Capital Flows and Indonesian Economic Crisis

An interesting observation of the current economic crisis among the Asian countries intrigues many economist to explore further to the possible variables causing the crisis. Articles, journals, and many opinions immerge and willingly to identify the condition, affect, and the relative cost of the economic turmoil in Asia.

Recent studies have shown that huge capital flight has occurred in Indonesia during the crisis and such behaviors are supported with the timing of domestic private debt disbursement. Such economic shocks obviously endorse speculators to attack the existing condition of the currency since they see the fragile condition of Indonesian international reserve. Central Banks intervention did not have any positive impact in any reaction towards the rapid depreciation of the rupiahs. Capital outflows provide rupiahs to the foreign exchange market and it is becoming the powerful weapon to attack the stability of the currency. Under the condition of rational expectation, speculators will be able to predict the expected depreciation and will match it with the central bank ability to make the currency stable. They use the central bank reaction as the buying moment and the increase for dollars demand will keep on and on until the capability of central bank intervene is no longer useful, such moment may become the sign to gain profit.

Asian countries, including Indonesia, suffer from the currency huge depreciation conundrum, are forced to adopt the semi-flexible exchange rate or known as the hybrid system. The IMF with their austerity policy tends to suggest the adoption of the managed floating exchange rate regime as
INTRODUCTION

1. Background

Asian countries, including Indonesia, suffer from chronic disease of huge depreciation. Many related complex problems of the financial systems create a tremendous effect on the economy and the development. The major problems of the crisis is the existence of hyperinflation to the country and layoffs of workers as a result of stagnation in Indonesia economy.

Another related problems would be the failure of financial intermediaries management that create another uncover problem to the crisis. Confidence of the people towards the financial systems is another uncovered problems, which deteriorates the currency condition further more. Fluctuation of rupiah and uncertainty obviously turn over the direction of the investor, to invest to the country. Under the floating exchange rate regime, investor must always hedge their investment to cover the risk of rupiah depreciation. Government policies to maintain the economic growth has been damaged by the recent crisis and vicious circle are unexpected to occur.

Recent data from World Development Indicators shows that a significant amount of capital outflows occur during the crisis and it implicates the negative condition in the investor perception. Foreign Direct Investment has become the key to growth of developing nations in the economic development perspective. Negative FDI implicates that people tend to invest abroad. Reduction of investment will not favor the economic activity of the country, and spontaneously will create unemployment to the country.

The paper will be about the condition of the FDI flows and another related capital flows to the country and its analysis as a cause of recent Indonesian economic crisis.

2. Statement of the problem

This paper will try to give solutions to the related problems:

1. What are the factors creating the recent huge capital outflows in the early days of the crisis?
2. What suggested policy should be done to face another same shocks to the economy?

BASIC PRINCIPLES AND THEORETICAL FOUNDATION

1. The Basis for International Financial Flows

The major variables of consideration for investor to decide upon investing in some assets, countries, or even sectors will be the expected rate of return or the perceived value of the future assets. Expected rate of return can vary in many kind of condition according to its constraint. Expected rate of return may well become the major influence of capital flows among the countries under the presumption of economic perspective. In some respect under special condition, people do not expect to gain return in the form of monetary values, however they expect to gain a qualitative approach such as health, productivity, or even pleasure. In this case, we only focus on the monetary reasons and judgments of people deciding to invest.

Since the real basis of the economic reason to invest is expected rate of return, we can withdraw the simple logic that the basis of capital flows from domestic to foreign countries or vice versa is the difference between expected rates of return from international assets to domestic assets.

The investor consider three elements when deciding to invest in the home country or in the foreign country: 1. The domestic interest rate or the expected rate of return. 2. The foreign interest rate or the expected rate of return. 3. Any expected changes in the exchange rate.

Equilibrium of the capital flows eventually occur whenever domestic assets give the same amount of expected return to the investor as is the foreign assets measured in domestic currency. Different currency expose exchange rate risk, therefore, expected appreciation (depreciation) must be accounted to manage the risk. Suppose we take Indonesia and Singapore as an example for assets options to Indonesian investor. Indonesian investor will perceive the Singaporean Bond indifferent towards domestic bond whenever he or she expect the same rate of return between the two assets.

We can draw a simple model as follows:

1. $1(1+i_1) = [(1+i_2)(1+i_3)(1+i_4)]\ldots$ Equation 1

To make the model easier to observed, we must simplify the equation as follows:

1. $1+i_1 = (1+i_2)[E(e)/e]$ Equation 2
2. $1+i_2 = E(e)/e$ Equation 3

Now the value of $E(e)/e$ is equal to $(1+\text{expected appreciation in the foreign currency over the period until the maturity day})$

1. $1+i_2 = (1+i_3) = 1+\text{expected appreciation in the foreign currency over the period until the maturity day})$

Equation 4

1. $1+i_3 = (1+i_4) - 1 = \text{expected appreciation in the foreign currency over the period until the maturity day})$

Equation 5

$\text{xa}$ is the expected appreciation of the foreign currency over the period until period of the maturity day.

This condition state that the equilibrium in the international financial market occurs whenever the expected appreciation of the foreign currency is exactly equal to the difference between the higher (lower) domestic return and the lower (higher) foreign return. This equilibrium condition is often approximated by
(I_1 - I_0) = xa \text{ Equation 6}

Since the investor bears all the risk of changes in the exchange rate, this equilibrium condition is referred to as uncovered interest parity. From the equation, we can obtain an interesting implication of the macroeconomic condition of the country. If the difference between domestic interest rate or expected rate of return and foreign interest rate or expected rate of return is higher than the expected appreciation of the foreign currency, investment in domestic are more attractive than those in the foreign country and capital should flow into the domestic country. If the difference of the interest rate or expected rate of return for domestic country and foreign country is lower than the expected currency appreciation, investment in the foreign country is more attractive than those in the domestic country and investment funds should be flowing to foreign country.

The important remark of the model is the expected appreciation of the currency becomes considerably determinant of the capital flows under the condition of uncovered interest parity

Other additional financial factor is needed by an investor to bear the risk of the change in the foreign exchange rate and such additional financial factor is often called the risk premium (RP). Risk premium is usually expressed in the form of percentage and the equilibrium level will be:

(I_1 - I_0) = xa - RP \text{ Equation 7}

Investor will consider the amount of the additional payment linked to the unanticipated condition of the development of the exchange rate.

2. Covered Interest Parity and Financial Market Equilibrium

Previous section holds an assumption whereby investor is readily enough bearing the risk of change in the foreign exchange rate. Any risk associated with changes in the exchange rate can of course be hedge in the forward market if the investor does not want to go uncovered.

In the forward market, we may have to recognize the terminology “premium” versus “discount” as we go proceed ahead. A currency is at a premium whenever forward rate, the domestic currency is stated in term of foreign currency units per unit of foreign currency, is higher than the spot rate. A currency is at discount whenever the forward rate is lower than the spot rate. Suppose we state the premium in the form of percentage, we can derive an equation as follows:

\[
P = \frac{e_{\text{fwd}} - e}{e}, \text{ Equation 8}
\]

or we may express it in the simple form as follows:

\[
P = \left(\frac{e_{\text{fwd}}}{e}\right) - 1, \text{ Equation 9}
\]

P is positive whenever the currency is at premium and negative as it is at discount. The link between the foreign exchange market and the financial markets can readily be seen by examining two types of the transactions that involve spot rate, forward rate, and interest rates. Let us take an example of Indonesian company signs a contract with US Company, say importing computer. The US Company does not want to receive the payment in rupiah and consequently the exchange rate risk is incurred to the importer. The importer can pursue many kinds of ways to hedge the exchange rate risk, by buying the foreign currency in the spot market now and investing the proceeds abroad until the delivery date, or by using one of the forward markets. We all are assuming that importers will choose the least expensive methods. The importer must compare the two distinctive methods, using the forward rate versus the current spot rate with an opportunity cost of associated with acquiring foreign currency now and investing it abroad with different interest rate abroad from what the money is earning at home.

If the financial market is working relatively well, in equilibrium the risk-averse importer should be indifferent between hedging by using short-term foreign investment and by using the forward market, and the risk-averse short-term investor should be indifferent between the domestic and the foreign investment. The link between the spot market, the forwards market, and the money market that produces this equality condition is achieved through covered interest arbitrage.

Such methods can also be used for either investor whenever they wish to invest in domestic or abroad. The forward rate is becoming an essential instrument to cover the risk of future exchange rate fluctuation and we can withdraw the equation as follows:

\[
(Rp) \left(1 + i_{\text{up}}\right) = (Rp) \left(1 + i_{\text{fwd}}\right) \text{ Equation 10}
\]

Note: \(e_{\text{fwd}}/e = P + 1\)

\[
\left(1 + i_{\text{up}}\right) / \left(1 + i_{\text{fwd}}\right) = (P + 1)
\]

\[
(i_{\text{up}} - i_{\text{fwd}}) / (1 + i_{\text{fwd}}) = P \text{ Equation 11}
\]

As it is in the equation 6, we will encounter another new equilibrium at:

\[
(i_{\text{up}} - i_{\text{fwd}}) = P \text{ Equation 12}
\]

Capital will tend to flow to the home country, under the assumption that the financial market is operating relatively well, whenever the difference of the interest rate between domestic and foreign country is greater than the premium and it goes vice versa to capital outflows.

The discussion to this point has assumed that the interest arbitrage activity does not incur any transaction cost. "No one gives anything for nothing and nothing is costless" what a nice expression to broad up the discussion, which in fact closer to the reality. Transaction cost will deter the initial equilibrium condition to another new equilibrium as follows:

\[
(i_{\text{up}} - i_{\text{fwd}}) = P + \text{transaction cost} \text{ Equation 13}
\]

In the previous assumption we ignore the role of politic in the capital market, however government by its major weapon of law, as the dream of Arthur of Camelot, or we may recall it as regulation can freeze any capital and it will obviously deter the equilibrium level and it is some way beyond the analysis.

Overview of Indonesian Crisis

1. Rupiah Depreciation

Stunning attack on the rupiah's value is remarkably unanticipated by the domestic macroeconomic policy since the fact that economic scissor are not so predictable. Tremendous amount of depreciation related in the early 1998 brought the society into a misery and an astonishing performance of the Indonesia economy is hardly to be expected. Lower growth, stagflation, high default, and many others related gloomy economy indicator is well express by any statistical data being brought up by many sources. Indonesia does not stand-alone to the impact of the crisis. Almost all Asian Economy must suffer to the cause of unprecedented storm. High Performances Asian Economies even cannot do any further of confronting the strong storm of enormous turbulence in the economy.

Signal of depreciation is in fact still to be in the process of inquiry, however, for the rupiah, the depreciation start in July 1997 when we still use the balanced budget policy and managed floating exchange rate. The
average rate of depreciation during the beginning year, around January to June 1997, is about 0.46% and rate of depreciation increases dramatically in July 1997 at the rate of 6%.1 Perceived expected depreciation of the speculative may deter and instigate an increase upon the demand for dollars. Such speculation behaviors kept continuing and depreciation of dollars became uncontrollable.

The predicted short-term disbursement of the domestic private debt by speculator and other economic variables encourage their profit-taking motive to buy dollars. Rapid depreciation was no longer being able to be anticipated at that moment. Central Bank intervention on the supply of dollars will be absorbed by speculators under the endorsement of their foresight.

Inflation during the 1997 had reached about 11.05% as a result of increasing money supply in the economy. The November 1997 turmoil of Indonesian financial intermediaries created a psychological fear to save, bank-run and rush was something to be encountered. Central bank acting as the lender of the last resort must provide money to the bank to return the saving deposits and their related policy is so known as BLBI. BLBI, or Liquidity aid of Bank Indonesia, increased the money supply of the economy and as all we can see, that monetary expansion will create depreciation of the exchange rate.

From the figure, we can observe that monetary expansion will increase the money supply in the economy so the LM curve shifts to the right (LM'), lowering the domestic interest rate. Low interest rate will give a signal to investor to invest more and we can say that it increases investment. Investment means more jobs is provided by the economy and it will absorb employment and people income will increase. An increase over income stimulates imports and deficit current account in the short run is the spontaneous consequent.

Another remarks of the resulting lower interest rate are capital inflows. Capital inflows are not possible to be avoided since the domestic interest rate is lower than the foreign interest rate. Capital inflows and deficit current account generate incipient deficit and depreciation occur. Such thing is describe by the shifting of the BP curve to BP'. Depreciation will endorse export and it shifts the IS curve to IS' and the expanding of export will stop until the three curves intersect in the same point.

It is easier to express the relation of the monetary expansion with the exchange rate through examining the Irving Fisher Equation as follows:

\[ \text{Ms} = k \text{ PY} \]  
**Equation 14**

Let us take an example of two countries and two monies with determined exchange rate between the two.

We will have two Irving Fisher equation and that is:

1. Country A: \( \text{Ms}_A = k_p \text{ Pa} \text{ Ya} \)
2. Country B: \( \text{Ms}_B = k_p \text{ Pb} \text{ Yb} \)

\[ \frac{\text{Ms}_A}{\text{Ms}_B} = \frac{k_p \text{ Pa} \text{ Ya}}{k_p \text{ Pb} \text{ Yb}} \]  
**Equation 15**

Note that Pa/Pb is exchange rate between country A currency and country B, let us use the symbol e to express it. So the equation will be:

\[ \frac{\text{Ms}_A}{\text{Ms}_B} = \frac{\text{Pa}}{\text{Pb}} \]  
**Equation 16**

An increase over the money supply of country A with another variables is fixed will increase the nominal exchange rate or in another word, we can say depreciation.

1. **Indonesian Capital Flows**

Mankiw in his book say reasonable remarks by putting that interest rate differential logical explanation does not always intrigue capital to flow since two related variable are not consider.

One reason is country risk. Investors have some consideration upon the condition of the country, such as political upheavals, disaster, and many other non-economic indicators. It is plausible to fear the investing in the LDC's since the political turmoil sometimes gets in the way and discourage investor. Country risk usually follows rumors, political change, and many kinds of changes in the country.

Second reason is expectation and Mankiw emphasizes on the expectation of future foreign exchange rate. The algebraic explanation is provided in the previous section.2

The theory describes a logical explanation why people do many things and how things are going, however, empirical studies are needed to observe the reality supported by the theory.

From the previous section, a subsequent explanation in economic term is provided to inquire the natural flow of capital and its related independent variables. However, Mankiw first remarks must be also accounted as one of the major influential variable in determining capital flows, especially to the case of Indonesian economy nowadays.

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**Table 1: Interest Rate Differential during 1994 to 1999**

<table>
<thead>
<tr>
<th>Year</th>
<th>LIBOR</th>
<th>SIBOR</th>
<th>US Prime</th>
<th>Jap Prime</th>
<th>domestic</th>
<th>d-L</th>
<th>d-S</th>
<th>d-US</th>
<th>d-Jap</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>4.89</td>
<td>4.91</td>
<td>7.24</td>
<td>2.95</td>
<td>14.79</td>
<td>9.9</td>
<td>9.88</td>
<td>7.55</td>
<td>11.84</td>
</tr>
<tr>
<td>1995/96</td>
<td>5.96</td>
<td>6.00</td>
<td>8.31</td>
<td>2.29</td>
<td>17.70</td>
<td>11.71</td>
<td>11.7</td>
<td>9.39</td>
<td>15.41</td>
</tr>
<tr>
<td>1996/97</td>
<td>5.52</td>
<td>5.52</td>
<td>8.27</td>
<td>1.63</td>
<td>17.61</td>
<td>12.09</td>
<td>12.09</td>
<td>9.34</td>
<td>15.98</td>
</tr>
<tr>
<td>1996/98</td>
<td>5.73</td>
<td>5.67</td>
<td>8.45</td>
<td>1.63</td>
<td>22.52</td>
<td>16.79</td>
<td>16.79</td>
<td>14.07</td>
<td>20.89</td>
</tr>
<tr>
<td>1998/99</td>
<td>5.52</td>
<td>5.51</td>
<td>8.31</td>
<td>1.56</td>
<td>43.93</td>
<td>38.41</td>
<td>38.42</td>
<td>35.62</td>
<td>42.35</td>
</tr>
<tr>
<td>Average</td>
<td>17.78</td>
<td>17.76</td>
<td>15.19</td>
<td>21.29</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>St. Dev</td>
<td>11.81</td>
<td>11.82</td>
<td>11.67</td>
<td>12.20</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This section will only discuss the interest rate differential and expectation of future foreign exchange rate as two major variables in instigating capital flows. Let us look back on our interest rate condition from 1994 to 1999.

Without any data on the actual depreciation or appreciation, we cannot withdraw any analysis on the related opportunity of capital flows. We will provide the data below:

Table 2: Rate of Depreciation of Rupiah and the Actual Exchange Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>Rp/US$</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>2219</td>
<td>0</td>
</tr>
<tr>
<td>1995/96</td>
<td>2338</td>
<td>5.36</td>
</tr>
<tr>
<td>1996/97</td>
<td>2419</td>
<td>3.46</td>
</tr>
<tr>
<td>1997/98</td>
<td>8325</td>
<td>244.15</td>
</tr>
<tr>
<td>1998/99</td>
<td>8685</td>
<td>4.32</td>
</tr>
</tbody>
</table>

Source: Indonesian Financial Statistics, January 2000

The theory says that equilibrium will occur whenever expected appreciation is equal to the interest rate difference of the two countries. Let us treat the interest rate difference as the steady values and we can treat them as the expected appreciation at equilibrium. The writer uses the interest rate differential of SIBOR and domestic interest rate as the basis of the assumption since SIBOR has significant impact to the Asian interest rate condition. Adjustment will be done on the fluctuation of foreign exchange rate and interest rate will be treated as determined variables. We cannot really know what economic agent predict about the fore coming of foreign exchange rate condition, so we will assume the interest rate difference as given and we can compare it with the actual depreciation. Expected appreciation equal to the difference of the interest rate of the two countries reflects that the investment on foreign assets and domestic assets will be indifferent.

During the mid-1997 large dollar demand starting to increase since domestic private firms must paid up their short-term debt. Interest differential is obviously lower than the pulling factor of expected foreign appreciation and country risk. Country risk was well responsible to the capital outflows since the real rate of foreign appreciation is lower than the interest rate differential in 1995/1997 and 1995/1996. Capital outflows during 1997/1998 is the dawn of the crisis as the tremendous supply of rupiah in the foreign exchange market was increasing and the demand remain the same, we can say that depreciation of rupiah was expected to happen more often. The supply of rupiah has become the major weapon of speculator to expand their movement and keep continuing attacking the rupiah condition. We can see clearly that 244.15% depreciation of rupiah really happens.

1. Foreign Direct Investment
Investment is the key to gain growth in every economy. Investment is an accelerator of the country's economy. Employment, as the consequence of investment, increases the income of the society and it will create growth simultaneously through multiplier effect.

The word "Foreign Direct Investment" becomes the major word in economic development strategies of less developed countries (LDC's). Attracting Foreign Direct Investment (FDI) is desirable to less developed countries in the form of Import Substitution Industrialization since the local firm cannot produce the same imported goods efficiently.

LDC's do need import substitution industry in the region, however, not all non-durable consumer's goods must be done by such strategies. Factors that need to be considered in determining the pace and reach of ISI include:

1. The size of the domestic market.
2. The size and skills of the existing pool of potential entrepreneurs who would operate the new enterprises.
3. The available skills of labor force and speed of migration of labor from agriculture to industry.
4. The availability of finance for the purchase of technology, needed physical capital, and other inputs, and for the needed training of managers and workers.

5. The potential for growth of demand over the future for the good and the learning by doing potential from production.
6. Possible linkage and spillover effect (positive externalities in production) that might accrue to other industries as the consequence of initiati

The LDC's purposes of saving foreign exchange and technological transfer through ISI policy are a daydream in the bright sunlight with a whispering breeze. Foreign exchange are still flowing to the developed countries because of unreliable domestic industrialization policy. Backwards linkage, say inputs for ISI, is not endorsed properly and dependence on foreign inputs still exists. Tremendous depreciation of the exchange rate and inelastic

![Diagram: The Impact of a Price Shock of an Imported Input in the Open Economy]
demand for foreign input made Indonesian Balance of Payment deficits even bigger. Depreciation will increase intermediates goods, which is inelastic. The impact of such price shock can be seen in figure 2 below. In the short run an increase in prices will depreciates the currency even more further and it will shift the aggregate demand to the right, AD to AD'. At the same time, production cost rises since the price of inputs also rises and the short run and long run aggregate supply will shifts to the right. The economy will face gloomy days by the existence of stagflation. It is picture of Indonesian condition during the crisis and we must go through with it. By seeing the economic activities are slowing down and growth is not so supportive to the investor will, investor turns their head over to another possible and nice environment. We can see through statistical data below that Indonesia is facing negative FDI. It implicates that many firms pull out their funds and invested abroad.

However, we must not be a pessimistic to our own capabilities. Indonesian market is large market for every economy in the world. The key to attract FDI is the attempt of creating a clear industrialization policy and an incentive that will make foreign firms to invest in Indonesia. But, to make it happen, the government must be responsible on the following factors: 

1. 질의 증가로 인한 대출: 수익성은 중장기의 대출과 연결되어야 한다. 
2. 자본 수출과 유출: 긴자본수출은 국가영향력과 경제안정을 저하시킬 수 있으며, 이런 현상은 긴자본수출이 관리되지 않으면서 발생하니, 이를 해결하기 위한 정책이 필요하다.
3. 기업의 고용: 수 nombreux의 고용은 경제의 안정성을 제공하며, 경제성장을 촉진한다.

Conclusions and Recommendations

1. Conclusions

Remarkable experience of Indonesian past we can no longer foresee during the days of the crisis. Stagflation haunted the clouds of Indonesian economy nowadays. Policy coordination and economic reform is needed to recover from such a tremendous shock in the economy. We have to learn from the past and may our mistake in the past become the lesson for the joy in the future.

The crisis teaches Indonesian economic agent to be more cautious on the demanding loan and investing it. The short-term debt disbursement is in a fact become the cause of shock to the economy and higher demand for dollars depreciates rupiah's spontaneously. Since all the domestic private debt denominated in dollars and almost none is hedge, it creates higher default and it does not give a nice signal to investor.

Capital outflows has become another uncover problem of the crisis. It major impact to Indonesian economy is known for a fact during the crisis. The interest rate differential is not the possible factor of the capital flows during the crisis. Indonesian country risk and expected foreign appreciation are leading factors causing the recent capital outflows before and after the deprecation.

Current FDI of Indonesia is negative and it implicates that people tends to invest abroad and domestic resident investment abroad is larger than foreign investment in the country. Major cause of the crisis is the adoption of ISI as development strategy without endorsing the backward linkage industrialization. In the absence of backwards linkage industrialization, ISI produces goods with very small domestic content and it is not so supportive to the foreign exchange saving and BOP problems. Increasing prices in the input market as a result of rupiah depreciation created gloomy condition of stagnation to the economy nowadays. Regulation and many kind of endorsement in backward linkage and human resources are substantial necessity to the FDI encouragement. Domestic resident assets must be stopped from flowing abroad by pressing the courage of desire to invest outside. Capital control to domestic resident assets in backward linkage will be the suggested policy to furnish the gloomy outlook of Indonesia.

2. Recommendation

Macroeconomic policy in the short-run will not favor the longer-term condition of the country. Appleyards express it in his book that the long-run aggregate supply is vertical. Long-run equilibrium can be standing still on the natural level income and natural level of employment.

However, we need to take action now to stop the heavy desperate condition of the economy. From the previous explanation, we can derive three uses of the recent economic crisis:

1. Unhedge debt in domesticated in the foreign currency.
2. Capital outflows.
3. High import costs.

The related macroeconomic policy must be taken carefully to the causes of the crisis. The first problem can only be solved by developing the inflows market and introducing them to the economic agent more. There must be a reformation in the financial intermediaries, management condition of Indonesia. Efficient banking system and non-banking financial intermediaries will make the money flows easier and velocity will increases. Money deposition will have smaller effect in the exchange rate with higher velocity than it is with lower velocity.

Capital outflows must be stopped under any circumstances of such action must only be done to domestic resident assets. Performance of the economy will be gloom under capital outflows and action of the government through the policy must be done to prevent any further damage to the economy.

For the last case, we need to solve it in long-run perspective. We need to build up a real affirmative industrialization in Indonesian development strategy. Applying ISI must in any cost continue as we need to catch up with the technological progress in developed country. Transfer of technology is the key to success. We need emphasize on the ability of endorsing the backward linkage industry and the demand input will not be in elastic anymore.
Footnote

2 Ibid 1 page 407
3 See Dennis Appleyard. International Economics page 409
4 The rate of depreciation is based on the Bank Indonesia; Indonesian Financial Statistics January 2000
6 See Theoretical Foundation

BIBLIOGRAPHY


Bank Indonesia; Statistik Ekonomi Keuangan Indonesia (Indonesian Financial Statistics); January 2000