

INDONESIA: The Road to Recovery

Opening Speech

by
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Honored Guests, Fellow Speakers, Ladies and Gentlemen:

I would like to welcome all of you to the *Indonesia Forum*. The organizers have chosen as the theme *"the waiting game is over!"* And indeed it is. During the past months, in a series of policies, we have put into place a foundation for our economic and political recovery. With the foundation now in place one can truly say, *"the waiting game is over!"* But let us be honest: the recovery process has started but it will be long and slow. The benefits of the economic and political framework that we are creating provide the incentives that are needed for the renewal of economic prosperity in Indonesia.

The process of regaining growth will not be without setbacks. Some of these bumps on the road to recovery will come about through external events that we must be prepared to deal with as they arise. Some will come from domestic problems that will continue to emerge. And some will be the inevitable result of a nation seeking to express its collective political will after so many years of silence. At times the movement to a more open and more vibrant political society may appear to be chaotic. But, we are beginning to see the signs of the new Indonesia. All of us should welcome the new Indonesia in which different voices are heard and in which different views are expressed. This is part of the dynamic new nation that is now struggling to emerge.

One of the lessons we have learned is that successful development requires the ability to resolve conflicts. All economic policies, including the structural reforms that we are currently implementing, advantage some groups and disadvantage others. Only if there is a sense of equity, of fairness, about the development process, derived from a sense of ownership that flows from participation in the framing of the policies, can we be successful in transforming our economy. A new social openness must be the basis of our recovery.

It is heartening to note that our domestic policies are beginning to yield some positive signs. Yet our domestic policies will only succeed if there is a supporting international environment. It is critically important for Indonesia, and indeed for all the affected countries of Asia, that strong economic growth continues in our major export markets, notably Japan, the United States, and Europe. The past few weeks have delivered some good news. *First*, we have seen a series of interest rate cuts in the United States and Europe. In particular, the decline in the US interest rates allowed the Japanese yen and other regional currencies, including our own rupiah, to strengthen. This should help reduce the likelihood of a devaluation of the Chinese *yuan*, removing a major risk that had confronted the Asian economies.

Second, we are seeing a growing international awareness of the need for concerted actions to deal with the emerging global financial crisis. In APEC, intensive discussion was held on the issue of financial and economic crises and how the economies can work together to overcome the crises and prevent their recurrence. Over the past few weeks we have seen an announcement by the IMF of a new facility that should help reduce risk perceptions by global investors. The announcement of the new Japanese economic package will strengthen its own financial system and thus help to restart lending in Japan and throughout Asia. A new US - Japan initiative to

revitalize private sector growth in Asia has also been launched during APEC meeting in Kuala Lumpur. The two countries together with the World Bank and ADB will target mobilizing US\$ 10 billion in bilateral and multilateral support initially which will leverage substantial new private financing.

These and other positive changes in the international sphere augur well for our own recovery. If the United States can continue to enjoy low inflation and strong growth, it will be able to absorb more imports without an immediate political backlash that might be expressed in constraints on trade. The same holds true for economic growth in Europe. Stronger growth in Japan is obviously critical and we believe that the Japanese government is now actively seeking that mix of policies that will reinvigorate its economy. All of these elements provide a much needed positive background for our own economic recovery.

We see the evidence of stabilization in a number of important economic variables. In the real economy, some benefits of the massive depreciation are gradually making themselves felt. Our balance of trade recorded a surplus of \$15.2 billion during the first eight months of 1998. Not surprisingly, this has come about both through a sharp fall in imports and some growth of exports. Although there continues to be considerable pessimism surrounding our export performance, there are also many reasons to be optimistic about. The growth in export volume is masked by the continuing decline in the prices for many of our major export commodities, most importantly the sharp fall in international oil prices. But if we focus for a moment on manufactured exports, these increased by 14% during the January-July 1998 compared to the same seven months one year earlier. Exports of textiles and textile products increased by 13.8% during the same seven-month period, and other manufactured exports, a category that includes furniture exports, grew by 35% during the first seven months of this year. These figures indicate that our export sector remains vibrant and will help us in our recovery.

Some analysts have asserted that factories are dismantling machinery as they leave Indonesia. But we need to put this information into perspective. Although import demand as a whole has fallen, imports of machinery continue to be twelve times as large as machinery exports. Indeed, machinery imports are only slightly below the level that prevailed from 1992 to 1994. This suggests that a significant amount of new investment is still taking place, despite the economic slowdown.

Perhaps the most encouraging news is the dramatic slowdown in inflation. As you are well aware, the consumer price index fell slightly during October, the first time the average price level has fallen since June 1997.

Several factors contributed to the slowdown in inflation. Perhaps the most important was the sharp appreciation of the rupiah. During October the currency appreciated by an astounding 40%! Even during and in the days following last week political turmoil, the rupiah has not been weakened. This, perhaps more than any other indicator, suggests that the markets have already recognized the improvements in our economic outlook. Another factor is that we have been able to control prices of basic food commodities, through improved distribution and availability.

Because of the slowdown in inflation and the more stable monetary situation, interest rates have begun to decline. These developments have had an impact on investor expectations and will continue to do so. Indeed, as risk perceptions about Southeast Asia, and Indonesia in particular, normalize we are seeing some return of interest in regional equity investments. This is still a very nascent development but it is beginning to contribute to the strengthening of the currency.

We should however be realistic. These improvements in our economic condition are not meant to suggest that a rapid rebound is in sight. There is a long way to go. But there are powerful adjustment factors now at work all pointing to the beginning of a recovery in 1999.

There are two areas of reform where work is still needed. Both areas are critical to our economic recovery. We realize that weaknesses in our financial and corporate sectors were a prime cause of our economic breakdown. And we cannot expect a strong recovery until we clean

up the debris from the collapse of our financial system and restructure the debts of our corporations. A modern economy needs both a strong and viable financial sector and a corporate sector that can meet global competition. Until we achieve these goals, we will not have achieved real recovery.

Recapitalizing our banks is among our highest priorities. We are working on a plan to place new capital into banks that remain sound or have the potential to become sound again. The work on the reform of our banking sector is going to be costly and the proposals we are putting in place may not be perfect. But they offer the best hope for the resolution of our financial sector problems and they will go far to ensure that we emerge from this crisis with a strong financial sector that not only meets the needs of a modern domestic economy but that also will be able to compete in the global market place.

Our crisis was to a large extent a private debt crisis and substantial surgery is needed in the corporate sector. The government has worked to develop a framework that will deal with external debt as well as providing assistance to domestic debtors and creditors as they seek a debt workout. But, to be frank, our companies need to recognize that they can no longer carry on in a "business as usual" mode. Creditors must be willing to negotiate a reasonable settlement but debtors must offer an honest appraisal of the value of assets and revenue expectations. The precise revaluation will depend on project specific factors but no settlement can be reached unless there is a free exchange of information on which realistic assessment of corporate value can be made.

To ensure that our recovery leads to sustained growth we must formulate a new development strategy that not only will result in a resurgence of growth but one that will transform our society. It is a strategy that must address all components of society: the private sector as well as the public sector, and must involve all elements of civil society.

Over time we have come to appreciate that the government has a very limited capacity for managing productive assets. It is for this reason that we have shifted our emphasis away from government involvement in the direct production of goods and services and have allowed a much wider role for the private sector. In this process, first, it is imperative that we develop the legal infrastructure to ensure competition and as well as commercial laws that will ease both the entry and the exit of firms. Too often in the past we have allowed private sector agents to flourish behind protective barriers and have allowed inefficient corporations to continue to operate. This will no longer serve our purpose. A more competitive environment is needed if the private sector is to contribute to the national welfare. Second, we need to reestablish a stable macroeconomic framework. At the center of this new macroeconomic framework must be a stable and effective financial system based on regulations that ensure safety and soundness. Such a system must enhance competition, protect depositors, and create confidence in securities markets. We have amended our banking law, that now allow more freedom for foreign participation in the national banking. We are soon going to introduce a bill to the Parliament for an independent central bank. And third, we must eliminate those remaining distortions in the economy that interfere with the efficient deployment of resources.

Broadly then, these are among the important pieces that constitute an effective development strategy for our nation. The restructuring efforts we have put into place are beginning to rekindle economic growth. But we need to do more to ensure that growth this time is sustainable.

Indonesia is indeed on the road to recovery. But our efforts are not focused solely on regaining the growth we enjoyed in the past. Our aim is to create a development framework that will create a new society, combining the energies of the private and public sectors, both operating within a strengthened legal and administrative framework that will ensure proper oversight and transparency. And above all we recognize that the benefits of growth cannot be realized unless we create an educated and healthy citizenry which participates in the economic and political life of our nation, unless we ensure that the fruits and opportunity to participate and gain from development are enjoyed by all. These are the goals we have set for ourselves, and these are the

objectives we strive to achieve. Much of what we are doing can be accomplished in the near term, but other elements of our new strategy will only be realized over the longer term.

The agenda of the Indonesia Forum will provide many points that will help to flesh out these ideas. I encourage you not only to listen, but to learn, to discuss and to criticize. I hope your efforts in organizing and participating in this forum will bear fruit, at least to have a better understanding of Indonesia, of where we are, and where we are heading.

Thank you.