Working Paper 2024.1.1.6
- Vol 1, No 1

CHÍNH SÁCH TÀI KHÓA VÀ TIỀN TỆ CỦA CHÍNH PHỦ INDONESIA TRONG CUỘC KHỦNG HOẢNG TÀI CHÍNH Ở INDONESIA VÀO CUỐI THẬP NIÊN 1990 VÀ BÀI HỌC KINH NGHIỆM CHO VIỆT NAM

Ngô Lê Mai[1], Nguyễn Thị Tố Như, Phạm Thị Thu Hà, Nguyễn Thùy Linh, Lương Thị Minh Huyền, Nguyễn Thúy Nga, Đoàn Thị Thúy Quỳnh

Sinh viên K60 CLC Kinh tế đối ngoại – Viện Kinh tế & Kinh doanh quốc tế

Trường Đại học Ngoại thương, Hà Nội, Việt Nam

Hoàng Hương Giang

Giảng viên Viện Kinh tế & Kinh doanh quốc tế

Trường Đại học Ngoại thương, Hà Nội, Việt Nam

Tóm tắt

Cuộc khủng hoảng tài chính xảy ra tại Indonesia vào cuối thập niên 1990 đã phơi bày một số quan điểm đáng chú ý liên quan đến chính sách tiền tệ và tài khóa. Do mô hình chuyển động vốn và áp lực lạm phát, một nền kinh tế nhỏ mở như Indonesia phải đối mặt với các khó khăn khác nhau. Mục tiêu chính của việc cải cách chính sách tài khóa là tái hiện vai trò của chính phủ. Ngoài ra, nó cũng là một công cụ để nâng cao hiệu suất và hiệu quả của các doanh nghiệp sở hữu nhà nước (SOEs). Bên cạnh việc cung cấp thông tin về cuộc khủng hoảng tài chính, bài nghiên cứu này chứng minh rằng một chiến thuật chính để quản lý hiệu quả tam giác chính sách tiền tệ và chính sách tài khóa trong môi trường hiện tại, không đoán trước được, là việc thực hiện phối hợp của một sự kết hợp các công cụ chính sách. Cuộc khủng hoảng tài chính của Indonesia trong giai đoạn 1997-1998 cũng mang đến cho chính phủ Việt Nam những bài học quý giá về quản lý kinh tế quốc gia.

Từ khóa: Khủng hoảng 1997-98, Chính sách của chính phủ, Khủng hoảng tài chính ở Indonesia

THE INDONESIAN GOVERNMENT FISCAL AND MONETARY POLICIES DURING THE FINANCIAL TURMOIL IN INDONESIA IN THE LATE 1990S AND LESSONS LEARNED FOR VIETNAM

Abstract

[1] Tác giả liên hệ, Email: k60.2112150105@ftu.edu.vn

The financial turmoil that occurred in Indonesia in the late 1990s has revealed some noticeable views with regard to monetary and fiscal policies. The various difficulties that monetary policy faces in a small open economy like Indonesia's due to capital movement patterns and inflationary pressure. A primary goal of the reform of fiscal policy is to reinterpret the role of government. Additionally, it serves as a tool to raise state-owned enterprises (SOEs) productively and efficiently. Beside giving information about the financial crisis, this research paper demonstrates that a key tactic for effectively managing the monetary policy and fiscal policy trilemma in the current, highly unpredictable environment is the coordinated implementation of a policy instrument mix. Indonesia's financial crisis in 1997-98 also brought the Vietnamese government valuable lessons on managing the national economy.

Keywords: 1997-98 crisis, government policy, Indonesia financial turmoil

1. Introduction

Indonesia has been seen as one of Southeast Asia's most prosperous, rapidly industrializing economies in recent years, having followed in the footsteps of the Asian tigers (Hong Kong, Singapore, South Korea, and Taiwan). Although Indonesia's economy expanded at an astonishing rate in the 1980s and 1990s, the country faced enormous difficulties during the 1997 financial crisis, which prompted important political reforms. Numerous gains were reversed by the 1997 financial crisis, which resulted in a drop in GDP, an increase in unemployment, a deterioration in earnings, and a sharp rise in prices. The quick decline into economic hardship exacerbated social tensions that were already there and led to a rise in crime.

Monetary policy in Indonesia was characterized by regime changes before the 1997–1998 financial crisis. It all began with the relatively conservative credit and interest rate control policies, capital flow management, and exchange rate during the 1970s. In the period of financial sector liberalization, monetary targeting was progressively introduced, while a more market mechanism-based approach to monetary management was used from the early 1980s to the first part of the 1990s. The Indonesian economy was experiencing a boom at this time, with plenty of inflows of foreign cash.

Regarding fiscal policy, prior to 1997, foreign financial assistance typically in the form of official, concessionary loans was always used to pay the budget deficit. Due to Indonesia's flexible, ineffective, and less progressive tax system like that of most emerging economies the attempts have had only patchy success.

2. Research methodology

This research paper explains the Indonesia Government fiscal and monetary policies during the financial turmoil in Indonesia in the late 1990s. It involved the information and data of the turmoil from a variety of reliable sources which were mainly about the Asian financial crisis in Indonesia in the late 1990s and the Indonesia growth dynamics. The team made enquiries about fiscal and monetary policies enforced by Indonesia government during that period in order to analyze and bring out valuable lessons for the Vietnamese government to learn from experience and suffer from negative financial situations.

3. Theoretical framework

3.1. Monetary policy

3.1.1. Definition of Monetary policy

Monetary policy is a set of tools that a nation's central bank has available to promote sustainable economic growth by controlling the overall supply of money that is available to the nation's banks, its consumers, and its business. Depending on the institutional structure, political system, and level of development of each nation, different central banks have various instruments at their disposal for implementing monetary policy.

3.1.2. Types of Monetary Policy

Depending on how much the economy is growing or stagnating, monetary policies are viewed as either **contractionary** or **expansionary**.

● A **contractionary policy** raises interest rates and limits the outstanding money supply in order to halt development and prevent inflation, which occurs when the prices of goods and services in an economy rise and the buying power of money decreases.

● An **expansionary policy** boosts economic activity during a downturn or a recession. Saving becomes less appealing when interest rates fall, while consumer spending and borrowing rise.

3.1.3. Monetary Policy tools

The instruments utilized in monetary policy differ among central banks and are contingent on factors such as the country's developmental stage, institutional structure, tradition, and political system.

Interest Rates

The central bank has the ability to impact interest rates through adjustments to the discount rate. The interest rate, also known as the base rate, represents the discount rate imposed by a central bank on banks for short-term loans. For instance, when the central bank raises the discount rate, it results in higher borrowing costs for banks. Consequently, the banks then raise the interest rates they apply to their customers. This leads to an overall increase in borrowing costs within the economy and a decrease in the money supply.

For central banks that directly target inflation, the adjustment of interest rates is a crucial element in the monetary transmission mechanism, ultimately influencing inflation rates. Alterations in the policy rates of central banks typically have an impact on the interest rates set by banks and other lenders for loans to businesses and households. This, in turn, affects private investment and consumption levels. Changes in interest rates also have repercussions on asset prices, such as stocks and housing, influencing households' consumption decisions through a wealth effect.

Open market operations

Through open market operations, a central bank has the ability to impact interest rates, the exchange rate, and/or the money supply within an economy. For instance, if central banks choose to buy government bonds, this action leads to banks acquiring more funds, subsequently boosting lending and expanding the money supply within the economy.

The manipulation of interest rates is achieved by either expanding or contracting the monetary base, which includes currency in circulation and banks' reserves held at the central bank. When a central bank engages in the purchase of securities, like government bonds or treasury bills, it effectively generates new money. In this process, the central bank swaps money for security, thereby increasing the monetary base while decreasing the supply of that specific security. Conversely, the sale of securities by the central bank diminishes the monetary base.

Open market operations commonly take two forms:

● Buying or selling securities directly.

● Temporarily lending money against collateral securities, known as "Reverse Operations" or "repurchase operations" (commonly referred to as the "repo" market). These operations occur regularly, with fixed maturity loans (such as one week and one month for the ECB) auctioned off.

Additionally, foreign exchange operations, including foreign exchange swaps, are part of the central bank's toolkit.

Exchange rate

To impact the money supply, certain central banks may mandate the conversion of some or all foreign exchange receipts, typically derived from exports, into the local currency. The rate used for purchasing the local currency can either be determined by market forces or set arbitrarily by the central bank. This strategy is commonly employed in countries with non-convertible or partially convertible currencies. The recipient of the local currency might have the freedom to utilize the funds as desired, be obligated to hold the funds with the central bank for a specified duration, or be permitted to use the funds with certain restrictions.

In implementing this approach, the central bank boosts the money supply by exchanging the foreign currency for the local currency through issuance. Subsequently, the central bank may decrease the money supply using various methods, such as selling bonds or intervening in foreign exchange markets.

Credit easing

Credit easing refers to a set of unconventional monetary policy measures employed by central banks to enhance the accessibility of credit and liquidity during periods of financial turmoil. This involves central banks acquiring assets like government bonds. The primary objective of credit easing is to augment the available resources for financial institutions during challenging economic conditions.

Collateral policy

Central banks commonly impose standards for the quality of assets held by financial institutions, serving as a restriction on the level of risk and leverage within the financial system. These standards can be direct, such as stipulating specific minimum credit ratings for certain assets, or indirect, involving the central bank providing loans only when collateral of a certain quality is pledged by counterparties.

Reserve Requirements

Reserve requirements play a pivotal role in determining the extent to which the banking system can generate money based on each unit of reserves. When reserve requirements are heightened, banks are mandated to maintain a larger portion of reserves, reducing the amount they can lend out for every deposited dollar. Consequently, an increase in reserve requirements elevates the reserve ratio, diminishes the money multiplier, and reduces the overall money supply. Conversely, a reduction in reserve requirements lowers the reserve ratio, enhances the money multiplier, and amplifies the money supply.

Central banks typically establish the minimum reserve requirements that commercial banks must maintain. Altering this mandated reserve amount provides the central bank with a means to impact the money supply within the economy. When the required reserve amount is raised by monetary authorities, commercial banks have less money at their disposal to lend to clients, resulting in a reduction in the money supply.

3.2. Fiscal policy

3.2.1. Concept of fiscal policy

The use of government spending and tax policies to alter economic conditions, particularly macroeconomic conditions, is referred to as fiscal policy. The effects of fiscal policy include total goods and services demand, employment, inflation, and economic growth. This policy is usually used as the government's tool to fix the economic recession and stabilize the economy.

3.2.2. Mechanism of fiscal policy

There are two main types of fiscal policies which are expansionary and contractionary ones. The increase of government’s spending along with lowering taxes is the expansionary policy, which is to bump money into the ciculation with the purpose of stimulating the ail economy. In reverse, contractionary policy includes tightening the government's budget and increasing taxes to cool down an overactive economy.

This can be explained through following function: **Y = C + I + G + NX**. In which, Y is output, or national income, C is consumption spending, I is investment spending, G is government spending, and NX is net exports. (Horton, M.)

In expansionary policy, consumers have greater disposable income when the government lowers taxes, which stimulates consumer spending. Increasing government spending has a similar impact. Thus, expansionary fiscal policy makes the populace wealthier and increases output, or national income. Expansionary fiscal policy is usually characterized by deficit spending, which occurs when government expenditures exceed receipts from taxes and other sources. In practice, deficit spending tends to result from a combination of tax cuts and higher spending. Vice versa, implementing contractionary policy through lowering government spending and raising taxes, which can be explained by the same mechanism, makes the population less wealthy. This type of policy is usually adopted to achieve the budget surplus.

4. Analysis of financial turmoil in Indonesia in the late 1990s

4.1. Summary the case

In 1997, the crisis in Indonesia began as a minor currency crisis after Thailand pegged its currency to the US dollar. At this time, Indonesia's monetary authorities have widened the fluctuation range of the exchange rate between Rupiah and US Dollar from 8% to 12%. Then, by August, the Rupiah was under attack by speculators and by the 14th the managed float was replaced by a full float as the economy suffered large capital outflow. Because of this, by January 1998, the rupiah depreciated from Rp 6,000 to Rp 15,000 per US dollar, experiencing a historic low (Historical rate tables). Overall, the rupiah depreciated 95% against the US dollar in 1997 and 73% in 1998, while inflation rose to 58% in 1997 and 20% in 1998 (Basri, M. Chatib, and Hal Hill, 2011).

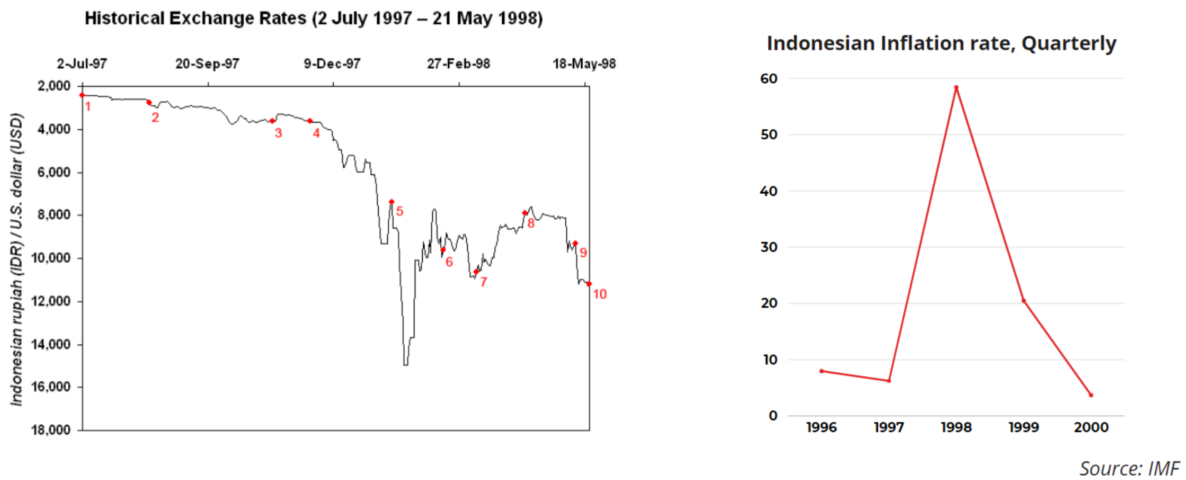


Figure 1: Historical Exchange Rates (2 July 1997 – 21 May 1998) and Indonesian Inflation rate, Quarterly

4.2. Causes of the financial turmoil

4.2.1. Regional recession and contagion effects

The late 1990s witnessed the emergence of the 1997 Asian financial crisis, a period of financial turmoil that had a widespread impact across East and Southeast Asia. It originated in Thailand in July 1997 and subsequently spread to other nations in the region, causing concerns about a global economic crisis triggered by financial contagion. The crisis was triggered by the collapse of the Thai baht following the decision of the Thai government to abandon its fixed exchange rate regime with the US dollar due to a shortage of foreign currency reserves.

4.2.2. The fragile banking system and the accumulation of non-performing loans

Prior to the financial crisis, a number of Indonesian banks were characterized as being in a highly distressed state. After the banking system was deregulated in the 1980s, the number of commercial banks quickly increased to about 237 by the middle of 1997, but seven state banks and ten private banks still had the lion's share of the market, accounting for 70% of all banking assets. The majority of these banks were small in size and relied on the inter-bank market to obtain funds, as they lacked a significant deposit base. However, in 1998, there were insufficient regulatory and supervisory mechanisms in place to go along with the financial sector's rapid liberalization, which released local banks from the constraints of loan ceilings and government credit allocation rules and encouraged quick lending for real estate development. As a result, banks started lending large sums of money to particular company groups while ignoring the lending restrictions that were in place for individual borrowers. The number of banks expanded quickly at the same time as non-performing loans, which were mostly held by the seven state-owned banks, also expanded quickly. Bad debts grew by an average of 32% between 1992 and 1997, reaching a total of almost US $4 billion by that year. Bank Indonesia provided financing to failing banks between August 1997 and early 1998 in an effort to keep them afloat. Regrettably, these actions appeared to make matters worse as capital flight took place, bank mismanagement intensified, and the severe devaluation of the rupiah raised the value of foreign debt in local currency.

Furthermore, Indonesia's central bank discovered that, due to the Suharto government's strict control over it, its activities were extremely political and that it was unable to implement laws intended to protect the public's health as both a lender and borrower. Because of this, Bank Indonesia hasn't been able to maintain the health of the nation's banks and grow into a competent overseer of national savings. They utterly failed to keep an eye on the growth in corporate debt and, as a result, were unaware that the currency would probably collapse when the rupiah was floated in August 1997. Many commercial banks are still struggling with bad debt in spite of Bank Indonesia's efforts to restrict bank real estate loans, raise capital adequacy ratios, and open the banking sector. This, coupled with the mounting corporate debt, left the country's financial situation in a state of disarray.

4.2.3. High level of external debt

Following economic-wide reforms, particularly in the banking sector in October 1988, Indonesia experienced a rapid increase in foreign debt. The private sector held over 60 percent of the foreign debt, with almost 90 percent originating from the non-banking private sector (Nasution, A., 2014). Leading up to 1997, numerous private Indonesian companies obtained short-term, unsecured loans denominated in US dollars from overseas sources. The majority of private sector foreign debt was characterized by its short-term nature and lack of collateral. The continuous depreciation of the Indonesian rupiah exacerbated the situation as Indonesian companies rushed to acquire dollars, exerting downward pressure on the rupiah and worsening the debt situation for these companies. Consequently, private sector debt was effectively transformed into public debt due to safeguards protecting domestic firms from bankruptcy proceedings and external takeovers.

4.3. Consequences of the financial turmoil

The crisis has caused serious macroeconomic effects, including currency devaluation and stock market collapse in Indonesia. Many businesses went bankrupt, leading to millions of people being pushed below the poverty line in 1997-1998. A long-term and serious effect is that GDP per capita measured in US Dollars at purchasing power parity decrease. Specifically, per capita income went down from 932.1 USD to 389.1 USD from 1997 to 1998 (World Development Indicators). Banks closed as depositors lined up to receive their savings. Devaluation of local currency is the direct cause of this phenomenon. In terms of politics, this financial turmoil also led to political instability with the departure of Suharto from the state apparatus. Islamist and separatist movements thrive in Indonesia as the country's central government weakens.

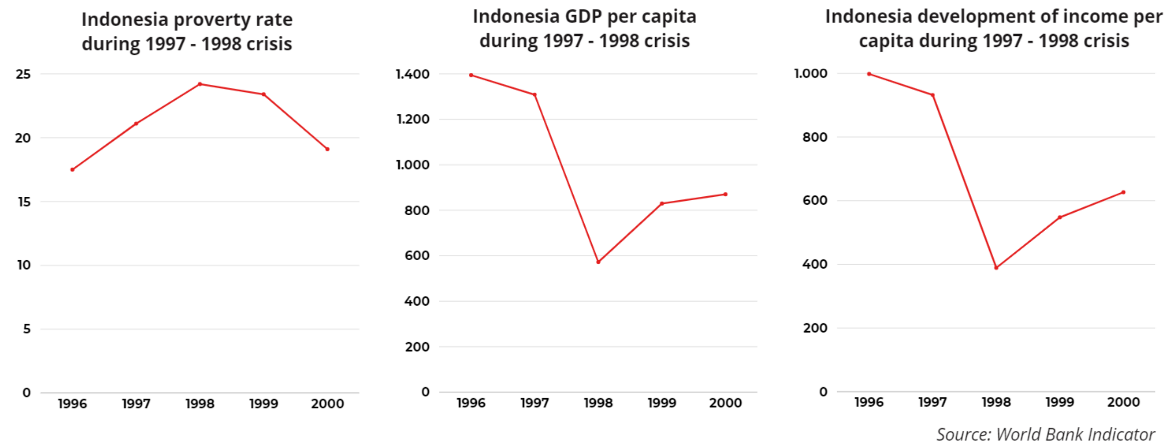


Figure 2: Indonesia poverty rate during 1997 – 1998 crisis, Indonesia GDP per capita during 1997 – 1998 crisis and Indonesia development of income per capita during

4.4. Government's policies to rescue the economy from turmoil

4.4.1. Monetary policies

Policies implementing in banking system

The substantial actual depreciation of the Indonesian rupiah in 1997–98, accompanied by a significant increase in interest rates and the reluctance of creditors to extend the maturity of loans, led to the liquidity problems, particularly the shortage in liquidity amongst the Indonesia banks. A deficit in market liquidity is reflected in the overnight interbank rates and SBI interest rates, which experienced a notable surge from 11% in early June to approximately 30% in August 1997.

In addressing the crisis, the Central Bank of Indonesia emphasized efforts to control economic liquidity using Open Market Operations (OPT). On October 16 1997, The Board Directors of Bank Indonesia decided to buy Money Market Securities (SBPU) in the form of repo sale from other banks in order to help resolving temporary liquidity problems in the banking system at that time. Furthermore, the Central Bank of Indonesia also established the use of special Money Market Securities (SBPU-K) as a financial support for the bank system with a term of 3 - 18 months in late 1997.

Furthermore, at that time, the Central Bank also provided liquidity assistance for the banking system with the help from International Monetary Funds (IMF) in the form of Letter of Intent (LOI) to assist banking liquidity difficulties. By the end of January 1998, liquidity support from the Central Bank of Indonesia exceeded 60 trillion rupiah.

However, the money used for liquidity assistance in the form of open market operation and financial aid from IMF and Bank Indonesia directly entered into circulation, adding to the incline of the money supply as people tended to make a withdrawal from the deposit of the bank. This situation directly led to the increase in the inflation and worsened the situation of weakening national currency in Indonesia. Furthermore, this policy also put Indonesia at risk of hyperinflation and also conflicted with the contractionary monetary policy that Indonesia was aiming at to control the interest and foreign exchange rate.

Rupiah intervention through foreign exchange market

To limit the growth of money in circulation, the Central bank also strictly controlled the minimum reserve requirements of the commercial banks. Commercial and state banks had to pay a fine for the violations of minimum statutory reserve requirements. Moreover, Bank Indonesia also lowered the statutory reserve requirement for foreign currency deposits from 5 percent to 3 percent which helped to increase the money supply of foreign currency in Indonesia, directly helping to stabilize the foreign exchange rate of rupiah.

Furthermore, Bank Indonesia Certificate (SBI) discount rate increased for all maturities from 20% in December 1997 to 70% in August 1998 which made the lending rate and borrowing rate in commercial banks also consequently increased, which can be seen as a method of reducing the amount of broad money in circulation. Indonesia also restricted the forward transaction between national banks and non-resident up to 5 million dollars in order to control the foreign exchange rate (rupiah/US dollars) in foreign exchange markets.

The contagion effects from Thailand financial crisis and the pre-existing weak economy had led to the shock of Indonesia rupiah, resulting in the worst effect of the value of rupiah felt by one fifth of its June 1997 value against the US dollar value.

With these continuous devaluation of the rupiah, the Indonesian government had to continuously extend massive liquidity to prevent the collapse of commercial banks. However, this led to the increase in inflation and carried with it a threat to hyperinflation. To prevent this, monetary extension has to be halted. The Indonesian government after realizing this threat had implemented "Rupiah intervention" as a means of monetary restraint and a fine tuning instrument to tackle the inflation. Monetary policy was predominantly aimed at supporting the exchange rate by setting high interest rates: "The exchange rate was the objective, and interest rates were the instrument".

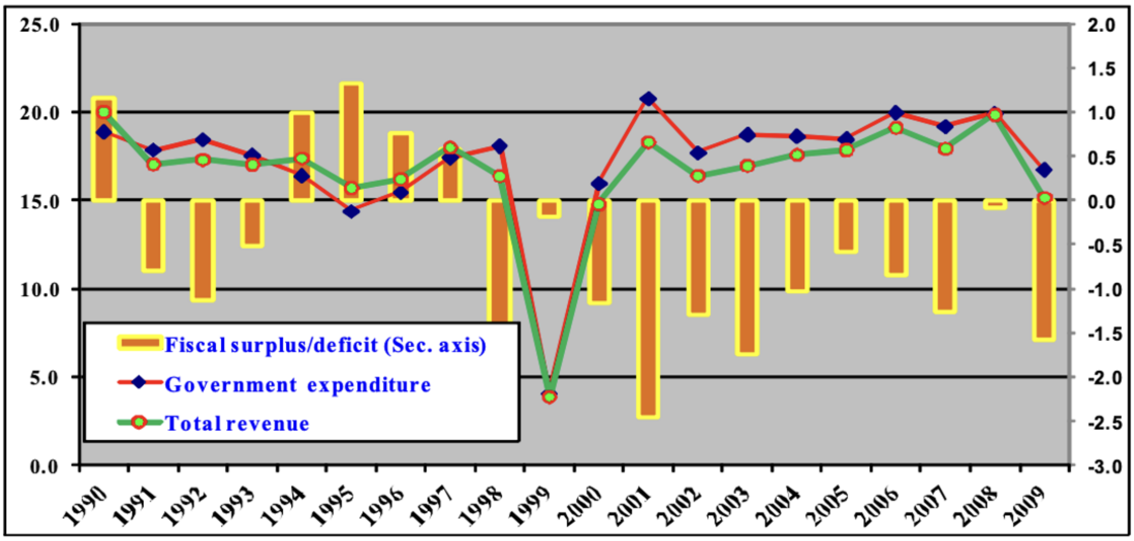
As mentioned above, the Bank Indonesia - The Central Bank of the Republic of Indonesia, increased the interest rate as an attempt to rescue the economy. Higher interest rates offer lenders in an economy a higher return relative to other countries. Therefore, higher interest rates attract foreign capital and cause the exchange rate - in terms of the US dollars (IDR/USD) to decrease. The decrease in IDR/USD together with the attempts to control the monetary expansion arising out of liquidity support originating in government expenditures simultaneously increased the supply of foreign exchange, thereby helping to stabilize the domestic currency.

Since the Indonesian government attempted to raise the foreign exchange supply in January 1998, the IDR/ USD exchange rate decreased from 15000 to 11000 in May 1998. It means that there was an appreciation in the Indonesian currency compared to USD, illustrating that the economy had shown the sign of stability again even though it could not reach the pre-crisis condition. The inflation rate dropped from around 46 per cent in 1988 to about 20 per cent in 1999.

4.4.2. Fiscal policies

Before crisis:

Before the crisis, the Indonesian government had been adopting contractionary fiscal policy consistently. This was the authority's effort to control the growth of consumer's credit through preserving budget surplus, controlling inflation rate and reducing excess demand. Despite these contractionary fiscal and monetary policies ahead of the crisis, the economy still enjoyed steady growth due to strong capital inflows, which led to an overall increase in domestic demand. These conservative policies had successful outcomes of 4 years of budget surplus (Figure 3) before the crisis and expansion of foreign exchange reserves. However, the maintenance of high interest rates as a result of tightened policy contributed to the build-up of excess foreign borrowing, which directly led to the turmoil (Charles, H., 1999).



Source: Government Finance Statistics, Bank Indonesia

Figure 3: Revenue and Expenditure Ratios and Fiscal Balance in Indonesia, 1990-2009 (Percentage of GDP)

During 1997-1999 crisis: Contractionary fiscal policy followed by expansionary fiscal policy

As mentioned above, at the onset of the crisis in June 1997, public debt was rising to 60% of the GDP, which caused a burden on money liquidity. To alleviate this, the IMF had supported the Indonesian government by providing loans to release stress on liquidity. However, this resulted in a reverse effect which exacerbated the problem by increasing money in circulation, leading to devaluation of Rupiah currency and higher inflation up to 80% in 1997-98.

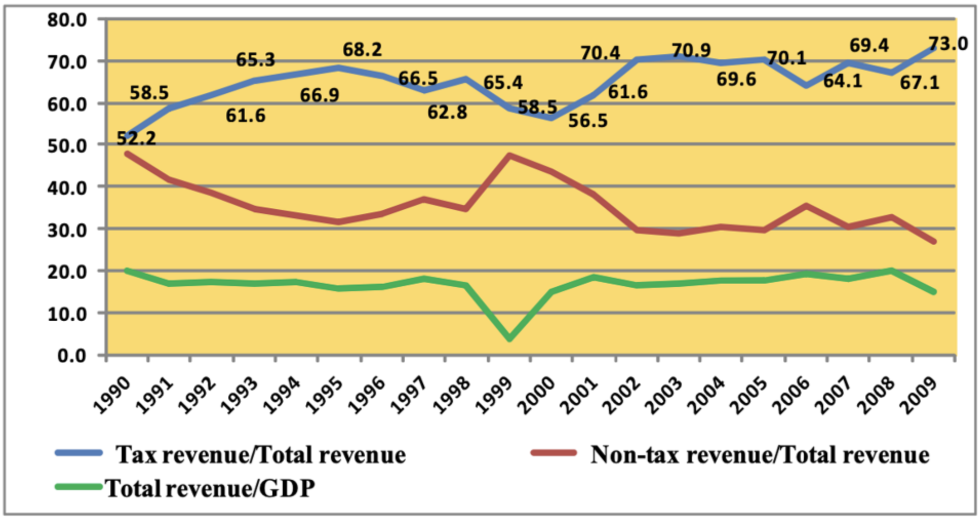
In this phase of the crisis, the revenue ratio was also incredibly low due to the drastic downturn in economic activity (Figure 4). This is because the depreciation of the exchange rate increased the cost of subsidies and debt service which increased government spending significantly; falling tax revenues; declining oil prices; and escalating bank restructuring costs. Meanwhile, funding from external sources was sporadic and inadequate (Charles, H., 1999).

Table 1: Indonesia’s Overall Budget Performance, 1990-2009

(Percentage of GDP)

Budget Aggregates	1990-96	1997-2000	2001-04	2005-08	2009
Government expenditure	17.0	13.9	18.9	19.4	16.7
Total revenue	17.2	13.3	17.3	18.7	15.1
Fiscal surplus/deficit	**0.3**	**-0.6**	**-1.6**	**-0.7**	**-1.6**
Real GDP growth rate (%)	7.3	-0.6	4.5	5.9	4.6
Interest payments	1.8	2.3	4.0	2.1	1.0
Primary surplus/deficit	**2.1**	**1.7**	**2.4**	**1.4**	**0.1**

Source: Government Finance Statistics, Bank Indonesia



Source: Government Finance Statistics, Bank Indonesia

Figure 4: Composition of Indonesia's Total Revenue, 1990-2009 (Percentage)

In the effort of preserving the budget deficit at the lowest level possible and controlling inflation rate through managing money supply, the government rationally tightened fiscal policy including tax reforms to gain more tax revenue, sharp cuts in current expenditure and the cancellation or scaling down of large investment projects. Moreover, this also meant the government quitting control over some problems. Specifically, the government had fulfilled its promise to reduce expenditure by limiting spending to 13,9% in 1997-2000 compared to 17% GDP prior to the crisis (Table 1), especially dropping to only 4% GDP in the first half of 1999 (Figure 3).

However, as the government cut off spending, several groups were negatively affected, especially those with low income and other vulnerable groups. Given the severity of the crisis and its disproportionate impact on the poor, there was an urgent need to strengthen the social safety net, to alleviate the impact of higher unemployment and underemployment and the greater incidence of poverty.

This has led the Indonesian government to adopt a more expansionary fiscal approach in the second half of 1998/1999 (Francis, S., 2012). Therefore, the budget deficit for fiscal year 1999/2000 was projected at nearly 6% of GDP which then came at only 1,2% in reality, with four main objectives that aimed to loosen the fiscal policy including a targeted fiscal stimulus to support demand, especially through higher development expenditure. Specifically, the government has provided food and other essential goods at subsidized prices and initiated labor-intensive public works projects to assist the poor. However, due to ineffective administration in the initial stages, these subsidies failed to reach the intended beneficiaries (Charles, H., 1999).

4.5. Effects of the government's policies

4.5.1. Positive effects

Monetary policy

With regards to monetary reform, the intervention of the government in this case has yielded positive results with the rupiah beginning to strengthen from mid-June 1998 (when it had dropped to 16,000 rupiah per dollar) to 8,000 rupiah per dollar in October 1998. The inflation rate experienced a significant decline, going from approximately 46 percent in 1988 to around 20 percent in 1999, additionally, government policy to increase the interest rate also attracted foreign capital and resulted in a higher IDR/ USD exchange rate, all of which increased investor confidence in the Indonesian economy. The rate of poverty has also decreased more or less continuously, with inflation (particularly for food) being the main determinant of short-term departures from this trend. By 2003, the share of the population living in poverty had decreased to pre-crisis levels in both urban and rural regions, which was consistent with the 1996 recovery of per capita income levels at that time. (Hal, H. and Takashi, S., 2007).

Fiscal policy

Following a series of actions by the Indonesian government to improve its fiscal structure, fiscal reform has allowed Indonesia to maintain a comparatively low budget deficit. Despite the criticism of the IMF's recommendations for Indonesia to apply tight fiscal policies during the AFC, in the long term these requirements have made Indonesia more fiscally cautious. Therefore, Indonesia's fiscal position was stronger entering the global financial crisis. The government debt-to-GDP ratio has steadily declined since 2000 because of the government's ability to keep the budget deficit at less than 3% of GDP (M. Chatib Basri).

4.5.2. Negative effects

Monetary policy

The banking sector, which was severely damaged by the Asian financial crisis, survived the crisis through the banking sector rescue program, but lending activity declined as a result of the stringent risk management efforts required in the reforms. In specific, the banking sector remained vulnerable since banks were reluctant to extend loans due to the large percentage of non-performing loans. Also, saving the banking sector was quite expensive at Rupiah 658 trillion (Sato, 2005). Moreover, the banking sector after reform had caused a sharp increase in government debt as this debt was primarily due to the issuance of bank restructuring bonds. The negative reaction to the implementation of the reform program was more pronounced when a reversal was announced to postpone big government projects.

Fiscal policy

The government's fiscal balance had a sharp turnaround, with a 1.2 percent GDP surplus in 1997 turning into a roughly 7 percent GDP deficit in 1998. This was a result of growing government expenses for aiding the impoverished, reviving the economy, reorganizing banks, and revenue-related shortcomings during the period of 1997-1998. After that, the number marginally improved in 1999 due to the execution of contractionary fiscal policy thereafter. (Charles, H., 1999).

5. Lessons learned from the Indonesia turmoil for Vietnamese government

5.1. Analysis of Vietnam's economic situation before and after the financial turmoil

During the financial crisis of 1997 - 1998, because Vietnam began to open up for integration, it was also affected to a certain extent. Economic growth decreased sharply throughout the crisis, in 1996 it reached 9.34%, in 1997 it decreased slightly to 8.15%, and in 1998 it only increased to 5.76% (World Development Indicators). Besides, the inflation rate increased sharply, reaching 9.2% in 1998 (General Statistics Office of Vietnam). Regarding USD price, in 1997 it increased by 14.2%, in 1998 it increased by 9.65% (World Development Indicators). Faced with the above situation, Vietnam has soon proposed appropriate fiscal and monetary policies to curb inflation, stabilize the macroeconomy, and achieve sustainable growth. As a result, in 2008, the growth rate of consumer prices tended to decrease, and inflation was gradually more controlled. Foreign direct investment increased sharply in both registered capital and realized capital.

5.2. Analysis of Vietnam's fiscal and monetary policies

5.2.1. Vietnam's fiscal policy

The same with Indonesia, Vietnam was not in a good position to manage an easy withdrawal from the financial crisis. Government adopting an expansionary policy to assist the nation through the Asian crisis put great pressure on the fragile economy.

The Vietnamese government then presented a stimulus package. The package includes tax breaks (Corporate Income Tax, Personal Income Tax, Value Added Tax, licenses and fee) in total of 25.4 trillion VND, additional expenditures such as interest subsidy, investment in infrastructure, etc value in total of 117.6 trillion VND.

Although the recovery of the Vietnam financial crisis could also result from other external factors, it is believed that the fiscal policy that the Vietnamese government adopted had worked and pulled the economy out of the recession. The obvious results could be seen as the interest subsidy helped reduce financial burden from borrowing of business and enabled them to continue production.

5.2.2. Vietnam's monetary policies

The 1997-1998 Asian financial crisis had a negative impact on the domestic economy, causing economic growth to slow down, a decline in import-export activities, a halt in foreign investment, and increased risks and challenges for the banking system. The capital weaknesses of the banking system became more severe due to the repercussions of the mentioned crisis. Although inflation decreased overall (3.6% in 1997, 9.2% in 1998, and 0.1% in 1999), there was high volatility.

The pressure led to a significant increase and continuous depreciation of the Vietnamese dong (VND). Real estate values plummeted and froze, leading to numerous commercial banks falling under special control and being merged into state-owned banks (17 out of 53 commercial banks had their names removed during this period).

In 1997, the National Assembly passed the Laws on the State Bank and Credit Institutions, laying the fundamental legal framework for the banking system to innovate its operations, aligning with market mechanisms and international integration.

To address the financial and currency crisis, the State Bank of Vietnam (SBV) implemented flexible and cautious monetary policies, contributing to minimizing the negative impacts of the 1997 Asian financial crisis. The SBV continued to improve the mechanism for managing monetary policies, especially interest rate management, issued regulations and safety measures to enhance the ability to prevent adverse fluctuations of credit institutions, applied increasing risk provisions, established the Deposit Insurance of Vietnam, separated policy credit from commercial credit, and established the Social Policy Bank.

The banking system also showed signs of instability and excessive debt. To address these challenges, the monetary policy aimed not only to control inflation but also to stabilize exchange rates and the currency market while securing the banking system. The State Bank utilized mandatory reserves as a tool to manage monetary policy during this period.

However, during that period, the State Bank and other policies were primarily focused on addressing immediate challenges, neglecting inflation rate because at that time inflation was very low due to low food, beverages, and oil prices. Therefore, this strategy proved to face difficulties when food prices rose and global oil prices became unpredictable starting in 2004. As a result, ineffective investment stimulation and money supply management contributed to a substantial increase in inflation (3.6% in 2003, 9.5% in 2004, and a significant 19.98% in 2008).

5.3. Lessons learned for Vietnam

Since the monetary and fiscal policies in Vietnam are not independent from each other, it is superficial to separate and assess the results of monetary and fiscal policy independently.

First of all, the lessons learned from previous crises apply now, the significance of robust fiscal policy in mitigating the decline in aggregate demand resulting from the economic recession. Experience also demonstrates that although it is not simple to design a stimulus package that is appropriate, timely, well-targeted, and financially sustainable, it has to be done. Basically, should Vietnam experience such a case of crisis, the sooner issues are detected or recognized and the sooner they are properly solved, the lower the associated costs and, thus, the higher the likelihood of success.

Secondly, it is important to strike the right balance between stimulus and stability. Stability and economic growth must coexist, and the government must find the correct balance between the two.

Thirdly, the Vietnamese government should consider banking liberalization together with strict supervision, legal protection and market discipline. The deregulation of the financial sector should be accompanied by improvements in bank supervision and in enforcement of rules and regulations. And, to reduce the burden of a recapitalization program, the non-viable banks should be liquidated immediately, and the viable ones should get a clear signal of support.

Lastly, exercise extreme caution while developing and putting into action a program that integrates banking reform with monetary policy. Although monetary policy has long-term effects, it deals with factors that have a short time lag. Choosing a tight or loose monetary policy is a matter for short-run but bank restructuring is a long-term issue.

6. Conclusion

Some important lessons about monetary policy have been highlighted by the difficulties faced following the financial crisis of 1997–1998. The various obstacles that capital flow patterns present to monetary policy in a small open economy like Indonesia, along with inflationary pressures, indicate that the monetary authorities should use a variety of tools. In order to make it more effective, monetary policy must go with fiscal policy. In Indonesia's late 1990s case, by means of several policy measures implemented by the government, which included the aforementioned improvements in fiscal and monetary policies, Indonesia managed to successfully traverse the financial crisis and enable an economic rebound that yielded several favorable consequences. However, the monetary policy that the Indonesian government implemented has also had negative effects over the positive effects it brought. This also gives Vietnam valuable lessons to learn and fix when it comes to our turn.

References

Abubakar, A., Utari G.A.D. & Chen, S. (2018), "Case study: Bank Indonesia Policy In Responding To The Crisis: Economic Liquidity Issue", *Bank Indonesia*, Available at: https://www.bi.go.id/id/publikasi/kajian/Documents/WP_15_2018.pdf

Basri, M. Chatib & Hal Hill (2011), "Indonesian Growth Dynamics.", *Asian Economic Policy Review,* Vol. 6 No. 1, pp.90-107.

Corporate Finance Institute. (2023), "Monetary policy", Available at: https://corporatefinanceinstitute.com/resources/economics/monetary-policy/

Charles, H. (1999), "Indonesia: recovery from economic and social collapse", *University of Wollongong*, *Working Paper Series 1999*, Available at: https://ro.uow.edu.au/commwkpapers/8/.

Chen, J. (n.d.), "Credit easing: What it means, how it works, Criticisms", *Investopedia*, Available at: https://www.investopedia.com/terms/c/credit-easing.

Djiwandono J. Soedradjad. (2001), "Asian Financial crises: Origins, implications and solutions", *International Monetary Fund*.

Djiwandono J. Soedradjad. (n.d.), "Chapter 8 Causes and Implications of the Asian Crisis: An Indonesian View", *IMF eLibrary*, Available at: https://www.elibrary.imf.org/display/book/9781451965476/ch008.xml

Ehnet. (n.d.), "The Economic History of Indonesia", Available at: https://eh.net/encyclopedia/the-economic-history-of-indonesia/

Francis, S. (2012), "Fiscal Policy Evolution and Distributional Implications: The Indonesian experience", Available at: https://www.networkideas.org/working/may2012/01_2012.pdf

General Statistics Office of Vietnam. (n.d.), Available at: https://www.gso.gov.vn/

George, F. & Ross H. M. (2002), "Banking Collapse and Restructuring in Indonesia, 1997-2001", *EliScholar. YPFS Resource Library*, Available at: https://elischolar.library.yale.edu/cgi/viewcontent.cgi?article=10648&context=yp fs-documents

Hakes, D.R. & Mankiw, N.G. (2011), "Study guide: Principles of economics, sixth edition, N. Greogry Mankiw. Mason", *OH: South-Western Cengage Learning*.

Hal, H. & Takashi, S. (2007), "Indonesia After the Asian Crisis", *Asian Economic Policy Review,* Vol. 2, Issue 1, pp. 123–141

IMF. (1998), "Indonesia—Memorandum of Economic and Financial Policies", Available at: https://www.imf.org/external/np/loi/011598.HTM?fbclid=IwAR1gvn4ijEsg0Jz82 cab7SrX7SB6tzKzLBxMBL1Vzaww1Z7SmqABW4A7ezE

Indonesia Investments. (n.d.), "Asian Financial Crisis in Indonesia", *Indonesia Investments*, Available at: https://www.indonesia-investments.com/culture/economy/asian-financial-crisis/item246

Investopedia. (n.d.), "Monetary policy meaning, types, and Tools", Available at: https://www.investopedia.com/terms/m/monetarypolicy.

Lucas, B. (2015), "Indonesian financial crisis (1997-1998)", *GSDRC*, Available at: https://gsdrc.org/publications/indonesian-financial-crisis-1997-1998

M. Chatib Basri. (n.d.), "Chapter 2: Twenty Years after the Asian Financial Crisis", *IMF eLibrary*, Available at: https://www.elibrary.imf.org/display/book/9781484337141/ch002.xml?fbclid=IwAR0QARBx0ZiYlxoe2W2Bu-LErrh3kegHZrRVVUkltTtbsrg-mm9q_fG_0K4#:~:text=The%20rupiah%20depreciated%20by%2095,a%20monetary%20target%20in%201998

Nasution, A. (2014), "The Meltdown of the Indonesian Economy: Causes, Responses and Lessons", *ASEAN Economic Bulletin*, Vol. 17 No. 2, pp. 148-162

Reserve Bank of Australia. (n.d.), "RDP 9805: The Origin of the Asian Financial Turmoil", Available at: https://www.rba.gov.au/publications/rdp/1998/1998-05/what-happened.html

Sato, Y. (2005), "Bank Restructuring And Financial Institution Reform In Indonesia", *The Developing Economies*, Vol. 43, pp.91-120.

World Bank. (n.d.), "World Development Indicators", Available at: https://databank.worldbank.org/source/world-development-indicators

Xe. (n.d.), "Historical rate tables", Available at: https://www.xe.com/currencytables/