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Indonesia on the Brink – Choices and Lessons
by Donald K. Emmerson

Jakarta, Indonesia – The farther this country's currency, the *rupiah*, plunges in value relative to the dollar, the more urgent becomes the question: Austerity or liquidity? Which policy is more likely to rescue Indonesia from its worst economic crisis in over thirty years?

Championed by the International Monetary Fund (IMF) and most economists, the case for austerity rests on the belief that crony capitalism has badly misallocated credit, crippling the ability of markets to "get prices right." Austerity's proponents want to cut public subsidies, dismantle nepotism and other privileges, and keep interest rates high. The pain of zero or negative growth in the short run, they argue, is needed to restore long-term confidence in the economy.

On 15 January in Jakarta, in the presence of IMF Managing Director Michel Camdessus, President Soeharto signed a letter pledging to implement such reforms. The next morning a local newspaper front-paged a shot of Camdessus standing with his arms crossed while Soeharto bent over to sign on the dotted line – visual proof of the Indonesian government bowing under foreign pressure to reform.

The IMF package would reward austerity now with liquidity later by making injections of funds from abroad conditional on domestic changes. But a few economists and quite a few Indonesian business people and politicians worry that the assiduous pursuit of austerity first could throttle an already gasping economy. Their feared scenario runs thus: The vanishing dollar value of Indonesia's currency, the *rupiah*, completely dries up credit. For lack of credit, firms slash output and payrolls. Downwardly spiraling supply and demand plunge the world's fourth largest country into a lengthy depression. The remedy to prevent such a calamity? Lower interest rates and more credit to stimulate production, along with increased public spending to revive demand.

Free-market logic and IMF money have driven the policy pendulum toward austerity. Flushing the system with money, it is plausibly said, would only lift inflation above the government's already high target of 20 percent for 1998. Liquidity would also reward profligate borrowers and imprudent lenders who deserve to suffer. Investors would shun the Jakarta Stock Exchange. Arbitragers would short the *rupiah*. The Indonesian economy would sink.

But the IMF and its local allies in the campaign for austerity are racing against time. The longer it will take for the economy finally to bottom out and bounce back, the greater will be the risk of unrest and protest. And that could propel the regime away from reform.

No one I have spoken to here anticipates an organized revolution from the bottom up. The opposition to Soeharto is still too fragmented and too conservative to rise up as one against his regime. But mounting disturbances could overwhelm the economic logic of austerity with the political need for security. Not even the IMF will object to a little laxity if it forestalls anarchy – more *rupiahs*, fewer riots.

Also, at some level of intensity, austerity wounds national pride. Relevant is the "love the *rupiah*" campaign recently launched by president's eldest and politically most savvy daughter, Mrs. Siti Hardijanti Rukmana known as "Tutut, whose extensive economic holdings, like those of her five siblings, are threatened by reform. Cabinet ministers, business executives, and well off Indonesians generally are being encouraged to exchange their dollars and sell their jewelry for *rupiahs*, as if that could restore lost value to the national currency. Economically meaningless, the "love the *rupiah*" movement is a political gambit by the partisans of liquidity to don the mantle of patriotic sacrifice and pride.

But if the front-page photo of the taskmaster Camdessus standing with crossed arms while Soeharto bent to the IMF's demands embarrassed many of the Indonesians who saw it, subsequent coverage of the "love the *rupiah*" movement has not fooled them into feeling proud. News stories that this magnate or that politician has converted, say, a thousand dollars into *rupiahs* merely raise mocking questions in the minds of ordinary Indonesians: Why so little? Why only now?

A further instance of economics and politics intersecting is the recent report that Soeharto may want Research and Technology Minister B.J. Habibie to become his vice president – and thus potentially his successor as president. From the standpoint of the IMF and the international markets, Habibie would be a disastrous choice. By signing on to the 15 January reforms, Soeharto agreed to stop subsidizing his minister's costly and unrealistic plans to build and sell passenger aircraft. That provision in the agreement, in effect, singled Habibie out as having contributed to Indonesia's woes. It is hard to think of a prospective successor to Soeharto who has been associated more with profligacy and less with austerity.

The plunging of the *rupiah* to record lows in the wake of rumors of Habibie's selection may have deflated his balloon. But if the president really does consider his big-budget minister a credible successor, the lessons for foreigners should be clear: First, do not underestimate the political power of economic nationalism in Indonesia. Second, expect conditions here to worsen before they improve.

Meanwhile millions of ordinary Indonesians are being pulled back down into poverty. And that underscores a third lesson for foreign policymakers: In this delicate and volatile situation, what you do not do may be as important as what you do. By all means help the economy recover. But try not to back Soeharto personally against the growing number of Indonesians in whose eyes he lacks credibility. And avoid fueling a nationalist backlash by insisting on economic austerities whatever their political cost. For if the destruction of the rupiah goes on much longer, injecting at least some liquidity into a financial system on the verge of shutting down will cease being a choice and become a necessity.

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On January 15, 1998, a major CSIS Project, the Enterprise for the Environment (E4E) released its final report entitled "The Environmental Protection System in Transition: Toward a More Desirable Future." This report is the culmination of a two-year project aimed at building a bipartisan agreement in improving the United States' environmental protection system. E4E developed policy recommendations in three areas: 1) transforming EPA's regulatory system; 2) increasing the use of economic and other incentives to encourage continuous environmental improvement; and 3) promoting higher levels of responsibility, accountability, commitment, and stewardship in the private sector.

The project is chaired by William D. Ruckelshaus, former EPA Administrator and its project director is by Dr. Karl Hausker of CSIS. Copies of the E4E report can be ordered by contacting:

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