

## KEY NOTE ADDRESS

By

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It is a pleasure and honor to be here this morning. I would like to thank the Organisation for Economic Cooperation and Development for inviting us to this meeting, and especially H.E. Angel Gurria, the Finance Minister of Mexico.

We are rapidly approaching “the second anniversary” of the economic crisis that began in July 1997. The economic and financial crisis brought to an abrupt end many years of rapid economic growth. With economic upheaval came declining real incomes, higher unemployment and rising poverty which have created social and political stress. The economy, as measured by real GDP, shrunk by 13,7% in 1998. High interest rates, damaged economic infrastructure, a battered banking sector out of control inflation 77,6% in 1998, acutely high debt servicing costs, plummeting assets prices and social and political instability all contributed to the depression. Despite the competitive exchange rate, exports have failed because of numerous obstacles, including trade financing problems and the discription to the country’s economic infrastructure. Meanwhile, imports have been depressed because of the currency depreciation and lackluster domestic demand.

The resulted larger trade surpluses have been offset somewhat by Indonesia’s large external debt servicing costs.

In response to this approved situation the government has moved quickly and desively on a number of fronts to lay the ground work for an economic recovery. We recognized from early on that there are essentially three requirements for an resumption of strong economic growth. Two of these have been largely met; the third awaits resolution.

*First*, the macroeconomic fundamentals must be reestablished. *Second*, an institutional framework that can support long term domestic growth in the global economic system is being put in to place. Clearly such an institutional transformation cannot be achieved overnight. And *third*, investor confidence, domestic and foreign, will only return once the political situation is clarified.

To establish that condition the has embarged, a board-based policy package, with the financial support of the international commity, in coordination with the IMF, the World Bank and the Asean Development Bank. The policy package included: (i) a tightening of monetary policy, with sharply higher interest rates and strict control over central bank net domestic assets; (ii) and adjusted fiscal framework that took into accounts the less favourable outlook for growth as well as expeditures to cushion the impact of the crisis on the poor; (iii) an actions programme for the restructuring of the banking system; (iv) and the restructuring of corporate debt, bank both external as well as domestic debt; and (v) a number of a far-reaching structural reform and adjustment programme to improve effeciency.

Let me touch briefly on the most solient elements of the economic recovery strategy.

Our first and immediate target was naturally the stability in prices and exchange rates, and we devoted our monetary policy and other economic policies to reach that goal. As regards the monetary policy, we said targets of monetary aggregates based upon a tight monetary policy and established strict discipline to meet the targets. We also stressed the importance of transparency to enhance public confidence, where by the targets as well as the actual numbers are announched on a weekly basis. Interest rate is decided by the market through weekly action. These together has apparently improve

confidence on our policy management as well on the determination of the Government to attain stability. We are consistently adhering to open capital account and full exchange rate system. We have just past law that ensure that it remains depolity whoever is the Government.

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We have also pasted a law determines the full autonomy of our central bank. The central bank is the only authority that set up monetary policy. The center of bank is restructured from providing credits including to the Government. The Government will have to find other source of financing, it is need funds for it's fiscal purposes.

Another the key in the macroeconomic policy to our stabilization and recovery program is to provide fiscal stimulus, to compensate for the contraction in the economy and allowing for social safety net program.

On social safety net the deepening of the crisis harshly affected the poor. To mitigate the social impact on the poor, the social safety net programme was designed through subsidies ensuring the availability of food and other basic need including education and health throughout the country. This brought about an overall fiscal deficit of 5.6% of GDP, of which Rp 17 trillion equivalent to 1.7% of GDP was spent on the social safety net programme.

We have learned along the way that implementing social safety program is not easy. There are complaints of inefficiency, ineffectiveness and lachages in the execution of the program. We have since, together with the World Bank, made improvements to the design of social safety net programmes. For example, the community fund programmes now include strengthened representation of civil society, greater availability of information about fund allocation, and tighter supervision.

Special measures are being taken to ensure that social safety net programmes are monitored carefully and budgetary resources safeguarded. The Government will improve its own monitoring system, work closely with a “control team” established with prominent members of civil society, and provide timely and accurate information to the public so the local communities are empowered to monitor safety net programmes.

The two most challenging problems to getting the economy back on its feet are bank and corporate debt restructuring. Although these are complex areas, there has been significant progress in recent weeks. The Indonesian government's bank recapitalization program is now underway.

A major step in our effort to rebuild our financial system was the creation of the Indonesian Bank Restructuring Agency (IBRA). IBRA has also taken on supervisory responsibility for troubled banks, equipped with an assets management unit. These efforts will further facilitate the restructuring of insolvent banks.

Government also issued blanket guarantees to all depositors and has assumed the obligation of meeting the cost of bank restructuring. Some 96 domestic banks have been found insolvent and their cumulative negative net worth is roughly US\$40 billion. About half of the total banking system loan portfolio is non-performing while many banks are maintaining liquidity, and meeting daily operating expenses, by offering deposit interest rates substantially in excess of what earn from money lent out. This is clearly an untenable long-term situation.

The bank restructuring plans consist of two broad elements. First, four state-banks, as well as part of a fifth will be merged into a single bank. The resulting state banks, all of which have to be recapitalized, will form part of the “core” elements of a new banking system. Second, those private sector banks that meet pre-established criteria will be recapitalized while those that fail to meet these same criteria will be closed. On March 13, 1999, the government announced a major bank restructuring and recapitalization program. Nine banks will be recapitalized and now join the 73 banks that do not require recapitalization because they meet, or exceed, a 4% Capital Adequacy Ratio (CAR) and other prudential standards. The government has taken over 11 banks and, in its latest move to strengthen the banking system, closed further thirty-eight banks. The basics of the recapitalisation programme are that the Government will inject approximately 80% of the funds required to bring the bank to a 4% capital ratio via Government bonds. Bank shareholders must inject the remaining 20%. Problem loans will be transferred

to IBRA Asset's Management Unit for workout. All existing shareholders will continue to own their shares in each bank, but these will dramatically diluted. At the same time, the Government will enter into a management contract with the existing bank management in which strict performance requirements will be monitored to protect the Government's investment.

The cost of recapitalizing the banking system will impose a substantial burden on the nation. The future sale of assets recovered from the banking system will help meet part of the recapitalization costs while the remaining costs will be financed through a blend of indexed bonds and conventional notes. Nevertheless, the cost of the bank recapitalization will create a substantial financial burden for years to come. For fiscal year 1999/2000 alone the interest cost of the bank recapitalization is estimated at US \$ 4.5 billion. But we know that there is now then course if we wish to strength the banking system.

The foreign ownership limit for private banks has been raised to 99%. This should encourage mergers and takeovers of viable but weak domestic banks and lead to the creation of a stronger and more internationally competitive banking sector.

Although establishing the credit worthiness of the banking system is a sine quo non for any resumption of lending to the real economy, issues of corporate governance is of interest importance. But corporate lending will only become possible after the corporate sector has effectively dealt with its debts. As is true of the other Asian economies in crisis, the Indonesian crisis is primarily a private debt crisis and its resolution will require substantial reductions in the debt overhang.

An important principle, to which the government strictly adheres, is that while it stands ready to help in any debt workout, it will not turn private debt into a sovereign responsibility. Corporate entities that freely took on debt must accept the current situation and seek a fair debt workout with their creditors. This can only be achieved if creditors are willing to negotiate a reasonable settlement and if debtors offer an honest appraisal of the value of assets and of revenue expectations. No debt settlement is possible unless there is a free exchange of information leading to a realistic assessment of corporate values. To assist in this process the government has passed a new bankruptcy law, established a more modern bankruptcy court, and created an agency, INDRA, the Indonesian Debt Restructuring Agency, that will guarantee the payment of restructured foreign debt if the debtor continues to repay the debt in local currency. This modality ensures that the government is not burdened with debt repayments for unproductive projects. To further assist in the debt workout, including of smaller firms that have less access to international resources, we have established the Jakarta Initiative. Restructuring is gaining momentum with recent announcements by a few large corporations that they expect to finalize debt restructuring programs with their creditors over the next few months. To accelerate movement on corporate debt rescheduling the Indonesian government recently announced measures to provide inducements to creditors and debtors to negotiate debt workouts in good faith.

Efforts are also underway to create a stronger sense of corporate responsibility. A new bankruptcy court is in operation.

In order to reduce the role of the state in directly productive activities, the role of the state enterprise sector is to be reduced. Through an external programme of privatization. This reflects not only a need to raise fiscal resources but recognition that government is poorly equipped to manage productive facilities. Even in 1998/99, the overall profitability of the state-owned enterprise sector has increased as results of effort to cut costs, strengthen efficiency, and promote restructuring. The legal limit on foreign ownership in state-owned enterprises has been effectively removed.

All the while, we are transforming our economic environment and cultural and institutions forward establishing a market economy.

We are pushing ahead with structural reforms, improving transparency, eliminating monopolies, establishing level playing fields, to assure the efficiency and competitiveness of our economy as well as the sustainability and equitability of our future growth. We are in the process of reforming our legal infrastructure to support good public and corporate governance.

The Government has made commitments to lower many tariffs and eliminate many of the remaining restrictions. Investment procedures in retail and wholesale activities have been simplified and

liberalized, and other reforms have shortened the list of activities closed to foreign investors. Interregional trade has been made less expensive through the elimination of restrictions on the shipping industry. And in production and trade, not only have many tariffs been lowered, but we have also reformed many markets that had been dominated by special relationships. Special national projects that once received not only protection but also preferential access to other resources and facilities now must compete on market principles. Monopolistic arrangements have been eliminated or reduced.

We have reduced or eliminated subsidies except those that are targeted for the poor to enhance competition and encourage domestic production and income of producers, especially farmers.

We have now a new era competition based on the modern concept, learning from experience of other countries. We have a new law on consumers protection. On governance, the parliament has just passed a tough law against corruption, collusion, and nepotism. Requiring government officials to declare their wealth and establishing an independence investigation committee.

We have earlier passed amendments to the banking legislation, that allow 99% foreign participation in national banking. The new law on the central bank, will make the central bank as mentioned earlier free from government interference. A strong supervisory body will be established to ensure that our prudential regulations are enforced and our regulations will reflect international banking standards. Taken together, these reforms that are either enacted or are still being developed represent the commitment to the establishment and protection of an economy that is solidly built on fairness, transparency and market principles that the rules that structure the economy will be more transparent than those of the past.