CHAPTER 8, TRADE AND PROJECT FINANCING

The framework for trade and project financing in Indonesia changed significantly in the wake of the 1997-8 financial crisis. Indonesia's banking system has only partially recovered from the crisis, and many banks remain technically bankrupt or are hamstrung by very low capital reserves. Unprecedented levels of corporate debt have limited the ability of many private sector firms to obtain trade or project financing, and the cost of imported capital goods has risen substantially in the wake of the Rupiah's devaluation. These economic factors coupled with lingering political instability have led to steep declines in both imports and direct foreign investment, and private capital inflows have remained strongly negative since 1998.

Banks were at ground zero of the 1997-98 financial crisis. When the smoke cleared, the total number of banks had declined from 238 to 146 (5 state-owned national banks, 27 state-owned regional development banks, 104 private banks, and 10 foreign branches, not counting joint-venture banks and foreign banks' representative offices). The GOI launched a massive bank recapitalization program in 1999 that has stabilized the banking sector. While the banking sector is no longer in immediate threat of collapse, lending activity is far from pre-crisis levels, and several large state-owned banks continue to lose money. Banks remain reluctant to make new loans outside of the consumer sector, leaving the interest earned on bank recapitalization bonds as the prime source of income for many. While local banks are not expected to return to normal levels of business in the near-term, lending by foreign banks and joint venture banks has resumed on a modest scale to selected customers, primarily exporters.

Corporate loan restructuring has progressed very slowly, and most Indonesian firms find it difficult to access usual means of trade and project financing. Many local companies can neither meet requirements for new loans nor service their existing bank debt. Letters of credit remain difficult to come by and can face difficulties in gaining acceptance abroad.

Despite lagging progress on bank and corporate debt restructuring, the Indonesian economy has shown some signs of recovery. Since 1999 Indonesia has resumed positive GDP growth but at levels far below those enjoyed in the early 1990’s. In 2001, the economy grew 3.5%. Inflation and interest rates have declined dramatically from their mid-crisis levels, but is still in double digits and putting a serious strain on government finances. Since the depth of the crisis, improved export earnings have enabled Indonesia to have a positive current account balance but export growth slowed in the wake of 9/11 amidst faltering growth rates in Indonesia’s major trading partners. The GOI has accumulated foreign exchange reserves above the targets set in its IMF program.

Since the onset of the crisis, the GOI has taken a number of steps to encourage private sector lending. Indonesia retained an open capital account with no foreign exchange controls both during and after the crisis. The May 1999 foreign exchange law requiring banks and other businesses to report large foreign exchange transactions for monitoring purposes has not had a significant effect on capital flows. The GOI has also implemented specific measures aimed at increasing the supply of trade financing, including: Establishment of a $1 billion collateral fund deposited offshore to encourage acceptance of Indonesian letters of credit (set up in mid-1998);

Government insurance for repayment of trade financing extended by Indonesian banks (set up in late 1998, but little used);

Establishment in July 1999 of Bank Ekspor Indonesia, a Trade Maintenance Facility arising from the June 1998 "Frankfurt Agreement" (renewed in May 2000). Creation of a $1 million short-term credit guarantee program in collaboration with foreign export credit agencies, including the U.S. Export-Import Bank.

In June 2000 Bank Indonesia (BI) announced a package of regulatory changes designed to encourage bank lending, including trade financing. These measures include amendments to BI's prudential regulations concerning the recalculation of capital-asset ratios to permit additional credit expansion. A second amendment to the prudential regulations extends until May 2001 (or December 2002 for loans restructured through the Jakarta Initiative) the time limits by which all banks must comply with BI's legal lending limit (the limit concerns the percentage of bank credit which may be allocated to individual firms). A third BI circular relaxed the requirement that banks liquidate equity positions in a debtor company after 5 years or when the company achieves net profits in two consecutive years (the latter provision was changed to require divestment only once a company achieves a cumulative profit).

A. Financing Options

Prior to the financial crisis, a large number of Indonesian banks maintained correspondent relationships with American banks. However, given the fundamental restructuring underway in the banking system, many of these relationships are no longer in effect. Exporters should contact the U.S. Commercial Center in Jakarta for up to date information on correspondent banking relationships. J.P. Morgan Chase Bank, Citibank, American Express Bank and Bank of America maintain branch offices in Indonesia. Eight additional U.S. banks have representative offices in Jakarta: FleetBoston Financial, Bank of New York, Union Bank of California, Bankers Trust, Wachovia Bank NA., Morgan Guaranty Trust Company, Nations Bank, and Republic National Bank of New York.

With the sharp drop-off of private capital flows since the economic crisis, Indonesia is now heavily dependent on official financing, primarily from the Asian Development Bank (ADB), World Bank, and major bilateral donors. The World Bank, ADB, and other multilateral and bilateral donors meet periodically in the Consultative Group on Indonesia (CGI). At the November 2001 CGI meeting, donors pledged to disburse up to $3.2 billion for the 2002 fiscal year. On April 12, 2002, Indonesia negotiated a third Paris Club arrangement with bilateral creditors. The arrangement covers principal and interest rescheduling from April 1, 2002 to December 31, 2003. The terms of the arrangement are as follows: 20 years repayment including 10 years grace for ODA loans and 18 years including 5 years grace for non-ODA loans. The agreement will reduce Indonesia’s debt service obligations during the consolidation period from $ 7.5 billion to a maximum of $ 2.7 billion.

American firms can participate in projects funded by the ADB and the World Bank. Information on projects and procedures is available through U.S. Commercial Service officers assigned to each multilateral development bank as well as commercial officers in individual countries (See Chapter XI for contact information). See web home pages, including http://www.ita.doc.gov/mdbo for information on all development banks.

B. Asian Development Bank

The Asian Development Bank, Asia's premier nonprofit, multilateral financial institution, is headquartered in Manila, Philippines. ADB-financed social, physical and financial infrastructure projects in the public sector create commercial opportunities in many areas, such as: agriculture and natural resources (including disaster management); education and training (including distance learning); energy (including power generation, renewable energy and energy efficiency); environment (including water supply, waste treatment and air pollution control); financial services (including banking and insurance reform, small business finance, microfinance and capital markets development); healthcare (including telemedicine); infrastructure (including housing and urban redevelopment); and transportation (including rail, road and port projects). Every ADB-supported project aims to reduce poverty as it fosters sustainable economic growth, social benefits and good governance.

Indonesia was a founding member in 1966 and is one of the bank's largest borrowers. In 2002, ADB approved $766 million in loans to Indonesia and $20.2 million in technical assistance grants. The loans were for a basic education project and a governance and privatization program. In the ADB's revised operational strategy for Indonesia, the bank's assistance is focused on private sector, human and social development, and environmental management. The bank's planned lending for the period 2002-2004 includes over $3 billion in loans for rural microfinance, irrigation, coral reef rehabilitation, financial governance, power transmission, road rehabilitation, urban poverty reduction, water supply and sanitation, health service, and government decentralization.

With East Timor's membership in 2002, ADB now has 61 member countries. The Bank's membership in the Asia Pacific region includes 33 active borrowers from Southeast, South, East and Central Asia, Mongolia, and the island nations in the South Pacific.

ADB’s total lending in 2001 totaled $ 5.4 billion. In addition, the bank provided $146.4 million in technical assistance to its member countries. For the second straight year, India was the largest borrower (28.1% of total, or $1.5 billion). The PRC, traditionally the largest borrower, came in second (18.7% or $997 million). Third largest was Pakistan (17.9% or $956.8 million), followed by Indonesia (9.4% or $500 million), Bangladesh (5.6% or $297.9 million), and Vietnam (4.9% or $260.6 million).

Sectorally, transport and communications received the largest share of bank lending in 2001, garnering 26.7% of total lending. As ADB focused on cross-cutting issues, "multisector" projects ranked second with 14.2%, followed by "others", 14%. Energy follows with 12.4%; agriculture and natural resources - 11.3%; finance - 10.6%; social infrastructure - 9.2%; and industry and nonfuel minerals - 1.6%. (Detailed plans for each borrowing member country and project information can be found on the ADB website: www.adb.org.

ADB's grants and loans generate substantial, hard-currency commercial opportunities in borrowing Asian developing countries for consultants, suppliers, prime contractors, subcontractors, banks and project sponsors from the bank's member countries. In 2001, American companies won over $309 million worth of contracts under ADB projects for a wide range of equipment and services. The U.S. maintained its number one ranking in total procurement awards for the year among donor countries. Cumulatively, U.S. companies have won $4.8 billion worth of contracts since the bank began its operations.

Aside from its public sector operations, ADB has also been lending directly to the private sector since 1983. ADB private sector operations serve to mobilize further investments for projects that have a high developmental impact as well as technical, socioeconomic, financial and environmental viability. In 2001, ADB's loan/equity assistance to the private sector totaled $67.8 million for 6 projects. ADB financed two pioneering social sector projects in Vietnam for pilot projects in healthcare and education and invested in a private Thai equity fund and a new housing bank in Sri Lanka. In Indonesia, ADB has financed 12 private sector projects with a total value of $170 million.

ADB maintains a resident office in Jakarta and in 17 other member countries. There are also field offices and extended missions in four cities as well as three representative offices in Tokyo, Washington, D.C., and Frankfurt.

The U.S. Department of Commerce maintains a Congressionally-mandated Commercial Liaison Office for the ADB. The Office's mission is to help American firms access, enter and expand in Asian emerging markets that benefit from ADB assistance. The Office provides market research (project leads and status information), counseling, advocacy, and outreach/training programs in the Asia Pacific region as well as in the continental U.S. to help U.S. firms take advantage of ADB-related commercial, financial and infrastructure project development opportunities in countries borrowing from the ADB.

To perform its mandate, the U.S. Commercial Liaison Office (CS ADB) cooperates with the Office of the U.S. Executive Director of the ADB and works closely with U.S. Commercial Service, including CS Jakarta, and U.S. Department of State posts throughout the Asia Pacific region. An American Senior Commercial Officer heads the office, supported by two Commercial Specialists and focuses on environment projects primarily in South and Southeast Asia. CS ADB invites American firms to work with it in pursuing ADB commercial, financial service and infrastructure project development opportunities.

The Office contact information is:

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C. World Bank

The World Bank Group is a multilateral lending agency consisting of four closely related institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). The World Bank provides loans to developing countries to help reduce poverty and to finance investments that contribute to economic growth.

D. The International Bank for Reconstruction and Development (IBRD)

IBRD provides funding for creditworthy developing countries with relatively high per capita income, as well as technical assistance and policy advice. Loans are made only to governments or to agencies that can obtain a government guarantee. The IBRD also provides partial risk or partial credit guarantees (with a counter-guarantee from their government) to private lenders on development projects. Cumulative IBRD lending to Indonesia exceeds $11.5 billion through 2000. Opportunities exist for U.S. companies to supply goods and services in connection with these loans.

The International Development Association (IDA) provides assistance on concessional terms to the poorest developing countries (per capita incomes below $895 in 1998) that are not sufficiently creditworthy for IBRD financing. As with the IBRD, procurement procedures are well established and offer opportunities for U.S. suppliers, engineers and consultants. In 1998, the World Bank declared Indonesia eligible for IDA support again and beginning in the 1998-99 fiscal year, this program started up again in Indonesia.

The International Finance Corporation (IFC) is an affiliate of the World Bank that provides project financing for private investment in developing countries. IFC offers long-term loans and equity investments, as well as other financing services. Unlike the IBRD and IDA, the IFC does not require government guarantees. Since its first investment in 1971, the IFC has made $1.3 billion in net commitments to Indonesia. U.S. companies seeking investment funds should contact the IFC directly. (See http://www.ifc.org for contact information.)

The Multilateral Investment Guarantee Agency (MIGA) was established in April 1988 to promote the flow of foreign direct investment among member countries by insuring investments against non-commercial (political) risk and by providing promotional and advisory services to help member countries create an attractive investment climate. Indonesia is a member of MIGA and has benefited from guarantees totaling $313 million. U.S. companies seeking investment guarantees should contact MIGA.

The World Bank is the second largest aid donor to Indonesia, disbursing $659 million in 1998, $2.1 billion in 1999 and an estimated $530 million in 2000. It has a large resident office in Jakarta.

Examples of World Bank projects in Indonesia include:

Energy:	Suralaya Thermal Power Project
Environment:	BAPEDAL Development Project
Banking Reform Assistance Project:	Telecom Sector Modernization
Health/Nutrition/Population:	Water Supply & Sanitation for Low Income communities
Rural Development:	Agricultural Financing
Transport:	Highway Sector Investment II
Urban:	Surabaya Urban Development Project

World Bank structural adjustment lending has included two policy reform support loans focusing on financial sector restructuring, corporate restructuring, and governance, a social safety net adjustment loan, and a water sector adjustment loan.

Contact information for the World Bank and the U.S. and Foreign Commercial Service Liaison staff at the bank is available in Chapter XI. An excellent resource for all the multilateral development banks is the Office of Multilateral Development Bank Operations at the Department of Commerce. Services offered include a newsletter, counseling center, referrals and business outreach. Contact information for the office is also available in Chapter XI.

E. The U.S. Export-Import Bank

The U.S. Export-Import Bank (Ex-Im) currently offers short, medium, and long-term loans to support U.S. exports to Indonesian public sector buyers as well as private sector buyers who obtain a sovereign guarantee from the GOI. Ex-Im can also support exports of consumer goods, spare parts, raw materials (on terms up to 180 days), and bulk agricultural commodities (on terms up to 360 days) under its short-term credit insurance policies. Exports of capital goods and related services can be supported by Ex-Im's long-term loans and guarantees of commercial bank financing (up to 10 years repayment), or medium-term loans, guarantees and insurance (up to five years repayment).

Ex-Im can generally offer the maximum support allowed within OECD rules. Ex-Im also has "war chest" monies available to match soft loan offers from competitor countries that exceed OECD guidelines. Ex-Im does not initiate soft loan offers without evidence of a competitor offer already having been made. Ex-Im programs are explained on their homepage, located at http://www.exim.gov.

F. Trade and Development Agency

Funding for feasibility studies, technical assistance, technology visits to the U.S., and trade-related training on major infrastructure projects is available from the U.S. Trade & Development Agency. TDA-funded studies are then used by financial institutions, such as the U.S. Ex-Im Bank, to make project financing decisions. TDA has maintained a significant presence in the Indonesian market, even during the economic crisis period. Recent examples of TDA activity include $302,400 for a Gas Development/Procurement Plan, $249,000 for a demonstration of LIDAR Remote Imagining Technology, and $483,500 for a Wastewater Treatment Plant feasibility study on the island of Batam.

Most recently, TDA funded two definitional missions to visit the Aceh region to identify project opportunities of potential U.S. exporters.

TDA maintains a regional office in Manila and activities in Indonesia are represented by the U.S. Commercial Service office in Jakarta. (See Chapter XI for contact information).

G. Overseas Private Investment Corporation (OPIC)

The Overseas Private Investment Corporation plays an important role in helping U.S. firms reach expanding markets. Since beginning operation in 1971, OPIC has been the key U.S. government agency encouraging American private business investment in developing countries, newly emerging democracies, and fledgling free market economies. OPIC assists American investors through four principal activities: financing of businesses through loans and loan guarantees; supporting private investment funds; insuring investments against a broad range of political risks; and, engaging in outreach activities designed to inform the American business community of investment opportunities overseas. Investors are urged to contact OPIC directly for up-to-date information concerning availability of OPIC services in Indonesia (See Chapter XI for contact information).

H. Islamic Development Bank

Established in 1973, the Islamic Development Bank seeks to foster the economic development and social progress of member countries and Muslim communities through participation in equity capital and grant loans for projects, as well as providing other types of financial assistance. The IDB recently dispensed a $500 million loan to Indonesia within the framework of the Consultative Group on Indonesia (CGI), and has given $49.29 million in loans to build Islamic schools in various regions of Indonesia. In additions, the IDB is planning to give loans to Bank Mandiri for export financing. The Islamic Bank is headquartered in Jeddah, Saudi Arabia (See http://www.isdb.org or Chapter XI for additional information and contact information).

I. Financing of Agricultural Exports

The Embassy's Agricultural Affairs Office and Agricultural Trade Office in Jakarta helps administer several credit guarantee programs to facilitate the export of U.S. agricultural products to Indonesia. Under the GSM-102 Credit Guarantee, the U.S. Department of Agriculture, via the Commodity Credit Corporation, will issue a loan guarantee with repayment terms of up to three years. Coverage is available for a wide variety of products ranging from cotton, soybeans and feedgrains to leather, lumber and planting seeds. The program grew from an initial allocation of $15 million in FY92 to $650 million in FY 2001. The program was suspended at the start of FY02 pending discussions with the Ministry of Finance concerning issues involving the Credit Guarantee Assurance from the Government of Indonesia. It is not known when these issues will be resolved and the program operational again in Indonesia.

With the USDA guarantee, banks are generally able to offer lower interest rates than may otherwise be available. The interest rates, however, are negotiated by the banks and are not set by USDA. Use of this guarantee facility has increased during the economic downturn in Indonesia. The guarantee is assisting Indonesian companies, which are otherwise having difficulty with trade financing. The U.S. Department of

Agriculture has also made an additional regional program available. Another program, the GSM-103 facility, is available for animal breeding stocks with credit terms of seven to ten years.

Two other facilities, the Supplier Credit Guarantee Program (SCGP) and the Facilities Guarantee Program (FGP), have been introduced in Indonesia. The SCGP program is aimed at commodities that are generally traded without Letters of Credit. The SCGP covers 65 percent of the principal for up to 180 days. Eligible commodities are generally high valued products such as meat, fruit and consumer-ready products. The FGP program for the region covers equipment and services aimed at facilitating imports of U.S. agricultural commodities.