

INDONESIA'S FUTURE

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by

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It is a pleasure to be here today to talk with you about Indonesia's future.

Before moving into a discussion of where I think Indonesia is going, it is useful to look at where we have been and where we are today. I hope that you will forgive me if I go over some of the same ground as the speakers who have come before me. When most analysts think of the Indonesian economy, they mostly think of a country that has experienced a decline in real GDP of around 13% since 1997 and a nominal depreciation of the rupiah of approximately two-thirds. When they think of Indonesian society, they remember the messy overthrow of President Soeharto in May of 1998, the sad last days of East Timor as part of Indonesia, and the social and political unrest in various parts of the country. These memories paint a fairly bleak picture of Indonesia. Fortunately, they mischaracterize the true state of the country.

It is important to put these items into perspective. Some observers suggest that the economic crisis has set Indonesia back two decades or more in terms of economic development. This is not true. In real rupiah terms, GDP per capita has fallen back to the level attained in 1994, not 1984 or 1974. If we can sustain what should be a realistic real GDP growth rate of only 5% a year, by 2004 we will be back to where we were before the crisis. However although this is not the loss of a generation, it is a loss of seven years, which is a long time for people who have lost their jobs or their businesses. Fortunately, I believe that it is reasonable to expect that we will recover more quickly and that when we do recover to our old level of well-being, income will be more equitably distributed so that in a very real sense the nation will be better off than before the crisis.

Moreover, these figures hide the great strides that we have made over the past year and a half. The middle of 1998 was, by almost any measure, the worst point of the crisis. The rupiah had lost well over 80% of its pre-crisis value. The economy was in free fall. Our banking system was collapsing. Inflation was threatening to reach triple digits.

Despite these difficult conditions, we had already begun taking the steps that were needed to turn the economy around. The tight monetary policy that we had begun to adopt in March of 1998 and fully implemented by August began to significantly improve the macroeconomic situation. Monthly inflation, which had been 8.6% in July of 1998, became deflation in October of that year and has, but for seasonal price movements, stayed near zero ever since. GDP which collapsed in late 1997 and early 1998 began to grow by early 1999. Exports, which had initially benefited from the depreciation of the rupiah but which had collapsed after the violence of May of 1998, began to recover by mid-1999.

Where does Indonesia stand today? On most fronts, the picture is quite positive. This is particularly true with respect to the macro economy. Despite recent concerns over the delay in implementing our agreement with the IMF, the rupiah has generally been trading between Rp. 7000 and Rp. 7500 per dollar for well over a year now. Inflation over the past twelve months has been negative due to falling food prices. But even if one looks at a measure of core or non-food inflation, prices have been rising in the very low single digits over the past year or more. Exports have continued to recover through early 2000, with non-oil exports in January and February being remarkably strong. With imports still significantly depressed, the trade balance continues to improve putting upward pressure on the current account surplus. Interest rates have fallen significantly, though they are still some of the highest in the region.

What is then Indonesia's future? I am optimistic about our prospects but I am realistic enough to know that we will have to work hard in both the economic and social realms to make a newly prosperous Indonesia a reality.

The general consensus among economists is that Indonesia will grow by around four to five percent a year for the next few years. This will mostly be driven by domestic consumer spending augmented by slowly increasing exports. If this scenario comes to pass, as I indicated earlier, we would expect real incomes per capita to return to pre-crisis levels in rupiah terms by 2004.

Clearly I believe that Indonesia will recover from its current depression. My feeling in this regard was reinforced recently when the IMF released its latest World Economic Outlook. In that report, it estimated that Indonesia, Malaysia, the Philippines, and Thailand will grow by 4.0% in 2000 and 4.4% in 2001. This dramatic turn around from the minus 9.5% growth that the region experienced in 1998 is proof of the underlying strength of our economies and the fact that with a reasonable policy environment, recovery is possible. Moreover, the strong rebound of other economies in the region in 1999 gives us reason to be optimistic that external factors will be conducive to growth over the next few years.

Internally, this recovery and eventual growth will be sustained by our efforts to strengthen the foundations of our economy. Structural reforms are preceding in a number of areas to make our economy more efficient, market oriented and competitive. We in Indonesia recognize that it is not an easy process but we are determined and committed to the reforms that are now underway.

Important though they are, economic reforms can only succeed if there is political and social stability.

I believe that there are reasons to believe that this will happen, though I am quite mindful of the serious challenges that we face in this area. I am optimistic because we have been through this before and succeeded. In mid- to late-1998, few observers believed that the government of President Habibie could follow through on its pledge to quickly hold fair and democratic elections. Most observers predicted that widespread violence would erupt and that we might not even hold elections at all. Those observers were wrong. We were able to hold peaceful elections and elect a new President with only limited social unrest.

I will not try to mislead this audience. I am not saying that the process of recovery will be smooth and predictable. On the contrary, we recognize that the road will be bumpy, and that some of the reforms that need to be taken will be painful. But there is no other way but to go through it. Things will not happen simply because we wish them to happen.

To succeed we need strong political leadership and consensus among the political leaders.

On the economic front we face immediate challenges: to restore confidence and rebuild economic institutions that have been shattered during the crises.

We have to give priority to the reestablishment of law and order as this underpins all other measures. Then there is the whole set of difficult actions in the area of governance and institutional reforms. The most urgent among these are tackling the problems in the banking sector and corporate debts and improvements in judicial practices, without which investors' confidence will be slow to return and resources will be slow to move. We need to address the grievances of the regions and establish a workable arrangement for resource allocation and regional autonomy, based on fairness but also sound economic considerations. We also need to address the problems of budget and fiscal sustainability. Improved governance and institutional reforms thus support the recovery in an indirect but very crucial way. But they themselves can also be an important source of efficiency gain, thus contributing directly to the recovery process.

With the election of the new government in October of 1999, there was a new sense of optimism in Indonesia; a sense that anything was possible and that the well known social prob-

lems would be solved quickly. Clearly, we underestimated the breakdown in the confidence of the population in public institutions and the degree to which decades of pent up resentment would be expressed through violence throughout the country. Separatism in Aceh, widespread violence in Kalimantan, Ambon, Halmahera, and Lombok exposed the underlying threat to our national unity and the peace.

To resolve those highly sensitive problems we need a lot of patience and persistence but also finesse and negotiating skills. In our long history we have been through these difficulties arising out of regional dissatisfaction and religious intolerance. Although the social and political environment is much different now, they are not unsolvable problems.

I am also aware that many are concerned about our domestic politics. Seeing our new democracy unfold, I am reminded of the statement made by Winston Churchill that "It has been said that democracy is the worst form of government except all the others that have been tried." In a young democracy like ours, it is often easier to oppose than to lead.

After the downfall of the Soeharto Government, social unrest has continued to rear its ugly head. The reform movement has been seen as justification for some citizens to take the law into their own hands in other matters. We need to develop ways of channeling the dynamic forces of democracy into more productive directions. But this will take substantial institutional reforms, particularly in the area of democratization. This is a task that we are addressing in our current hearings on our constitution. One of our primary goals is to redefine our state institutions to give greater voice to the aspirations of the people and to ensure that the government is indeed the government of the people, responsible and accountable to the people through transparent and fair constitutional procedures. Only in this way can we be sure that the legitimate concerns of the people for justice will be channeled into actions that will strengthen the country and the rule of law.

While there are so many pressing problems demanding immediate actions, we should not lose sight of the longer-term perspective. No doubt we do want to get out of the crises as quickly as we possibly can. However we need to make sure that we will never again be in such a dire situation. From now on there must be greater emphasis on equity, justice, freedom from poverty, basic health and education for all, rules based institutions and fair play in business ethics, clean government, and the like and make them the paradigms of reform and development as we move forward.

Conclusion

I would like to conclude by emphasizing that with reasonable economic policies and a commitment to developing the new social and political institutions that will guarantee political transparency and social justice, we can create the basis for long-term growth. This is particularly true for Indonesia. The fundamental advantages that made Indonesia a magnet for foreign investment in the early- and mid-1990s still remain. We have a strong natural resource base. With recovery, we have a large and growing domestic market. With the implementation of AFTA, investors in Indonesia have preferred access to the other ASEAN economies. We have a large and trainable workforce and, after the devaluation, relatively low wages. The transition that the country is now passing through, I believe is creating an opportunity for the benefits of development to be shared more broadly which will build stronger support for economic policies that promote investment.

I will not stand here and say that investing in Indonesia is going to be easy. There are likely going to be many bumps on the road to recovery. But we have begun to take the steps that are needed and foresee gradual improvement in the economy over the near and long-term. For investors who can accept some volatility, investments in Indonesia should offer returns that more than compensate for the risks. You have an opportunity to join in the development of the new Indonesia and I hope that you will choose to do so.