

OVERVIEW OF INDONESIAN MACRO-ECONOMIC SITUATION AND INVESTMENT PROSPECTS AFTER THE CRISIS PERIOD

by

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I am honoured to be with you here today. The topic of this Indonesian Mining Investment Summit: "Tomorrow's Wealth, Today's Challenges", have been perfectly chosen by the organizer, considering the on-going economic crisis. And I, so applaud the focus of today's forward-looking exhibition and conference.

I find it entirely appropriate that a group of private-sector players, such as yourselves, is gathering today to discuss the opportunities that will emerge as the crisis recedes. I am confident that you have already given considerable thought to the specific investment opportunities that you think may arise in the coming months. That is appropriate, given your role as main players of the mining business.

This morning, I would like to address my comments more to the Indonesian macro economic situation and investment prospects. But first, let me just briefly highlight the achievement of the Indonesian economy before the current crisis, because it is important that albeit the crisis, we recognize the demonstrated capacity of the economy to deliver rapid growth and welfare improvement. Such a comparison will not only illustrate how far the economy has declined, but more importantly, it will indicate the basic strength of our economy, and the benefits to be gained by the large contribution of investors such as yourselves to make, in support of our recovery efforts.

Over the period 1985 to 1997, the Indonesian economy grew at annual rate of nearly 8%, one of the fastest sustained rates of growth among developing countries. Inflation averaged 8% during the period. This remarkable achievement allowed millions of our people to rise out of absolute poverty and to enter the modern labor force.

I have chosen to remind you of these economic achievements, not because I want to argue that there were no shortcomings in management or in policy implementation. There obviously were many such shortcomings. For example, increases in wages were not offset by increases in labor productivity, eroding our competitive advantage and reducing the growth of manufactured exports. A growing number of monopolies robbed our economy of its vitality and its capacity to respond to changes in international markets. Eventually, these and other shortcomings contributed to the sharp depreciation of our currency, to the loss of faith in our economy, and to a rapid reversal of the capital inflows that had previously supported our development efforts. As a consequence, growth has been seriously disrupted, and we have to go through a painful restructuring process.

Growing unemployment and shrinking incomes have the potential of creating social unrest. And longer-term unemployment, will most surely lead to a demoralization of our labor force and a loss of competitiveness, as workers fail to acquire new skills. The capacity of unused physical plant, deteriorates as maintenance lags and as new equipment purchases are delayed. Measures to bring our underutilized human and physical capital into full productive use as quickly as possible are of urgent priority.

To be able to do so, it is imperative to create a stable economic environment. The key to our economic recovery is regaining the confidence on our economy. It should be reflected in the

return of capital; those that have fled the country, as well as new capital. The level of confidence could be measured not only by exchange rate but also the stability of the rupiah. Restoring stability calls for stringent measure to prevent hyper-inflation that will paralyze the real sector. Therefore, tight monetary policy is a cornerstone of our economic stabilization program.

Given our current state of the economy, we have to rely on exports to restore our economy. A number of factors impede a return of rapid exports' growth. Foreign buyers are reluctant to place orders with Indonesian manufacturers, fearing that the Indonesian firms will be unable to deliver their orders. This is partly a political problem and naturally, exporters will only place orders if they have confidence in Indonesia's political stability. We are committed to maintaining political stability even as we embark on the process of establishing a more open democratic and social society. At times, more open and vigorous debate as well as the movement to more vibrant political society may seem to suggest a lack of stability and to be chaotic. But this is not so. A new social openness must be the basis of our recovery. This is part of the dynamic new nation that is now struggling to emerge and we will ensure that the process of democratization does not lead to social instability. This is the signs of the new Indonesia.

We will also take steps to ensure that exporters have access to short-term financing to cover cost of imported raw materials and of production. Without access to foreign and domestic credit, export production cannot take place. We have already taken steps to eliminate the backlog of overdue trade credits. But we must also ensure that exporters have access to domestic credits to finance production. We have begun a detailed examination of other factors that might inhibit export production. We will be looking at the operation of our ports, at the efficiency of our customs and tax administration, and at the implementation of all regulation affecting export activities. We are taking measures to improve security in the flow of goods and distribution lines. We will do what ever is necessary, so that exporters can access international markets with a minimum of obstacles.

Despite the devastating crisis, much of Indonesia's economy continues to function. The rural economy was battered by the 1997 drought that extended into early 1998, but its resilience is already apparent. Indeed, parts of the country that produce cash crops for exports are actually better off today than they were before the crisis, and are demanding new consumer goods. And we are optimistic, that even the rice growing areas will respond to new high-price environment by producing more than ever before once normal weather patterns return. The distribution system that once was considered broken and malfunctioning has shown its resilience, as well.

Equally important, there are several aspects of the economic environment that I believe provide reasons for optimism regarding future business opportunities in Indonesia. Our progress on the elimination of barriers to investment since the onset of the crisis, creates new markets and new opportunities. The past several decades had seen the Indonesian economy experience tremendous opening, with deregulation packages lowering tariffs, and eliminating trade restrictions. And during the crisis, the Government 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. Inter-regional 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.

There is, in fact, increasing transparency in the processes that govern economic activity in Indonesia. New competition legislation, which is now being deliberated in the parliament should also help demonstrate the commitment to the establishment and protection of an economy that is solidly built on market principles.

We are beginning to see the results of the economic policies that show we are already well on the way to recovery. One indicator is the dramatic slowdown in inflation. The consumer price index fell slightly during October, the first time the average price level has fallen since June 1997. In November it is almost flat, and is now expected to be about unchanged during the fourth

quarter of 1998. The most important factor that contributed to the slowdown in inflation was the sharp appreciation of the rupiah. During October, rupiah appreciated by an astounding 40%. Even during and in the days following last 3 weeks political turmoil, the Rupiah has not been weakened. More than any other indicator, this suggests that the markets have already recognized the improvements in our economic outlook. Average inflation for 1998 could be contained within the program assumption of 80 percent. During 1999, we expect inflation to fall toward 10 percent, close to the pre-crisis level. We also remain committed to a free foreign exchange system without surrender or repatriation requirements or capital controls, As our currency, inflation, and the domestic price environment stabilizes, forward planning will become a lot easier for everyone.

Because of the slowdown in the inflation and the more stable monetary situation, interest rates have begun to decline. These developments have had an impact on investor expectations about Southeast Asia, and Indonesia in particular. We are seeing some return of interest in regional equity investments. Although this is still a very nascent development, but it is beginning to contribute to the strengthening of the currency and demonstrate that there are powerful adjustment factors now at work, all pointing to the beginning of a recovery in 1999 and forward planning, hence, will become a lot easier for everyone.

Another important source of optimism is the fact that Indonesia is blessed with abundant natural resources. While many companies in other sectors have had to close their offices during the economic crisis, local and foreign investors in mining, agriculture and other resource-based sectors have not been affected at all. On the contrary, some of them have enjoyed huge, windfall profit. Why is this so? Minerals or resource-based materials for example, are required for both the overseas and the domestic markets to support the chemical and agro industries. Since minerals or resource-based commodities are not distributed evenly in the world, many countries must rely on importation of them in order to survive. This emphasizes to us that a resource-based economy should be the back-bone of our economic recovery and also further down the road of our economic development in the years to come.

As a developing countries, Indonesia has a large investment potential in this respect. The up-stream and intermediate minerals supplies can provide materials for a number of fast growing down stream-industries such as chemical and steel industries. In general, potential Indonesian mineral sites have been largely unexplored. Thus, there is a good chance that exploration would result in discovery of a large and high grade deposit. For example, a new copper deposit has been discovered in Grassberg, allowing Freeport to expand its mining under the Fifth Generation contract, which is essentially a revision of the contract first issued in 1967 under the First Generation. Meanwhile, world's demand for some minerals are increasing more than the current capacity to supply. World production capacity of copper, for example, is predicted to increase by 30 percent by the year 2000 as 13.4 million tones compare to year 2000 as 10.8 million tones. This production capacity is lower than world's demand and this shows us how great the opportunity for investors to fill in the gap.

I will refrain from going into further detail on the topic of mining here, since other presenter will cover the subject in depth. But, by taking this opportunity, I would like to invite you to create synergy with Indonesia companies to take the benefit of promising minerals potential of Indonesia. To attract more investors, the Government of Indonesia has introduced many market-friendly investment policies. Among others, the Government Regulation No. 20 of 1994 that allows foreign partner to own a hundred percent of share, and Presidential Decree No. 114/98 that simplify the procedure for foreign investment.

We should, however, be realistic. These improvements in our economic conditions are not meant to suggest that a rapid rebound is in sight. I do not mean to paint too optimistic a picture of the future. The Indonesian economy has been damaged by the regional economic crisis, and we still face difficult times ahead. But today's summit is organized around the concept of opportunities for investment, and even today I believe there are many reasons to be optimistic about the future. Although we still need to take care of today's problems with speed and integrity, but the system

we are putting in place should provide everyone in Indonesia with new opportunities for prosperity in the post-crisis period.

I want to close by offering my appreciation to all of you for joining in this conference, and the broad representation here speaks well for our mining future. From the Government of Indonesia, you can expect that we will do all that we can to help build a healthy economic environment that will foster opportunities for renewed growth. Let me re-affirm that advantages available in Indonesia make it very conducive for investment, and I sincerely hope that presentations and deliberations during the three days of this summit will be beneficial to all the participants.

Thank you very much.