

CHAPTER I

INTRODUCTION

The global economy is threatened with a deep recession as a consequence of the financial shaken that began with the housing price crisis in the United States. The financial implications of the global macroeconomic imbalances that have enabled the housing bubble to develop with the spread of toxic mortgage-backed securities first became apparent in September and October 2008 with the collapse of major investment banks and mortgage loan institutions, and the credit freeze and the panic that ensued in global equity markets. In general, financial institutions, particularly commercial banks and experience the most severe effects of the global downturn. A major deterioration in economic growth in world trade is likely to stall making it difficult for export-oriented economies in the region to continue rapid growth fueled by external demand. However, the Indonesian government has anticipated in many ways to reduce the worst effect of the crisis. So, what the solutions of the events and the effort of the Indonesian government

as the decision maker in the crisis.

A. Background

The crisis has gained the attention of the world in early 2008. The late governor of central bank of America, Alan Greenspan called financial crisis in 2008 as “*once-in-a-century credit tsunami*”, born of a collapse deep inside the United States housing sector. Instability has surged from sector to sector, first from housing into banking and other financial markets, and then to all parts of the real economy.

In 2008, the world was affected by the economic crisis which made weakened in the world economy. The trigger of the crisis this time is financial crisis which happened in the United States of America. This crisis happened because of the credit stagnancy in property sector which involved two big Investment Banking companies namely *Lehman Brothers* and *Merrill Lynch* which caused the value of stock in Wall Street stock exchange decreased. The consumerism behavior of American society and United State’s government made the world economics became imbalanced. The input of financial government of United State became more deficits. This deficit supported to the emerged inflation. On the other side, many corporations gave specialized loans for housing credits or “*subprime loans*” for the people who did not have strong guarantee to pay credits it self. They assumed that if credits or loans could not be paid, corporate will take and sell again that house credits. So, to pay this credit, corporations also borrow fund from the other parties. This loans mechanism were

Actually, that housing loans are include in long term credits (20 year).¹ So, it made mismatch or unbalanced credits in United State. Then it caused many corporations could not pay their debt to the loaners. Automatically, it caused corporations being bankruptcy. And it was initially referred to the credit crunch or "credit crisis". It means that the investors have lost their confidence to the value of security mortgages or it is called "*sub prime mortgage*" mechanism in the United States. Then it caused a liquidity crisis that prompted a substantial injection of capital into financial markets by the United States Federal Reserve, Bank of England and the European Central Bank.² On the other side, independent institution reporting should give objectively analyze about economics sector in United State that also manipulated to create positive sentiment toward America's housing. Unfortunately, it was not covered by the good economics safeguard. So, it raises the failure of credit payment from creditors. Because of this crisis, United State needed to implement systemic injection further emphasizing on the availability of the economic crises fixes only the financial crisis. There were also many states injecting their fund to the stock market in which to grow up their stock market.³

The United Sate is the first exporter country with the highest buying level and the first ranking in the world and as the centre of the world trade. There will be shown by economic index ranking of several states in the world it as follows.

¹Oetomo, Tjahjo: (2008) "*Krisis Finansial Global dan Dampaknya Terhadap Perekonomian dan Perbankan Indonesia*" Research Report, Seminars on Global Crisis 2008, Gajah Mada University. (October 24, 2008/08.00-11.30)

²http://www.Financial_crisis_of_2007-2009. (Accessed on: February 18, 2009//10:07 AM)

³Hamid, Suandi F. *Ekonomi Indonesia Menghadapi Krisis Finansial Dunia. Research Report, Seminars on*

Table. 1
Global Competitiveness index ranking

No	Economy	GCI 2005 Score /Rank	GCI 2006 Score/Rank	GCI 2007-2008 Score/Rank	GCI 2008-2009 Score/Rank
1	Australia	5.21/10	5.29/19	5.17/19	5.20/18
2	Canada	5.10/14	5.37/16	5.34/13	5.37/10
3	Chile	4.91/23	4.85/27	4.77/26	4.72/28
4	China	4.07/49	4.24/54	4.57/34	4.70/30
5	Indonesia	8.53/74	4.26/50	4.24/54	4.26/55
6	Singapore	5.48/6	5.63/5	5.45/7	5.53/5
7	Russia	3.53/75	4.08/62	4.19/58	4.31/51
8	Thailand	4.50/36	4.58/35	4.70/28	4.60/34
9	Peru	3.66/68	3.94/74	3.87/86	3.95/83
10	United States	5.81/2	5.61/6	5.67/1	5.74/1

Sources: Suandi Edy. *Ekonomi Indonesia Menghadapi Krisis Finansial Dunia*. (World Economic Forum from 131 economies). Research Report, Seminars on Global Crisis 2008, Gajah Mada University, On October, 24 2008

In this table inferred that the crises which happened in United State brought the domino impacts for the world economics including to the European countries such as French, Germany, England and Italy. As the example of domino impacts from crisis that the third party as the credit recovery (private financial institution) which has invested million dollars, they have to lose their fund. All association assets allocated in the United State economics movement stopped and it could not recycle for investment anymore. Then financial crisis in domestic state will

Financial crisis in early 2008, created the worst impact.⁴ For example, news of a sharp drop in the profits of the Citigroup banking led to a sharp fall on the New York Stock Exchange, a spectacular fall in share prices occurred in all major world markets, followed by a series of collapses. A number of American and European banks declared massive losses in their 2007 end of the year results. The countries in the Asia region began to worry to face financial crisis especially Indonesia in which the crisis gives impacts to the damage of funding market and foreign currency. Stock exchange rate has decreased from about 2.830 to 1.111 or it decreased more than 60 percent. Rupiah toward dollars has contraction from about 9.076 to 13.000.⁵

The decreased of rupiah toward dollars would influence to the prices unbalanced. Because, dollars is the tools trade product for basic investment, production's tools and electronics. So, the decreased of rupiah value made the decrease of demand export product such as Palm oil, textile and the others resources. Reasonably, with the decrease of American consumption, the demand level for product will reduce the demand value. The state with the high export volume in United State will be influenced by the decreasing of their export value. This financial crisis has also affected to the decrease of export and lack of income and then caused for the weakness of Rupiah rates. So, Indonesian's budget investment will lose because many of business economic sectors using dollars of the United States for transaction.⁶ The collapse of financial markets is being

⁴Ibid.,

⁵<http://www.google.com/custom?hl=en&safe=active&client=pub7434583833169252&channel=3242547252&...&FORID=12%2D&U=1&P=3&Q=Search%3DRI> ((Accessed on: February 11 2009/06:51 PM))

matched up by the decline of the real economy. The world appears headed for a period of inevitable economic stagnation/recession (a period of negative economic growth). This case will appear slow economic growth in the states with the primary export state is the United State. The impact of such a spiral on the United States would be substantial. As just noted, markets could suffer severe additional hits. Moreover, all of Asia would in essence be trying to export its way out of its current problems and most of those exports would be targeted at the United States. If the dollar remained at current levels, or strengthened further as a result of "*safe haven*" effects, Indonesian huge trade deficit would rise even further. Alternatively, a new round of currency depreciations in Indonesia could trigger a sharp run out of the dollar. Markets would at some early point recognize the adverse impact on Indonesia trade position, the instability of the deficits that would ensue. Since the United States is not immune to ultimate market sanctions for running huge external imbalances and the inevitable political backlash from the United States. A new dollar fall, in addition to further escalating the global spiral, could bring national current economic euphoria to a crashing halt, inflation concerns would soar, interest rates would follow them upward, and the financial markets would experience a very substantial "correction."

Automatically, this crisis will affect to the political sector such as the decrease popularity and image for the United State as the Super Power that is capable to regulate the economics world especially for Indonesia. It was not only security trade or the collapsed of companies have been affected, but the real sector

sharply decrease of Rupiah exchange rate, so export were not sale or conduct because there is not any consumer. But, it was also give the ambiguities for the other state in the world about financial crises which give impact to the unbalance of exchange rate and the ambiguities of Indonesian's Bank institution system. Suddenly, United State becomes poorly and they were not being able to buy products from Indonesia.

Correa (2008) said that what happen in the United State are not only financial crises but also it is the fact if one system has not been built seriously appropriate to the economics welfare and United State financial crises could not solve with only injection fund US\$700 million to the collapsed Banks.⁷ But, the important thing is the United State should make the fundamental changing in their system. The continuing of this crises condition shows that Indonesian's national economic has included to the Global system it self. Indonesia has developed financial market without putting on the real sector, with the limited economic Indonesian businessman can decide national economy with the role of foreign investor. It was also the limited role of government to influence in economic and only a little party which pro to the economic society. That situation make the state as like the state have rich of natural resources but poor in the human natural resources, so it will make Indonesia always depends on the other state and make Indonesian country poorer.

The impacts of this crisis for Indonesia, in trading and industry sectors were the falling value of the stock exchange rate in BEI (Indonesian's stock exchange).

Exporter should reschedule the sending of the package to USA because of the demanding of the importer in America. If this situation keeps continue, the company will fire some of the employees in order to save their companies. In farming sector, the falling value of palm fruit and rubber in farmer's level will increase the number of poor society in Indonesia. The Indonesian Government has the effort to reduce the impact of global economic crisis in Indonesia contain of recovery in the pair of scales and reserve investment which is all state firms or Corporation belongs to the state. And people have the obligation to put foreign currency in the domestic banks, add some investment and progress to the project activity, secure for some of bank's liquidities, secure of the investors believes toward security letters (Obligation Letters) and keep it balance in the market area, increasing export value, securitization for all of real sectors, securitization of national budget (APBN) in 2009, combating on violation or manipulation in the government bodies, increasing security on the product exploration and avoid for the non-political participant to overcome the crisis.⁸

Related to this case, the dependencies of the global system and less on involving of economic society in economic would raise problems for Indonesia. It could be seen from the Indonesian's geographically in which Indonesia called as "agriculture country". But the relations and the need to the highest import of foods and product commodity make some problem for the prosperity of Indonesian people. It means that with the economic development strategy that is not based on the society economic then it will create poverty, unemployment and destruction.

⁸ Sugiri, Syarief. *Global Crisis, Consensus and Development*. Research Report, Seminars on Global Crisis 2008, Gajah Mada University. (October, 24 2008/08.00-11.30)

Indonesia's economy has been stagnant looks to be headed into a new recession. There is little prospect of Indonesian recovery until its government launches a comprehensive restructuring of the financial system, including an infusion of substantial government capital to take the huge volume of bad loans off the books of the banks. Indonesia also must reverse its fiscal policy which means that the bad or good economics of the state is the description on how bad or good government which have significant function in the society. The cases were referred to this thesis attempted to explore the impact of the crisis on economic of the region. Experts assessed the impact of the crisis and significant developments employing a country by country analysis of those most affected or likely to be most affected. Criteria used for the country analyses included the prospects, possibilities and risks involved in maintaining domestic stability given the financial shocks placed on political systems across the region. The country analyses were followed by a discussion on congressional reactions to the crisis itself and the U.S. response, and suggestions for policy action.

Finally, we have watched with what being concern as it cascaded outwards from the sectors originally affected. What makes the recession in the United States must undergo adjustment to redress the imbalances of the bubble years. We have to know the crisis burst into the open after September 14th and the bankruptcy of Lehman Brothers, policy-makers acted swiftly and pragmatically to avoid the worst consequences a complete shutdown of the global inter-bank market, a rapid credit crunch, and its eventual consequence, the collapse of the global banking

political organization like a state make country as the product of economics fundamentalism.

B. Research Question

According to the explanation above, the research question is formulated as follows "What should Indonesia do to reduce the effects of the United State's financial crises in terms of policy?"

C. Purpose of the Research

This research aims to investigate what the anticipative ways from government of Indonesia toward financial crisis that effects to the Indonesian's economy. So, it will implement the ways that should be accommodate as the public policy to achieve real national economy.

D. Theoretical Framework

Hyman Minsky said that financial fragility is a typical feature of any capitalist economy. High fragility leads to a higher risk of a financial crisis. In this case, crisis is applied broadly to a variety of situations in which some financial institutions or assets suddenly lose a large part of their value.

This study would like to use derivative of foreign policy process which formed in analyses model in (*decision making theory*) taken from the neo-classical

theory by Stephen Waltz.⁸ The theory of threat in balance-of-threat theory perceived intentions.

“.....since it is individuals collectively termed as foreign policy elite, who determine how external threats are perceived, behavior of these domestic actors is necessarily subject to domestic processes, their identities and interests being shaped by intersubjectively shared culture, ideas and norms”.

Accordingly, if we want to achieve an accurate assessment of threats perceived by the elite, such an analysis has to look at the elite's social structure, within which these threat perceptions have been constructed. The balance of threat subsumes and refines the traditional balance-of-power theory in that it defines 'power' as something subjective, constructed in the minds of the policymakers.

The financial crisis in 2008 is neither surprising nor unexpected. Government institutions have warned the potential crisis in the annual prediction of Indonesian economy that report was presented in early January 2007, branded 2008 as *The Year of The Bubble* alerted the government of the negative consequences of allowing the financial bubble to inflate. The report noted that the probability of a recession in the United States was very high and rising owing to the structural weaknesses apparent in the American economy. The epicenter of the crisis in 2008 did not come from Indonesia. Unfortunately, the government did not heed these warnings as the top officials believed that Indonesia was not facing a threat of economic crisis. On the other side, Indonesian people such as (trader, businessman, and consumer) also economic experts have predicted that

⁸Waltz, Stephen. *The Origin of Alliances*. Ithaca and London: Cornell University Press, 1987.

Indonesian economy has serious problems in financial sector. For example economy expert like Sri Adiningsih from Universitas Gajah Mada said that

“Indonesia’s government could not anticipate the effect of the financial crisis from the United States, if this condition still keep continue then it will be disturbing Indonesian economic condition and also it condition will be worst than economic crisis in 1998”.⁹

When a shock hit the sector, the economy would be in turmoil. When the prediction that the financial bubble would be proved to be accurate, the government was immediately panicked and closed opened the Indonesian Stock Exchange. It means that the perception toward external factors (assumed as the threat for Indonesia’s national economy) has influenced why Indonesia’s government take reformation on the economic sector.

Indonesia is developing country with the highest level that depends on the development county. For example, the United States is the major market for Indonesian’s products export that 20% Indonesian’s products have exported to United State and 30% for Europe.¹⁰ It shown the relations that have created by countries, states always hope to get benefit for all sectors of their country. Whether in the future the state will get benefit with the others or no. So, the basic thinking of *neoliberal intuitionism* will use to as theory that there is any ‘*integration*’ in the form of international cooperation. That cooperation was learn about how did the functional activities in the certain boarder link like (trade and investment) would offering the long term cooperation for mutual benefit. Robert

⁹ http://analisis.vivanews.com/news/read/16139-law_helps_market_to_be_optimistic. (Accessed on: December, 12 2008. 11:09 PM)

Keohane and Joseph Nye (1970) said that the relations among western state have described as the *complex interdependence*.¹¹

“In reality, there are many relations among society as the addition of government political relationship and transnational relationship among business industries. This relations also as the kind of post modernization from *capitalist system* in which many industries sectors move to the physical and financial sectors. It is through the role of knowledge, information and communications”.

In this term “free market” as the key word of the economic relations among state in the global interdependence in which this free market is the basic thinking of any capitalist countries. Basically, states establish cooperation and peace international relations. Commonly, the capabilities of one state would measured by the economic activity. It is mean that when state have the strong economic working it conclude that state could control the world economic system. The decision making policy which will made economic strengthening.

Indonesian government have some instrument to influence macroeconomic activity as the anticipative ways to overcome the effects of crisis in 2008. In this ways, government have absolut power to control economic activity toward output composition, stability of cost, job vacancy and international trade. Mostly, government economic policies implemented industries sectors to the fiscal and financial sectors.

E. Hypotheses

To reduce the effects of financial crisis triggered in the United States, Indonesian government take some policies as follows,

¹¹ Robert Jackson and George Sorensen. *Pengantar Ilmu Hubungan Intenasional*. Pustaka Pelajar, Yogyakarta, Page 63-64

A. Fiscal Policy

The action to maintain the growth of national economic Indonesian government was using domestic economic through increased Small Middles Enterprises, farming and informal sector. Indonesian government has also give priority to maintain the growth of economy about 6 percent.

B. Monetary Policy

Indonesian government has declared some amendment of constitution as the basic of economic policy changing. Those constitutions contain of

1. Government regulation in lieu of acts (Perpu) number 2 of 2008 about Bank Indonesia,
2. Government regulation in lieu of acts (Perpu) number 3 of 2008 on the Lembaga Penjamin simpanan (LPS),
3. Government regulation in lieu of acts (Perpu) number 4 of 2008 on the Jaringan Pengaman Sistem Keuangan (JPSK)

F. Data Collection

The data contains from the internet that provides to accomplish the description of the matters, general discussion or seminars, newspapers, electronic journal, books references and using qualitative method.

G. Scope of the Research

In this writing, the writer will limit the scope of the discussion started from the beginning of financial crisis in the United States to the final agreement of the Indonesian's government to the economic policies changing in 2008-2009 (Susilo

H. System of Writing

The system of writing was meant to answer the research question and hypotheses that were explained, these would be as follows:

The first chapter, the writer will discuss about the introduction of the topic and elaborate the background of the problems, the research question, purpose of the research, theoretical framework, hypotheses, method of research, scope of the research and system of writing.

Chapter two will explain the general description of the United States' financial crisis. It is including the United States' financial crisis in 2008 and the domino impacts of the United States' financial crisis.

In the chapter three, the writer gives the explanations about the Indonesia's economic condition, the relations between Indonesia and United State so it would explore the reason on why its crisis in the United States brought the effects for Indonesia's economy, then the influence of the United States' financial crisis to the Indonesia's economic growth. And also elaborate the factors of the United States' financial crisis in 2008 and the specification impacts of the United States' financial crisis to Indonesia 2008.

In chapter four, the writer will explain the answer of the research question. It would consist of the effort from the Indonesia's government as the ways to reduce its financial crisis that has affected to the Indonesian's economy in 2008-2009.

Chapter five will be included in the Conclusion