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## The Meltdown of the Indonesian Economy: Causes, Responses and Lessons

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### **Abstract**

Three sets of factors came together to cause the economic meltdown in Indonesia in 1997: negative external shocks (financial contagion, adverse terms of trade), weak fundamentals (financially fragile banks, over-reliance on foreign loans by corporations), and incompetent management (overly-rigid exchange rate, inadequate prudential supervision). When the crisis unfolded, the government was paralysed by indecision over adoption of a currency board, reduction of large state-guaranteed investments, and implementation of economic deregulation. The IMF's insistence on abrupt bank closures accelerated the bank-run, and its insistence on abrupt fiscal tightening deepened the output collapse. Recovery to sustained growth will require recapitalization of banks, improved monitoring of the financial system, prudent regulation of capital inflows, external debt relief, greater flexibility in the exchange rate, comprehensive microeconomic deregulation, and better macroeconomic management.

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