## Chapter I

## Introduction

### 1.1 Background

Indonesia has been actively opening its economy up to globalization ever since its independence in 1945. With that, the Indonesian economy is often prone to external economic shock that may arrive through the financial channels and trade channels. These shocks refer to the sudden changes of fundamental macroeconomic variables that may pose a tremendous negative effect on macroeconomic outcomes. Shocks are oftentimes unpredictable and are often the result of force majeure. And yet, the regular yet unpredictable occurrence of economic shocks still poses a tremendous risk as the prospect of long-term damage to the economic and social fabric of the region may cause a long lasting and tragic outcome. These economic shocks exploit fundamental flaws of the countries' fiscal policy and will strain test the country's economic and financial system's resilience. Therefore, formulation of proactive policies and the preparedness of the economy is key towards making a country more resilient towards the uneventful event of economic shocks.[1]

[1] Blankenburg, S., and J. G. Palma. "Introduction: The Global Financial Crisis." *Cambridge Journal of Economics* 33, no. 4 (2009): 531–538.

Throughout history, Indonesia has gone through several shocks that derived from the global economic crisis. The most recent one being the Coronavirus Imposed to contain the virus, causing global output to drop significantly. One of the most significant crises that had impacted the Indonesian economy was the 1998 Asian Monetary Crisis. The crisis originated in Thailand and soon spread to ASEAN, and then to Indonesia through the financial channel as the Rupiah came severely under attack and heavy selling action, causing systemic failure of Indonesia's national and international banking and financial system. At its worst during the first weeks of January 1998, the baht had fallen by 40 per cent, the rupiah by 80 per cent. Therefore, the 1998 crisis caused Indonesia to fall into its deepest recession ever as it exposed Indonesia's unsound fundamental economy through incompetent fiscal and banking policy that was purely driven by greed and corruption. The crisis was a wakeup call for Indonesia as reformation soon ensued as a new era of Indonesia was ushered in.

The reformation era would see Indonesia reforming not only their political system, but also financial, banking, and macroeconomic policies and laws to ensure such effect would be avoided in the future. In 2008, a crisis that derived from the subprime mortgage crisis in the United States shocked the global economy as it sent a rippling effect through the financial channel and trade channel. Countries in the Southeast Asia region such as Malaysia, Singapore, Thailand, and Philippines were heavily impacted as they recorded negative economic growth in 2008.[2] Both crises from the 1998 and 2008 crisis include the elements of capital flight with bond spreads indicating initial rises in investment risk premia of similar magnitude, signalling the drastic fall of public confidence towards the economy. However, Indonesia managed to record a net 6.5% economic growth during 2008 despite other neighbouring countries falling into recession. This phenomenon is partly contributed by the reformed policies and experience gained through the 1998 crisis that Indonesia was able to avoid and mitigate a financial disaster.

The process of studying the decision making in formulating fiscal policies that include raising or lowering interest rates in accordance with the coexisting condition of the macroeconomy of the country is important and essential towards understanding how actors interact with economic shocks. Therefore, this paper will look upon the condition of the Indonesian economy during and after the 2008 crisis while studying the reformed fiscal, banking, and macroeconomic policies. The changes are then studied on a case study basis to figure out the impact and effectiveness of the policies in aiding Indonesia during the 2008 crisis.

[2] Sharma, Shalendra D. "The Indonesian Financial Crisis: From Banking Crisis to Financial Sector Reforms, 1997-2000." *Indonesia* 71 (2001): 79.

## 1.2 Research Questions

According to the information given previously, Indonesia manages to record economic growth during the Global Financial Crisis 2008 even though other country went into recession. Therefore, this research suggests these research questions:

1. How has the Global Financial Crisis impacted Indonesia's economy in 2008-2009?
2. How did Indonesia’s experience aid the Indonesian government during the Global Financial Crisis 2008?

## 1.3 Research Objective

Following the research questions above, the objective of this research are:

1. To address the cause and effect of the Global Financial Crisis to Indonesia's economy growth, unemployment rate and trade activities.
2. To analyse the actions taken by the government and other involved parties, including the effectiveness of the fiscal policies implemented prior to the 2008 Global Financial Crisis.

## 1.4 Research significance

This research aims to provide further information for people who shared the same interest on how Indonesia overcame the Global Financial Crisis and how Indonesia manages the crisis with preventive actions and policies.

## 1.5 Structure of the Thesis

The first chapter of this research has put a brief explanation regarding the past and current state of Indonesia's history and development in political and economic reforms during foreign economic shocks which will be further elaborated in the next chapters.

The second chapter provides the underlying foundation of this research which will be presented in two parts: the literature review and the concepts. The literature review will provide a foundation for analysing the research questions which include the economic disequilibrium of Indonesia during the 2008 Global Financial Crisis and the effects of reformational policy towards the political economy of Indonesia after the 1998 Asian Financial Crisis. Along with that will be the explanation of neoliberalism and economic shocks.

The third chapter will determine the research methodology which includes an explanation of the research method, data collection technique, and data analysis technique of this research.

The fourth chapter will be the highlight of this research, the presentation of data collected, and analysis will be provided. Following that, chapter four is provides answers to the research questions with the supporting data.

The fifth chapter, as the last chapter, shall conclude this research with a data summary and analysis and highlight the results of the research.