

Opening Speech

by

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Ladies and Gentlemen.

I would like first to extend my gratitude to the chairmen of this Symposium and their staff for their efforts and dedication to arrange what promises to be a very constructive and enlightening meeting. My gratitude also goes to the three institutions which have organized the Symposium; namely the Institute for Economic and Social Research of the University of Indonesia, the Asian Club Foundation and the Institute for Developing Economics of Japan External Trade Organization (JETRO). I thank you all on behalf of the Government of Indonesia for sponsoring this meeting and for arranging distinguished speakers from the two countries to attend the sessions. I look forward very much to hearing my guests and colleagues speak and to participating in the discussion.

It is amazing for us to be reminded that as recently as only two years ago Indonesia was highly praised, not only by the multinational development banks, but also by the market as one of the region's high performing economies with a long proven track record in stable macro economic management, high investment and saving rates, human resource development, poverty reduction and market-based, outward-oriented resource allocation. It was unquestionably presumed that the Asian region would be the engine of global economic growth in the twenty-first century.

But what a difference the last two years have made. Indonesian gross domestic product is estimated to have contracted by 13.7% in 1998. While the Indonesian economy appears to be showing signs that the worst of the crisis may be over, it will continue to contract this year, although the outlook for the second half is better than for the first. We, the Indonesian Government, however, are absolutely determined to do whatever it takes to overcome this crisis and to put the Indonesian economy back on a track of sustainable balanced growth with equity into the new century.

In order to look to the future, one should begin by looking back at the causes of recent economic turbulence which we have experienced and the measures we have committed ourselves to implement to overcome our difficulties.

With the benefit of hindsight, it has been pointed out that there are four key macroeconomic factors which contributed to Indonesia's affliction from foreign contagion to economic collapse.

First, there was a rapid built-up of private external debt in the years preceding the crisis. This was mostly the result of stable macroeconomic management over the years that attracted foreign financing. The average maturity of the credit extended to Indonesia's private sector tended to be shorter and thus large stocks of short-term debt made Indonesian companies particularly vulnerable to changes in international sentiment. Companies could have protected themselves if they had hedged their foreign debts, but many chose not to do so. Many really did not think that the exchange rate could depreciate as rapidly as it did. Most of this short-term debt remained unhedged as it was perceived that there was an implied exchange rate guarantee due to the “crawling peg” exchange rate regime. Against this background, the way in which capital

flows were liberalised also contributed to the accumulation of short-term debt: banks and companies gained ready access to large amounts of short-term external borrowing, while longer-term capital flows were being liberalized more gradually and monitored more closely. Indonesia had thus become highly vulnerable to sudden shifts in investor sentiment.

Second, Indonesia's banking system went into the crisis with several well-recognised flaws. The implementation and monitoring of accounting and provisioning rules had not kept pace with the rapid growth of the banking sector and did not provide important early warning signals on the true financial health of the banks. Bank regulation was not adequately enforced. Numerous banks, not surprisingly, were seriously undercapitalised. So when the Rupiah begun to depreciate, banks were poorly positioned to absorb a further deterioration of their balance sheet. The deteriorating situation in the banking system eventually led external creditors to cut interbank lines and refuse confirmation of letters of credit drawn on Indonesian banks. Determined to stop the situation worsening further, the Government announced a guarantee covering all depositors and creditors of locally incorporated banks.

Third, the question of governance also contributed to the crisis. For example, the lack of transparency in the decision making process, an untested legal system, etc. None of these perceptions worked against Indonesia significantly before the crisis emerged, but they definitely started to have a negative influence on perceptions of how Indonesia would manage the crisis and whether it had the institutional capacity to respond quickly, fairly and effectively, leading to a crisis of confidence which has been the most damaging of all of Indonesia's crises because it delayed the return of the capital flow which Indonesia badly needs.

The fourth and final factor was the evolving political situation when the crisis hit Indonesia and, in particular, the issue of Presidential succession, on which I do not think I need to elaborate to you further.

To be sure, recovering from this difficult situation will be slow but this is the challenge of the next year and century for Indonesia and its partners. Much will depend on whether Indonesia can achieve the necessary political stability. And also it will depend on whether it will receive the necessary financial support from the international community. It is in this context that I would like to speak about the topic which I have been asked to address at the beginning of this Symposium, - The Possible Roles of Japan for Indonesian Economic Recovery.

Before moving to the subject, and to put the discussions that will subsequently take place into context, I would like briefly to review several of the most important measures the Government has been taking to cope with the crisis. These are to restore stability, to regain the confidence of international investors and to resume economic growth.

First, the immediate action we took in trying to curb the steep and unrelenting depreciation of our currency was to adjust monetary policy by sharply increasing interest rates and tightening Rupiah liquidity. This was harsh medicine for domestic companies but it did allow us to avoid hyperinflation, a very real danger in the earlier stages of the crisis. The inflation rate, which reached an annual rate of 78 percent at one stage last year, is now much lower at around an annual rate of 35-40 percent. We expect the inflation rate to be below 20 percent in 1999. The stance of monetary policy will be kept under close review and adjusted when necessary to accommodate developments in the exchange rate, inflation and the real economy.

Whilst maintaining macroeconomic stability through monetary policy, we also set out a strategy of reform programmes. Arguably our most fundamental reform initiative has been to take actions to strengthen our banking system. A healthy banking system is absolutely essential to our economic recovery.

As part of our programme to rehabilitate our banking system the Government initiated a due diligence study of all 208 banks in the country which included 10 foreign banks and 32 joint venture banks. Based on this study which was completed in January 1999, the Government is currently assessing which banks will benefit from the Authorities' support for their

recapitalisation in addition to the 12 banks whose recapitalisation has already been announced. The criteria set is that the Government will assist the banks with capital adequacy ratios of between less than 4 % and minus 25 % and it will provide 80 % of the funds needed to raise the banks' capital adequacy ratio levels to 4 %, the minimum level required by the central bank. The remaining 20% will have to be provided by shareholders. Following this plan, out of over 200 banks, 65 are scheduled to be recapitalized.

Probably the second most important step taken in our recovery plan is to facilitate external debt restructuring, both in the private and public sectors. As mentioned earlier, our financial crisis was precipitated largely because of the large offshore debt obligations which our private companies had entered into on an unhedged and mismatched basis. A resolution of this problem is essential to reversing the financial crisis.

Responsibility for achieving a lasting solution to each company's financial situation must reside with that company and its creditors. The Government will not assume the burden of the private sector's debt. However, recognising that the solution of this problem has widespread effects on the economy, the Government has been instrumental in creating framework within which restructuring can proceed.

On this basis, the Indonesian Debt Restructuring Agency, INDRA, was set up following the Frankfurt Agreement in June 1998. An additional framework called "The Jakarta Initiative" has been launched in September 1998 to complement the newly amended bankruptcy law and facilitate the restructuring process as well as the use of the INDRA scheme. The Jakarta Initiative is intended to spur the recovery of distressed companies by providing incentives to reach agreement through out-of-court negotiations with their creditors so that these companies might have access to working and new capital. To facilitate the corporate debt restructuring process under the Jakarta Initiative, the Government has promulgated several rules, such as Revaluation of Fixed Assets, Income Tax on Foreign Loans and Repurchase of Shares by Issuers and Public Companies. Some of these rules are revisions while others are new.

With regard to the Government debt, in order to alleviate its debt service burden, the Government has agreed with its official lenders on the reorganisation of certain installments of its debt.

Along with the aforementioned policy measures in two areas, the task of improving governance is equally critical. Bank and corporate debt restructuring, for example, will need to proceed honestly and transparently, according to the law and regulation. This is essential for the credibility of these actions.

Other areas where we need to improve governance are (i) developing a sound and effective competition policy and supporting it with a legal framework and

(ii) completing an ambition privatisation programme while taking measures to ensure transparency. We expect and hope that many Japanese companies will participate in the privatisation programme and that many strategic alliances could be formed for the next century in this way.

So far, I have mainly touched upon the economic side, but I should also briefly mention our important political agenda.

On January 28th 1999, the Indonesian parliament unanimously passed three election reform laws. Elections are scheduled to take place on 7th June of the year. The laws codify rules for a proportional-style election to Parliament and to the regional parliaments. Parliament's first task later this year in November will be to select the President. We hope this election will form a strong base on which we can build interdependence among Indonesians into the next century.

All these policy measures mentioned, both in economic and political agenda, shall be implemented steadfastly by the Government. We, the Indonesian Government, are determined to do whatever necessary to overcome this crisis and to pave the way to the next century. We have

designed a strong economic recovery programme. We have already taken decisive actions. We definitely commit ourselves to continue to take more action. Still, even with our rigorous and unswerving commitment, we will not be able to solve Indonesia's problems by ourselves. Until recently, approximately 70% of Indonesia's development expenditure was covered by Government revenue and the remaining 30% was covered by foreign aid. However, due to the increase in current account expenditure caused by increased foreign debt service payments in Rupiah terms, and the continuation of subsidies to mitigate the effect of the depreciated exchange rate on domestic prices, among others, for the first time in 30 years, the Government of Indonesia is unable to finance its routine expenditure entirely from its own resources, not to mention development expenditure.

The draft budget for the next fiscal year beginning in April 1999 projects that the deficit will be 4.8% of GDP. The budget has to be heavily reliant on foreign official aid flows which will be necessary to cover the difference between domestic revenue and overall spending. We need help from multinational donors, friendly governments and business partners, especially from the Japanese government and Japanese businesses.

We all know that the close economic ties with Japan have greatly contributed to the rapid economic development of Indonesia over the years.

Indonesia's largest export market has always been Japan which accounted for 23.4% of Indonesia's exports in 1997. Indonesia's largest source of import has also always been Japan which accounted for 19.8% of Indonesia's imports in 1997. Indonesia's largest source of foreign direct investment on an accumulated basis has been always Japan which accounted for 16% of total investment as of the end of 1998. Japan has always been by far the largest ODA donor country to Indonesia. Japan's ODA disbursement has been particularly important to Indonesia's social and economic development. We therefore knew that we could count on Japan when the crisis hit East Asia and, indeed, the Japanese Government was always at the front line of countries that have provided support.

In addition to the financial support already provided by Japanese public sources, the Japanese government recently announced that they are positively considering the extension of financial support to Indonesia under the framework of the "New Miyazawa Initiative" amounting to US\$2.4 billion. We very much appreciate the Japanese government's generous offer. It is also encouraging for us to know that the Japanese government states that this financial support package will be the first step in their effort in assisting Indonesia under the framework of the New Miyazawa Initiative and that they will look continuously into Indonesia's further financial needs and consider appropriate support. We definitely have further financial needs.

One aspect I would like to mention in this context is a sharp drop of Japanese banks' total exposure to Indonesia. According to the BIS's consolidated international banking statistics, the total outstanding exposure of Japanese banks to Indonesia fell from \$23.2 billion as of June 1997 to \$19.0 billion as of June 1998. This 12 months difference exactly represents "before crisis" and "after crisis". During the same period, combined figures of the banks in 17 industrial reporting countries dropped from \$58.7 billion to \$50.3 billion. Japanese banks' portion amounts to 49% of total drop. I should not blame Japanese banks. I know it reflects a legitimate response to the developments in Indonesia as they perceive them during the period. But, I sincerely hope that Japanese banks eventually would put Indonesia's situation into a longer-term perspective as they definitely did as recently as two years ago.

Another aspect I would like to mention before concluding is the future role of the Yen. One of the factors contributing to the Asian currency crisis has been said to be the excessive dependence of Asian economies' on the US dollar. Enhancing the international role of the Yen is particularly important at this juncture when Asian countries are moving away from a virtually dollar-linked exchange regime. The advent of the euro, which is generally believed to become an international key currency of comparable stature to the US dollar, also necessitates the Japanese government to promote the Yen's role as one of the international key currencies. It is also in our

interest that the Yen, the currency of the country with which Indonesia has such strong economic ties will be used further internationally in various fields as one of the key currencies.

Finally, in order to establish closer links between Indonesia and Japan and to create a favourable environment for the 21st century, we also need to concentrate on developing the social safety net and our education system.

We recently received food aid from Japan and we continue to need this kind of support. In the education field, the Japan's experience would help Indonesia. Cooperation between universities of our two countries and exchange programmes could allow Indonesia to be better prepared for the twenty-first century and contribute to the economic growth. I studied for many years in Japan and I hope that many Indonesian students could have more chances to benefit from and enjoy the same experience.

I look forward to listening to other speakers' insightful opinions which will surely contribute to strengthen our mutual understanding and ties between the two countries into the next century.

Thank you.