

The Transformation of Indonesia

Remarks by

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On behalf of the Indonesian delegation let me express my appreciation to all of the representatives of the governments and international organizations participating in this, the eighth meeting of the Consultative Group for Indonesia. Your support over the past years, and particularly, over the past two years has been critical in the changes that have occurred in Indonesia. We look forward to hearing your views on what we have accomplished and what is left to be done as we continue to seek to move beyond the financial crisis to a new era of steady economic and social growth.

Let me also express my particular appreciation to the Chairman and the staff of the World Bank for their insightful paper summarizing the state of the Indonesian economy and their view of the challenges that lay ahead. As always, it provides a useful foundation for our discussions during this meeting.

When we met last time, exactly one year ago here in Paris, Indonesia was close to despair. The exchange rate of the rupiah had just touched the 17,000 per US\$ level, and stood at a fragile 13,700 per US\$, interest rates had skyrocketed to over 70 percent, inflation was over 50 percent and rising, the real economy was rapidly sliding in a deep recession, and a decade of poverty reduction was at risk. The country had just gone through an extremely difficult political transition, and investor confidence at home and abroad was shaken by riots and political uncertainty.

Today, Indonesia is on the road to recovery. The Rupiah has stabilized at the level of between 6,500 to 7,000 per US\$, inflation is rapidly declining and is likely to stay in single digits this year. Interest rates are now below 15 percent, and the real economy has started growing again. While unemployment is still a big problem, survey result indicates that some of the poor now have more to live on than only 6 months ago. These signs of renewed economic activity have encouraged the government to revise its economic projections for 1999. We expect end-of-period inflation to fall to about 5 percent by the end of year and for real GDP to grow by 1.5 to 2.5 percent. But perhaps for some observers the most striking achievements of Indonesia has been a political one; we finished counting the votes of parliamentary elections, and defied the expectations of violence and chaos. Instead, the elections proved to be a beacon of democracy, and one which sparked renewed confidence in our country.

Your support during the past difficult year has been invaluable. Your advice and financial support enabled us to do the right thing. It enabled us to implement the strict monetary policy that brought down inflation. It helped us to implement programs that mitigated the consequences of the crisis for the poor, kept their children in school, and ensured them essential health care. It allowed us to embark on a bank restructuring strategy that will give Indonesia a healthy banking system. And your support facilitated free and fair elections throughout the country.

To honor all of those that helped Indonesia through the crisis, let me just briefly elaborate on some of our efforts and accomplishments of the past year. We have passed a law to make the central bank more independent, and focused on the task of price stability. We have passed a law on

competition to improve the efficiency and competitiveness of our economy. We have passed new administrative and fiscal decentralization laws to enhance regional equity and participation, and an anti-corruption law to ingrain good governance in society. We have designed and implemented innovative social safety net programs such as the “stay in school” grants to prevent a lost generation lacking proper education from emerging. We have channeled rice to the very poor at times when rising food prices threatened to starve them.

I would like to go into a little more detail on the important area of bank and corporate debt restructuring. Earlier this year the government issued Rp 103 trillion in bonds to recapitalize private banks, including banks taken over by the government. An additional Rp 245 trillion in government bonds will be issued to recapitalize state banks. The government has also publicized the name of 1,600 delinquent borrowers and many of these debtors have signed letters of commitment providing for full disclosure, cooperation with auditors, deadlines for restructuring, and willingness to accept strategic investors or management changes.

The key strategy aims at giving priority to the largest borrowers on a uniform and transparent basis to maximize the returns to government. All state and taken over banks have adopted a phased approach, starting intensively with their 20 largest borrowers or the 200 largest in the case of IBRA, and moving sequentially to the next largest group of borrowers every 2-3 months. In this way, it is expected that restructuring negotiations will be underway with at least the 80 largest borrowers of each bank, and about 380 obligors of IBRA, by the end of this calendar year, with the target of completing at least 70 percent of these negotiations by the end of the fiscal year.

As critical as is the restructuring and recapitalization of the banking sector, growth will only return when the corporate sector is again able to prosper. This will require the restructuring of the debt of thousands of companies. The government has taken two steps in this regard. The first step was the establishment of the Indonesian Debt Restructuring Agency or INDRA. Through INDRA, debtors and their creditors who restructure foreign debt can obtain guaranteed access to foreign exchange at a fixed exchange rate.

The second step in our efforts to encourage the restructuring of private debt was the formation of the Jakarta Initiative. This program provides world-class technical assistance to Indonesian companies seeking to restructure their debt. To date, restructuring agreements between over 230 private debtors and their creditors involving over US\$20 billion in debt are being sought under the Jakarta Initiative. More importantly, through the program, more than 20 debtors have already restructured around US\$3 billion in debt obligations.

In addition to these new agencies, the government has also engaged in legal reforms to encourage debt restructuring. This has included the establishment of a special commercial court to resolve bankruptcy cases based on the new bankruptcy law, thus increasing the legal certainty provided to both debtors and creditors.

These are some of the more important programs that we have already implemented. Looking over the next twelve months, our program is to strengthen the key reforms that we have already put in place. IBRA will actively pursue collections on its portfolio of loans while selling off those assets that can be sold to the public. The Jakarta Initiative is now fully staffed and will press hard to assist the corporate sector in restructuring its debt. We will be actively privatizing public enterprises that are ready to be privatized while preparing other public enterprises for privatization. The remaining state banks will be recapitalized and restructured to function efficiently. We will take steps to improve the operation of our tax code to ensure that it operates fairly and efficiently. We will continue to eliminate unnecessary barriers to trade and commerce. In all of these areas, and in pursuing structural reforms in general we will continue to work closely with the IMF, the World Bank and the Asian Development Bank, and all other interested parties, both foreign and domestic.

Although the economic outlook has improved greatly, the recovery is still fragile and many difficulties lie ahead.

This is indeed no time for complacency, and our achievements should not block our view on the challenges ahead. Indonesia's return to the pre-crisis days of high growth and accelerated poverty reduction is still far from assured. The economy has stabilized, but that stability is still very fragile. Poverty is still severe, and many Indonesians continue to need protection from destitution. One area of deep concern is export performance. Despite the improvement in sentiment in financial markets, Indonesia recorded its worst non-oil export performance in over fifteen years during the past few months. We need to take effective steps to eliminate barriers and improve our export performance. Among others, we have established with help from the Japan Exim Bank a new institution dedicated to support export financing, the Bank Export Indonesia. The fiscal consequences of the crisis—notably of the bank restructuring, and the increased spending needs of the crisis—will be with us for some years to come. And the June elections were only a first step in the direction of more transparent, democratic, and open institutions which Indonesia needs as a basis for sustainable growth. We recognize that all these challenges can be overcome, and will be overcome if we remain focused on our priorities, can manage a smooth transition to the next government, and can continue to rely on your support.

A recovery of the economy requires sound fiscal management. For this year, the economy still needs a stimulus from the budget, and we should work hard to achieve our spending and deficit targets. Last year the fiscal stimulus was not as strong as we would have liked. In part this was because we passed three budgets rather than one, and therefore spending was slow to take off. In part it was because we experienced some delay in program assistance from abroad. This year, we are better prepared to deliver on our plans, and stimulate the economy. However, we are aware that the balance of fiscal policy will have to shift from **fiscal stimulus to fiscal sustainability**. The crisis has left the government deeply in debt, both domestically and abroad. While falling interest rates and a stronger Rupiah reduce the burden of this debt, we still face enormous challenges in servicing it. Moreover, a backlog in maintenance in all sectors, an overdue civil service reforms will add to the pressures on the budget. All this means that financing the budget deficit and the repayments due on the stock of debt will remain a serious challenge for government. We must therefore give every effort to raise financing domestically, by improving tax collections, privatizing state enterprises, and recovering assets held by IBRA. We also need to develop a bond market which will increase financing options for the government, as well as expand the range of instruments for monetary control.

In our effort to promote more equitable growth we need to develop sound programs for the development of small and medium sized enterprises (SMEs). We know the dangers that lurk in providing large programs of directed credit and other broad instruments that favor these types of firms. We are therefore working closely with various groups to make the efforts effective and identify international best-practice programs that can be implemented to promote their growth.

And finally, as important as the economic recovery is continued protection of the poor. We have been working hard to improve the working of the social safety net, to improve targeting, and to reduce leakage. This took longer than planned, and disbursements of social safety net money has been very slow this fiscal year. But now we feel we are ready to accelerate these programs, and provide a cushion for the poor against the hardships of the crisis. Make no mistake, this hardship may become worse before it gets better; accelerated corporate restructuring may mean that more people could lose their jobs, without finding new ones right away. We should stand ready to help, even though the nature of the safety net may change from a crisis-driven program to one more fit for a growing economy.

Indonesia's key medium term challenge is institutional reforms that will provide for good governance. Indonesia's weak institutional foundations were not only part cause of the crisis, but also made it the deepest crisis of all of the East Asian economies. Strengthening these foundations will require years of hard work and a fundamental overhaul of the way Indonesia does business, in the private sector and in government alike. A revamped democracy and the decisive move to decentralize will help speed up this change process, but the agenda is a long one; civil service reforms, judiciary reforms, and more participatory means to prepare, implement, and monitor

government policies all need to be part of it. If done well, these difficult institutional reforms will make Indonesia stronger than before, and capable of regaining the ground lost during the crisis. I will elaborate on this subject a little bit more in the afternoon.

We can not afford to lose time. Therefore, a smooth transition from the outgoing to the incoming government will be crucial. It is for this reason that we have already had consultations with leading political parties in the run-up to this meeting. It is also for this reason that we ask you not only to give your pledge for this fiscal year, but also an indication of support for the next fiscal year. It is a simple truth that by the time the next government comes to power, there is too little time left to start the budget process from scratch. We are conscious, however, of not overstepping our mandate and will concentrate our efforts to ensuring that the current fiscal year's budget is properly financed and implemented. If we leave any doubt in the investors' mind about the financial viability of Indonesia's plans during the transition, the hard-gained and fragile stability could wither.

May I conclude, by emphasizing that in carrying on with our reforms program, the assistance of the international community remains indispensable. We will continue to seek your advice and assistance in tackling the difficult reforms issues lying ahead. We also need your continued financial support. As I earlier, the worst thing that could happen to our recovery effort is for us to become complacent because of our initial success, and by "us," I mean all of us sitting around this table. External support is perhaps even more important now although the required amount is less than last year's; without it we cannot deliver the fiscal stimulus that will jumpstart growth, and create income for the poor and jobs for those who lost them in the crisis. For the next year, the need for external budget support will still be substantial, but it will further decline. In part this is due to a recovering economy and policy actions that will include broadening the tax base, and cutting untargeted subsidies. In part the need is lower, because we will seek a substantial increase in domestic financing of the budget deficit through asset recovery and privatization. I trust your indication of support for next fiscal year will be firmed up in pledges to be given in six month's time, January, when a representative of the next government will be sitting in my place.

Thank you very much.