF-Supported Macroeconomic Policies end the World Recession, 2009)

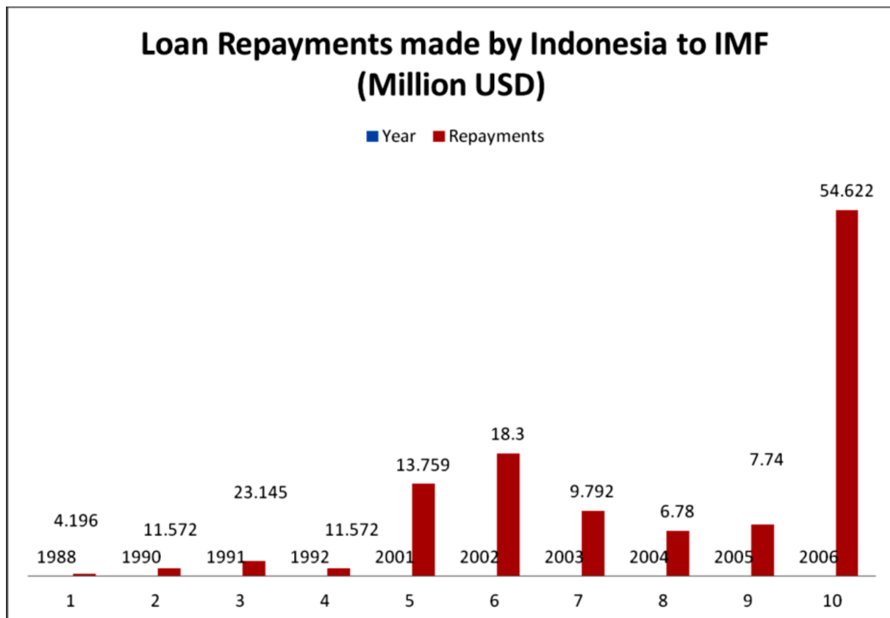
Figure-2: Loan Disbursements in Indonesia By IMF (Million USD)



Source: IMF Finance Department.

Figure number 2 confirms that Indonesia has been a major recipient of IMF loan facility for the past 40 years. Data shows a systematical distribution in terms of IMF lending. Apart from 1998, which is known as economic crisis year in the region, Indonesia hit severely by the financial crises in of 1997 to 1998 which influenced its economy to lend from IMF to come out from the Financial Burst.

Figure-3: Loan Repayments made by Indonesia to IMF (Million USD)



Source: IMF Finance Department

In the year 2006 the government got rid of bulk of her external debt burden and repaid the loan as much as possible.

Timing at Least As Important As Amount

From the Asian crisis two distinguishing features of capital account crisis have been learnt as: 1.Crisis occurs very rapidly and requires much more immediate response than current account crisis. 2. And the crisis occurs because the creditors lose confidence in a nation's capacity to serve debt.

In the Indonesian crisis time, IMF was called immediately and the first loan package was disbursed quickly by the IMF. Prompted response to the crisis country must result in restoration of investors' confidence; as such the crisis hit country would be fully able to meet its debt service obligations.

Excessive Conditionality

At the early stage of Indonesian crisis, indeed IMF’s large scale structural reform provided a strong ray of hope for restoring the confidence at an early stage of the crisis. But, this emphasis is based on large scale structural conditionality –particularly in IMF’s traditional expertise areas, detracted from macro-political core policies. In addition, IMF programs were highly supported the non-IMF supporter donors in regard to link the economic progress in Indonesia. In case of dilation in IMF’S disbursements, other donors followed suit, which led to misbalancing and lack of fiscal financing as the crisis got severed in 1998.

Exit Decisions

Over the span of time, the non-IMF financial support, under the shadow of IMF program, had become the major consideration of Indonesia to get rid of the IMF programs as early as suitable. Indonesia decided to be exited, as per the reason that the country herself had to come out from the crisis, due to the resentments as well as disappointments over IMF’s number of policy prescriptions. As policy credibility and financing must be considered as two major accounts, because of these, Indonesia considered getting exit from the Fund. Within a particular time, countries need to seize initiative to exit from the loan burdens. The exact time depends upon country’s progress under the program as well as other specific-country circumstances.

Exit Strategy

In many of the Indonesian like availed cases, exit strategy from IMF-supported program is not clearly stated. Indonesian experience explicitly suggests that lack of fully expressed exit strategy caused many uncertainties especially when the country used to give up the program. Thus, the explicit exit strategy may be documented in to a

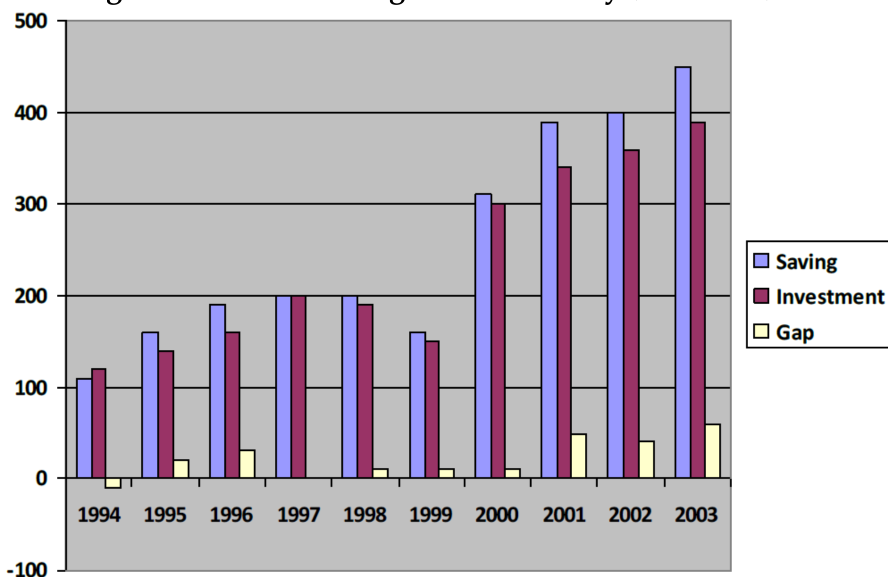
program for the clear guidance on a method of phasing the IMF program and to take precautionary actions against the negative effects from the exit. In Indonesia's experience, this should make for smooth exit and may decrease cases of prolonged use of IMF resources.

Indonesia and the Foreign Debt Burden

Whenever, any country becomes heavily indebted, it produces four major issues:

1. Heavy indebtness produces sustained downward pressure on the worth of currency- thus; the pressure on the currency further would strengthen the inflationary pressure.
2. Tight monetary policy causes to curb the inflation which results in unwanted side effects where-as hike in the interest rates could menace the fledgling economic system.
3. Excessive foreign burden merely affects to constrict Governments systematical options for promoting economic recovery through fiscal stimulus while the inflationary pressure can also get charged through high fiscal deficit conditions and tries to put upward pressure on exchange rate.
4. Last but not the least factor is, giant inflationary pressure can wipe out or even reduce the positive effect on currency depreciation on the current account, which, for sure provides an equal opportunity to re-pay the foreign debt.

Figure-4: Net Borrowing of the Economy (1994-2002)



Source: Bank Indonesia, 2003

Indonesian Debt Stock Expanding Drastically Since 1985

Following table which possesses the statistics about private sector borrowing that has increased every passing year at a rapid pace. Initially the debt was accumulated at US$ 800 million per year with an annual growth of US$ 1.5 billion to US$ 1.8 billion from 1981 to 1990 period, while the private sector borrowing came to their average limit with the expansion of US$ 5.9 billion, from 1991 to 1995, on per year basis. Statistics have shown that till the year 2000, the private borrowings were at their peak. This situation used to worsen the exchange rate crisis that further disabled many companies to service their debt. With the beginning of debt restructuring and repayments, from the past three years, private borrowings had seemed on the downward trend- with effect of no more fresh borrowings. The statistics show that, during this time, Government borrowings remained in stable conditions and gradually expanded by every passing year, the sharp expansion was

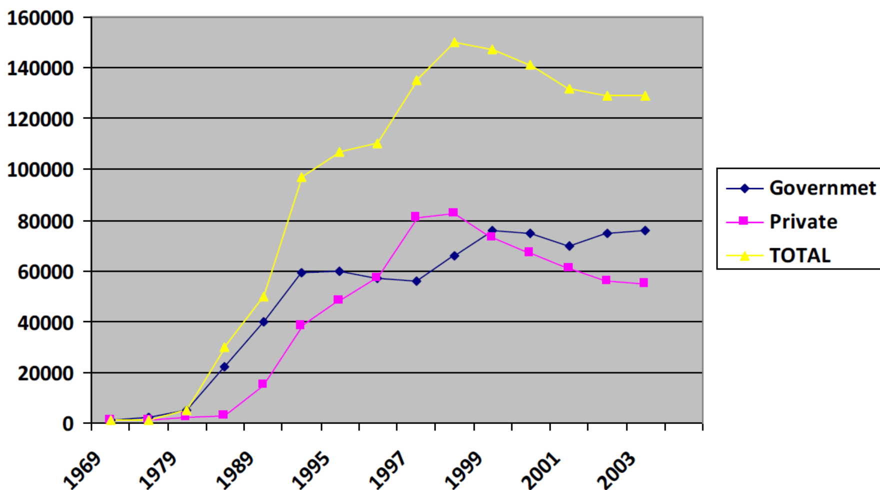
recorded in 1995-2000, while the year 1997 has shown extremely high debt disbursements, most of which was disbursed by the International Monetary Fund. Estimated funds were about US$ 3.03 billion in 1997, US$ 5.8 billion in 1998, US$ 1.4 billion in 1999, and US$ 1.1 billion in 2000 respectively with the average of US$ 2.8 billion per year (Senhadji, 2002).

Table-2: Indonesia's Foreign Debt Stock, 1975-2003 (million USD)

Year	Government Debt Level	Private Sector Debt Level	Total Debt Level
1975	6,611	1,832	8,443
1980	12,994	1,876	14,870
1985	25,321	9,836	35,157
1990	45,100	18,853	63,953
1995	59,588	48,244	107,832
2000	74,916	66,769	141,685
2001	71,378	61,696	133,073
2002	74,661	56,682	131,343
June 2003	75,530	55,217	130,747

Source: Bank Indonesia, 2003

Figure-5: Indonesia's Foreign Debt Statistics (1969-2003)



With this graphical presentation one can take a look at Indonesian foreign debt stock from 1969 to June 2003. An intense increase projected in government and private borrowings was in the year 1990-1996. After the year 1996, the government debt stock has come to normal with regard to restrictions on private sector borrowings. This stability shows that government's new foreign borrowings are equal to debt service payments due over the same period. Because not all government debt obligations fell during those years of fiscal restructuring, Indonesian debt stabilized. Debt was restructured only in the relation of bilateral loan obligations. However, debt repayments to multilateral agencies had to be arranged in the original borrowing terms. Under multilateral agencies credit policies, they are not supposed to restructure either through refinancing or debt rescheduling, these organizations were not allowed to participate in the government debt restructuring programme of Indonesia also.

Table-3: Composition of Debt by Tenor
(position till June 2003, US$ millions)

Sector	1 year	1 year	Outstanding
Government Private	95.0	75,435	75,530
Banks	278	3,822	4,100
Non Banks	208	2,787	2,995
Non Financial Institutions	1,039	47,082	48,121

Source: Bank Indonesia, 2003

Consequently, IMF aid was also taken into account for managing the safe foreign reserves-consistent with the intended use, these IMF financings were relatively short term (World Bank, 2005).

Indonesian Debt Service

Indonesian debt stock rose significantly from the year 1985 to 1995. Here, as shown in the table no. 4, the SDR and the Stick/GDP indicators at 20-30 % and from 50 to 75% figured out within the satisfactory limits, whereas after 1997 crisis, both, SDR and Stock/GDP rates soared before adopting a general decline in the year 2000. At the same time, the debt profile marked by high exposure in short-term liabilities with less economic growth projection of 4.5 % pointed that in servicing the foreign debt repayments, Indonesia could face the difficulties still. The mandatory action is to keep Indonesia away from falling in to permanent debt trap[**] and therefore it is mandatory to trim the debt burden of nation, specially the ratio of debt stock to national output. In case of the interest, payable on loan, the government is charged to pay commitment fees ranging from 0.25-0.75 % of undisbursed loan funds- here some of the lending economies used to charge the up-front fees or commitment fees at a flat rate of 0.125 % to 1 % of the loan amount. This simply means that if the disbursement of loan is gradual or, if the loan has been cancelled because of the disbursement period expiration, or the terms and conditions of loan disbursement are difficult to avail, the government is still bound to bear this expense. It is also very important to look upon the debt burden indicators that further show the inflationary pressures. In order to take precautionary measures to avoid the rising inflation, the monetary policy can take such initiatives like, to raise interest rate etc. (Goeltom, 2007).

[**] The term 'debt trap' usually known as 'debt pitfalls' is used to explain the borrower's difficulties in managing medium- long term repayments and such that the borrowers also become dependent on borrowing even to finance the repayment of the debt itself.

Table- 4: Indonesian Foreign Debt Indicators, 1997-2002

Ratio	1997	1998	1999	2000	2001	2002	Warning Indicator
SDR	44.5	57.9	56.8	44.8	41.4	33.3	20
Stock/Exports	207.3	261.8	252.1	191.0	200.7	195.0	130-220
Stock/GDP	62.2	146.3	105.0	93.8	91.1	76.0	50-80
STD/NIR	87.9	55.0	59.5	42.7	36.6	6.8	-

Source: Bank Indonesia, 2003

To give a smooth way to economic growth or to overheat the attractiveness of the domestic currency, if there is a situation when country dramatically falls in to the debt trap with heavy stock of debt, then in future and in present times, the economy will become fully dependent over debt financing, including refinancing of past debt. Thus full dependency on foreign flows for sure increases the susceptibility of balance of payments towards the external shocks, which in reaction could make exchange rate to fluctuate. This awful quality of fund placements including loans from creditors and investors will be a reason of capital flight.

Table-5 Structure of the Net Borrowing by Sector to GDP, 1994-2003

Sector	Average 94-96	1997	1998	1999	2000	2001	2002	2003
A. Non Financial	-3.74	-8.00	2.69	11.72	3.64	2.07	1.56	1.16
Government	1.74	3.45	0.57	0.51	0.79	0.11	0.79	1.07
Corporate	-8.88	-13.6	-2.8	6.09	5.45	1.66	1.83	6.33
State	-0.91	-1.23	-0.43	3.03	2.43	1.83	2.00	0.44
Private	-7.97	-12.44	-2.37	3.06	3.03	0.17	0.17	5.89
Household	3.40	2.22	4.92	5.12	1.03	3.84	2.60	4.10
B. Financial	0.44	7.69	-2.03	-10.73	4.50	0.86	0.15	4.05
Bank	0.28	7.97	-1.49	-10.42	4.50	0.93	0.07	4.05
Non Bank	0.16	-0.28	-0.53	-0.31	0.01	0.07	0.09	0.00
Total	2.27	-0.31	0.67	0.99	0.87	2.93	1.71	2.89
GDP (billion Rp)	456,434	627,695	955,753	1,109,979	1,389,770	1,684,281	1,897,800	2,086,758

Source: Indonesia's Bureau of Statistics, 2004

From the Indonesian recent crisis perspective, one should see the reflection of some foreign owned manufacturing operations as well as the stagnation in the international fund flows. Moreover, the mounted foreign debt burden also has to affect the monetary policy by providing a systematic linkage of loan burden to inflation.

Indonesia's IMF Experience

- Indonesia turned to IMF in 1967. In 1997, Southeast Asian crisis hit Indonesia hard. In less than one year, foreign capital withdrew from the country, value of rupee dropped drastically and mass unemployment set in.
- Starting from the crisis in 1997, IMF imposed emergency measures aggravated the economic situation and brought about the increase in internal and external public debt.
- As the loans for specific projects were given directly to the central government, it doled out the contracts on the political connections and facilitated the corruption.
- The IMF measures badly failed by extending and deepening the crisis, as majority of state budget was earmarked for debt re-payments.
- Although economic policy should have been directed at minimizing the depth and duration of economic downturn, this was neither policy nor the impact of the IMF prescriptions.
- The IMF money failed to do much help to Indonesian economy, despite the fact that she will repay the loan with heavy interest. Each Indonesian is now to repay US$ 250 per person plus interest to the IMF.

- By imposing the draconic conditions for aid to government, IMF encouraged the dictator of that time to implement very unpopular economic measures.
- People hard hit by the impact of these measures began to launch protest.
- The historic balance sheet of IMF's role in Indonesia is an unqualified disaster.

IMF also suggested policy advises, and financial assistance collectively played an important role in Indonesia's struggle to economic prosperity, stability and recovery. Subsequently, it is also important to magnify some critical assessments on the effectiveness of IMF programme and tools as implemented in Indonesia, that:

1) IMF suggested policy measures appear to be more suitable for countries focusing mounted fiscal problems, but it committed very less results during the economic crisis of Indonesia in 1997.
2) In many of the worse situations which were diagnosed early in the crisis, IMF had reported excessively optimistic situation, this highly optimistic data assessment provided by IMF staff were the reflection of miss-judgments which further resulted in the wrong identifications and even worse policy prescriptions.
3) The programme was fully focused on structural reforms and marked extra burden over the country's limited resources. By its design, the programme unnecessarily burdened the already deprived legal system, human resource capacity and institutional framework. Thus, all above factors smartly eroded the public confidence in the IMF policies and programs.

For a country, suffering by bureaucratic confusions and internal political disorder, the negotiable issue would be policy credibility not the size of the financial resources.

Conclusion

The Indonesian experience has marked some authentic lessons for some other countries. The robust macro-economic indicators in pre-crisis period had crucial vulnerabilities which must have been addressed at the earlier time. Financial sector weakness and the rapidly increased capital flows remained the strong reason to deepen the crisis and made it possible for IMF to enter in to the country. For Indonesia, IMF's cooperation had in a way been a blessing which raised awareness among the authorities to strengthen the financial sector.

On an eventual note, beside criticism and space for future progress, in recent years the Indonesian financial sector has made a successive history. Along with many experiences for moving ahead and to put the country fully back on track, full consideration of financial sector reforms would be needed indeed.

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