JULY 27, 1999: IMI: INDONESIAN ECONOMIC TRENDS 1999 -- SIGNS OF LIFE

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Summary

1. Indonesia's troubled economy showed signs of increased stability and reemerging confidence by July 1999. Key economic indicators had improved from 1998 levels. Landmark political events -- the parliamentary campaign and June 7 voting -- went smoothly. Together, these developments gave a sense of light at the end of the tunnel after almost two years of turbulence and economic contraction.

2. Macroeconomic indicators had improved since mid-1998, for both economic and political reasons. on the economic side, close cooperation with international financial institutions paid off. Careful monetary policy allowed inflation and interest rates to decline and the rupiah to strengthen. In addition, international financial support gave the government breathing room on its official debt and supported social safety net programs and bank reform. Abundant rains improved the food situation after the 1997-98 drought and eased rural hardship.

3. On the political side, President Habibie remained firmly in office despite initial speculation that his government would not last, student unrest dissipated in late 1998, laws governing early elections were passed in January 1999, 48 political parties campaigned peacefully in May and June, and parliamentary elections were held successfully. These political achievements helped begin to dissolve the cloud of political uncertainty hanging over Indonesia -- affecting the exchange rate, interest rates, and other factors - since President Soeharto's sudden resignation in May 1998. Starting in April 1999, offshore funds fueled a Jakarta Stock Exchange rally.

4. With a new president and vice president to be selected by late 1999, leading political parties agreed that Indonesia needed to stay on track with its IMF monitored economic reform program. Consensus on this issue meant that anti-inflationary monetary policy was likely to continue, and that the government would move ahead with the expensive-but-crucial bank restructuring program.

5. On the other hand, efforts to restructure the huge overhang of foreign and domestic debts had made little progress. By mid-1999, the overall impression was that Indonesia had achieved enough macroeconomic stability to keep its economy from collapsing further and to boost confidence, but was still moving at a snail's pace in cleaning up the financial damage. The slow pace of banking sector recovery and of corporate debt resolution was attributable in part to the depth of the financial sector's collapse and large number of borrowers and various nationalities of the lenders involved, but also to the lack of a dependable legal environment.

6. Increasingly, political parties, civil society groups and academics were saying that major reform of Indonesia's political and economic systems was needed before sustained economy recovery could be achieved. Simply repairing the damage the economy had suffered during the crisis was not the right answer, these groups said, because the pre-crisis economy favored a small circle of cronies and was fraught with corruption.

Overview of the Numbers -- Partial Improvement

7. In terms of several key financial and price variables, what a difference a year made.

8. Exchange rate: At end-June 1998, one month after President Soeharto resigned in the face of student protests and after rioting shook the capital -- the volatile rupiah stood at 14,900/US$ (compared to 2,450/US$ in June 1997). The rupiah stabilized by fourth quarter 1998, weakened somewhat in early 1999 amidst concerns about the political season, but strengthened in second quarter 1999 (see Table 1). By end-June 1999, it had strengthened to 6,700/US$ where it remained as of mid-July.

Table 1. Exchange Rate: Signs of Strength

End-Period	Rp/US$ Exch. Rate	Nominal Depreciation	Real Depreciation
Jul-97	2,599	0%	0%
Aug-97	3,035	-14%	-14%
Sep-97	3,275	-21%	-19%
Oct-97	3,670	-29%	-26%
Nov-97	3,648	-44%	-25%
Dec-97	4,650	-75%	-40%
Jan-98	10,375	-70%	-71%
Feb-98	8,750	-70%	-61%

Mar-98	8,325	-69%	-57%
Apr-98	7,970	-67%	-53%
May-98	10,525	-75%	-63%
Jun-98	14,900	-83%	-72%
Jul-98	13,000	-80%	-66%
Aug-98	11,075	-77%	-57%
Sep-98	10,700	-76%	-54%
Oct-98	7,550	-66%	-35%
Nov-98	7,300	-64%	-33%
Dec-98	8,025	-68%	-38%
Jan-99	8,950	-71%	-43%
Feb-99	8,730	-70%	-40%
Mar-99	8,685	-70%	-40%
Apr-99	8,260	-69%	-38%
May-99	8,105	-68%	-36%
Jun-99	6,726	-61%	-23%

* Nominal and real depreciation are compared to July 1997. As defined here, real depreciation takes into account Indonesia CPI inflation, and assumes zero U.S. inflation during the period..

9. Inflation: The consumer price index was increasing at 80 percent annually as of mid-1998 (5 percent per month for March-June) and calendar 1998 inflation was 78 percent. In contrast, prices increased only 2.7 percent for January-June 1999 (see Table 2). In light of recent signs of zero and even negative inflation, the GOI forecast in early July that inflation would be less than 10 percent for 1999. The low inflation figure testified to the tight money policy that the GOI introduced in mid-1998 (after several months of huge money supply expansion primarily through liquidity credits to banks), but was also seen as the result of depressed domestic demand for goods that had lowered inflation in the entire region.

Table 2. Inflation Negligible

Period	CPI	Percent change from previous month
Jun-98	163.9	4.6
Jul	177.9	8.6
Aug	189.1	6.3
Sep	196.2	3.8
Oct	195.7	-0.3
Nov	195.8	0.1
Dec	198.6	1.4
Jan-99	204.5	3.0
Feb	207.1	1.3
Mar	206.7	-0.2
Apr	205.3	-0.7
May	204.8	-0.3
Jun	204.1	-0.3
Inflation for		

Calender year 1997	10.5	10.5
Calender year 1998	77.6	77.6
Jan-Jun 1999	2.7	2.7

Source: Central Bureau of Statistics

10. Interest rates: The benchmark Bank Indonesia Certificate (SBI) annual interest rate soared to 70 percent for one-month certificates in August 1998 when a market-determined auction system was first introduced. Bank deposit rates followed suit. Both setsof rates had declined to the 20-percent level by end-June 1999, and declined again -- helped by the apparent absence of inflation -- to the 15-percent range by mid-July. This meant that bank deposit rates were again close to their June 1997 levels (see Table3).

Table 3. Interest Rates Down Sharply

	SBI*	**3-month deposits**
Jun-98	Annual	Percent
Jun-98	56.3	40.6
Jul	55.9	43.0
Aug	69.5	44.4
Sept	60.9	47.4
Oct	59.7	54.7
Nov	37.4	53.1
Dec	37.8	49.2
Jan	35.8	45.5
Feb	34.1	38.2
Mar	34.4	34.9
Apr	33.2	32.5
May	26.1	30.0
June	20.3	25.0
July	14.6	15.0

* Average annual interest rate for all SBIs, except May-Jul figures, which are for 1-month SBIs. Source: Bank Indonesia

11. Stock Market: The Jakarta Stock Exchange composite index sank to 276 in September 1998. In second quarter 1999, the stock market rallied, reaching 662 at end-June, within striking distance of June 1997 high of 724 (see Table 4). One brokerage firm's June report described the Jakarta Stock Exchange (JSX) as the best performing market in the world, up almost 70 percent in USD terms since the beginning of the year. Analysts described the JSX rally in part as a self-fulfilling process that began in first quarter 1999 when favorable news about other stock markets in the region prompted investment fund managers to look for the next recovery target. Relatively small amounts of offshore funding coming in were enough to push prices up: June 1999 daily trading value at the JSX was typically Rp 1 trillion (about US$ 150 million), or about one-half of one percent of the New York Stock Exchange's 1998 daily trading value. Domestic factors driving the index higher were signs of a recovery of consumer spending, and the perceived attractiveness of some listed banks that the government was helping recapitalize.

Table 4. JSX Composite Index on the Rise

End-Period	Index	Percent change from previous month
Jan-99	412	3.5%
Feb	396	-3.9%
Mar	394	-0.6%
Apr	495	25.8%
May	585	18.1%
Jun	662	13.2%

12. Oil Prices: The price of oil, a key Indonesian export, declined to US$ 12/barrel in mid-1998, declining further to US$ 10/barrel by end-December 1998. By end-June 1999, prices were back to US$ 16/barrel.

13. Investment figures: Portfolio investment figures were increasing, as reflected by rising stock prices, but there was negligible new foreign direct investment coming into Indonesia as of mid-1999. The exceptions were funds targeted at taking over troubled banks or other indebted firms -- not new ventures. Bank Indonesia figures showed that Indonesia underwent a stark shift in the composition of incoming capital after the onset of the crisis. Official capital flows such as IMF loans increased, but private capital flows reversed (see Table 5). A lingering question, despite the improvement in confidence in mid-1999, was when the private capital inflows (loans and foreign direct investment) that had fueled Indonesia's earlier growth would resume.

Table 5. Net Capital Flow Reversal

Period	Official	Private	Balance
	(US$ billions)		
1993/94	1.1	4.6	5.7
1994/95	0.1	4.6	4.7
1995/96	0.1	11.7	11.5
1996/97	-0.8	13.5	12.7
1997/98	4.1	-11.8	-7.7
1999/00	6.9	-4.9	2.0

Source: Bank Indonesia. 1999/00 figure is forecast.

14. There were preliminary signs of improvement in the real sector.

15. GDP: In 1998, real GDP declined for four consecutive quarters foran overall decline of 13.7 percent (see Tables 6-7). In 1999, in contrast, preliminary data showed GDP increasing slightly during real GDP was said to have increased 1.3 percent in the first quarter of 1999, compared to fourth quarter 1998, and by a further 0.5 percent in second quarter 1999, compared to first quarter 1999. However, analysts here cautioned against relying too strongly on these estimates because of their preliminary nature (the second quarter estimate was released the day the quarter ended).

Table 6. 1998 Real GDP: Decline in all but Agriculture and Utilities

	1997	1998	change
	Rp trillions, 1993 const. prices		
Manufacturing	109	95	-12.7%
Agriculture	64	64	0.4%.
Retail and wholesale trade, hotels, and restaurants	73	60	-18.6%
Mining and Quarrying	38	37	-3.6%
Services	38	36	-4.9%
Finance, Rentals, Company Services	39	28	-27.6%
Transportation and Communication	32	28	-12.9%
Construction	35	21	-39.7%
Electricity, Gas and Water	5	6	5.3%
GDP	434	375	-13.7%
GDP excluding oil/gas	399	340	-14.8%

Source: Central Bureau of Statistics, preliminary 1998 data

Table 7. GDP by Expenditure: Investment Slashed

	1997	1998	change
	Rp trillions, 1993 const. prices		
Consumption	274	266	-2.9%
Government Spending	32	27	-14.4%
Investment	147	80	-45.7%
Exports	121	134	10.6%
Imports	140	132	-5.4%
GDP	434	375	-13.7%

Source: Central Bureau of Statistics, preliminary 1998 data

16. Exports: Non-oil exports were disappointing in 1998, given the large depreciation that should have led to export growth, all other things being equal. Instead, average monthly 1998 export earnings denominated in U.S. dollars were 9 percent below the 1997 value (although export values increased in rupiah terms), and non-oil exports were down 2 percent. Early 1999 figures showed further declines. However, preliminary figures showed exports recovering somewhat in April and May 1999, when they were 4 percent above the same months in 1998 (see table 8).

Table 8. Exports Moving Toward Recovery

	(US$ billion)		
	Non-oil/gas	Oil/gas	Total
Jan 1998	3.35	0.80	4.15
Feb	3.06	0.75	3.81
Mar	3.84	0.72	4.56
Apr	3.14	0.51	3.65
May	3.27	0.65	3.92
Jun	3.86	0.62	4.48
Jul	3.96	0.62	4.58
Aug	3.48	0.61	4.09
Sep	3.39	0.62	4.01
Oct	3.17	0.66	3.83
Nov	3.25	0.61	3.87
Dec	3.24	0.67	3.91
Jan 1999	3.37	0.64	3.02
Feb	2.62	0.58	3.20
Mar	3.20	0.72	3.92
Apr	3.20	0.64	3.85
May	3.37	0.68	4.06
avg./mo. 1996	3.17	0.98	4.15
avg./mo. 1997	3.49	0.98	4.45
avg./mo. 1998	3.41	0.66	4.07
avg./mo. 1999*	2.95	0.65	3.61

*Jan-May
Source: Central Bureau of Statistics, "Economic Indicators," March 1999, and July 1 press release.

17. There were several theories for the lackluster export showing, but no clear explanation. Analysts cited exporters, difficulty getting trade credit (despite a number of government programs designed to address that problem), slowdowns in traditional Asian markets, order cancellations due to concern about unreliability of Indonesian suppliers, shortage of key imports used in production, and underreporting by exporters. In mid-1999, an added concern was that the strengthening exchange rate would erode exporters' competitiveness.

18. Imports: Also on the trade side, another symptom of the economic contraction, and of the difficulties facing exporters targeting the Indonesian market, was the collapse of imports in 1998 after years of strong growth (see Table 9). Anecdotal information suggested that imports were beginning to recover as of mid-1999.

Table 9. Leading Non-oil Imports Down One-third in 1998

	1994	1995	1996	1997	94-97 Change*	1998	97-98 Change
	(US$ billions)						
Machinery	9.8	9.0	9.1	12.4	8%	8.1	-34.8%
Chemicals	3.3	3.8	3.8	5.4	16.4%	3.0	-44.7%
Base metal	1.5	1.7	1.8	2.0	10.1%	1.6	-20.5%
Cereals	0.7	0.8	1.3	1.2	17.1%	1.5	26.8%
Cotton	1.0	1.3	1.1	1.0	0.1%	1.0	2.6%
Paper	0.9	1.1	0.9	0.9	1.8%	1.0	4.0%
Plastics	1.1	1.3	1.1	1.1	-0.9%	0.8	-29.8%
Metals	0.9	1.4	1.1	1.1	7.8%	0.6	-51.0%
Pharmaceut	0.5	0.5	0.6	0.6	5.1%	0.5	-17.0%
Total	30.4	33.7	32.2	37.8	7.3%	25.2	-33.3%

* average annual percentage change, 1994-1997.
Source: BPS

19. Rice Harvest: The 1997-98 drought caused Indonesia to become the world's largest rice importer. In 1999, in contrast, abundant rains led to a recovery in production, and imports were expected to decline to normal levels.

20. In addition, there was new information indicating the extent of the increase in poverty.

21. A range of studies conducted during 1998 estimated variously that poverty had increased from about 11 percent of the population before the crisis, using Indonesian poverty-line measures (per person expenditures of about Rp 50,000 per month as of mid-1998, deemed sufficient to cover 2,100 calories of food per day and other basic necessities) to between 18 and 24 percent of the population in 1998.

22. The broad range of estimates resulted largely from different methods of handling price increases during a turbulent period in which both prices and most incomes increased in nominal terms. Studies that used the increase in the general consumer price index (up 78 percent in 1998) concluded that poverty increased to the low end of the range, close to 18 percent (meaning from about 22 million before the crisis to about 36 million persons in 1998, out of a population of 200 million). However, studies that focused on the increase in food prices (up 118 percent in 1998), which account for a large share of purchases for low-income households, concluded that the increase in poverty was larger.

23. While the studies indicated that poverty had not increased to 40 percent of the population, as the GOI's Central Bureau of Statistics had estimated in mid-1998, analysts emphasized that there were also millions of "near poor" Indonesians. The studies showed that urban Javawas hardest hit, but that the effects of the crisis on lower-income groups varied greatly within and across provinces.

Economic Issues during the Political Transition

24. The above figures formed part of the backdrop for the public debate that surrounded the parliamentary

election and its aftermath. As of July 1999, it was unclear what sort of government would emerge by the end of 1999, and leading political parties (PDI-P, Golkar, PKB, PPP, and PAN) had not yet articulated clearly what changes in Indonesia's economic policies they would seek.

25. Though the politics remained uncertain, it was clear that the a new government would have to face at least the following financial, real sector, and institutional issues:

Financial Sector

- - Banks:

26. The banking sector took a direct hit in the financial crisis, and recovery efforts were still in the early stage. The IMF, World Bank, and Asian Development Bank were assisting Bank Indonesia, the Ministry of Finance, and the Indonesian Bank Restructuring Agency (IBRA) in this effort. The government had begun issuing recapitalization bonds to a few eligible private banks under a formula whereby the bank owners were obligated to provide 20 percent of the required capital, and the GOI would provide the rest, becoming the majority owner. An equivalent process involving the state-owned banks, where problems were larger, was to begin in July or August. The interest-bearing bonds replaced non-performing loans, which were in turn transferred to IBRA for collection/restructuring. Estimates were that the GOI would issue about Rp 550 trillion (US$ 80 billion) in recapitalization bonds, equivalent to 55 percent of 1998 GDP.

27. Paying the coupon (mostly linked to market interest rates) on those bonds would seriously crimp a new government's budget for several years, but declining interest rates made the payments appear more feasible. IBRA's program to restructure and recover non-performing loans from the rescued banks was'an essential element in financing the program. For FY 1999/2000, the GOI estimated that Rp 34 trillion (about US$ 5 billion) would be needed to pay the interest costs. Half of that (Rp 17 trillion) was on the GOI's budget, and IBRA was expected to provide the other half.IBRA's Rp 17 trillion was to come partly from sales of assets that firms pledged to pay for their earlier bank liquidity credits, and from loan recoveries. However, as of July, IBRA had hardly begun either asset sales or loan recoveries, having auctioned only some, vehicles and paintings.

28. The loan recovery effort was also a political issue because the debtors, whose company names and amounts were published in newspapers in June, included many Soeharto family members and close associates. IBRA faced a dilemma: on the one hand there was pressure to foreclose on debtors and sell their assets quickly to raise funds and to underline the seriousness of the program, but such quick sales would depress market prices and could lead to allegations of preferential treatment if some debtors managed to buy back their assets cheaply.

-- Debt:

29. Indonesia's private external debt stood at US$81.5 billion as of March 1999, according to the Bank Indonesia Governor's July 1999 testimony to parliament. (For a breakdown of the debt according to publicly available information as of late 1998, see table 10). In addition, there was approximately US$ 50 billion in domestic corporate debt. The debt had increased since the onset of the economic crisis in mid-1997, when borrowers were caught unable to service their debts as the rupiah depreciated and economy slowed, and lenders refused to roll over short-term loans or extend new credits.

Table 10. Indonesian Foreign Debt Overhang

Borrower	US$ Billion

Public Sector	
Central Government	61.1
State-owned banks	4.5
State-owned companies	5.4
Subtotal	71.0
Private Sector	
Joint-venture banks	3.9
Domestic Private banks	2.0
Foreign banks	0.6
Foreign and JV corporations	31.2
Domestic corporation	30.4
Subtotal	68.1
Grand total	139.1

Note: Available data for November 1998.
Sources: Bank Indonesia and World Bank.

30. Restructuring efforts were underway in many cases but were inherently complicated. Neither the Indonesian Debt Restructuring Agency (INDRA, essentially a swap facility allowing debtors to lock in a Rp/US$ exchange rate, with the requirement that they begin making rupiah payments immediately), the revised bankruptcy law that took effect in August 1998, nor the Jakarta Initiative (facilitation service, with assistance from internationally experienced debt workout specialists) launched in November 1998 had made significant headway in resolving the issue.

31. Foreign creditors said inconsistent bankruptcy procedures were a serious problem, since the result was that debtors did not feel compelled to come to the table. In some cases it was creditors (those who had already provisioned for the non-performing loans), rather than the debtors, who were seen as dragging their feet in hopes of improved economic conditions that would lead to more favorable settlements. The issue was becoming more complicated in light of IBRA's high-profile efforts to recover domestic debts, because many of the same firms had substantial foreign debts.

32. There were some signs of progress as of mid-1999, as the Jakarta Initiative started to get up and running and anecdotal evidence suggested the debtors were becoming more willing to negotiate. one high-profile group, Astra International (automobile assembly and sales and palm oil export, among other businesses), reached agreement in June 1999, after over a year of negotiations, to restructure US$ 1.1 billion in foreign debt and additional domestic debt.

Real Economy

-- Real sector recovery/restructuring:

33. It was essential to revitalize the real sector, but there was no way to address the real sector fully without resolving financial issues first. Banks had to be more stable and corporations had to become more creditworthy (by resolving existing debts, for example) before normal lending for working capital and business expansion could resume.

34. Furthermore, in the context of the overhaul of the political system that was underway, many Indonesians wanted to overhaul the economic system too, rather than try to simply restore the pre-crisis structure. This

added complexity to the recovery process. The deep recession that resulted from the financial crisis was not viewed as a purely economic issue that called for technical solutions, but instead as the result of years of crony capitalism in need of a top-to-bottom overhaul.

35. One line of argument -- stemming in part from the November 1998 People's Consultative Assembly (MPR) session that mandated development of a "people's economy" -- held that the government should foster growth of small and medium enterprises, so that control of the economy would not simply revert to conglomerates when the economy recovered. The issue was sensitive because many existing conglomerates were owned by ethnic-Chinese Indonesians. It was also difficult to imagine an impartial way to change the ownership of existing firms or parcel out shares in state-owned corporations. The "people's economy" debate was muted as of mid-1999, but remained a potential political issue.

Social Safety Net:

36. Indonesia has historically not had much of a social safety net system, so introducing one in mid-1998 to address poverty and unemployment on an emergency basis was difficult. The government initially created programs in three areas to help the poor: ensuring food availability (almost 10 million households were said to be purchasing rice at subsidized prices as of February 1999); supplementing purchasing power through job creation and loans to small enterprises (labor-intensive public works projects, for example); and preserving access to education and other critical social services (in part through block grants to poor schools).

37. In FY 1999/2000 (which began April 1), the GOI allocated 12 percent of its budget (about US$ 3.8 billion out of a US$ 33 billion budget) to social safety net programs, in part to be financed through a US$ 600 million World Bank loan. The program was widely viewed as necessary not only to help the targeted groups, but also to provide a general fiscal stimulus to the economy. Even so, the program remained controversial because there were allegations of leakage and because some non-government organizations argued that the assistance was not reaching the neediest families. A new government would have to contend with such criticisms, as well as decide at what level to continue such programs.

Institutional and Legal Issues

Corruption:

38. Eliminating "collusion, corruption, and nepotism" (KKN) remained the slogan of the day. The issue remained more political than economic, and more sound than substance, but a new government was likely to have to account for its efforts to overturn the culture of corruption that permeated business and government. That would be no easy feat. As of mid-1999, there were distinctions being made between the alleged corruption of former President Soeharto and his family and close associates, business tycoons who abused bank regulations, and "ordinary" corruption in the government. There were calls for the perpetrators in the first two categories to be brought to justice, but broad-based civil service reform was seen as needed for the latter. Public interest in anti-corruption efforts remained high. Non-government organizations were reporting allegations of government officials, corruption to the media, and had published detailed studies of the cost of corruption in certain areas of everyday life, such as obtaining identity cards.

Legal reform:

39. As a subset of the corruption issue, the dysfunctional legal system was increasingly being viewed as a root problem that had to be addressed before lasting economic recovery could occur. Both improved law enforcement

and improved laws were needed. The magnitude of the crisis meant that a range of new legal issues had arisen, placing increasing stress on a system that malfunctioned to start with. Issues such as bad loans were nearly impossible to resolve in a system where property rights were only vaguely defined, there was no central registry for collateral, and court decisions were often controversial or unenforceable. Foreign and domestic creditors attempting to use the commercial courts got a taste of this. Political figures appeared to appreciate the seriousness of the issue and were already calling for replacement of supreme court justices, but no one had come forward with a comprehensive action plan for legal reform.

-- Regional autonomy and fiscal equalization:

40. A new issue on the horizon--not directly resulting from the economic crisis, but part of the ambitious slate of laws passed in 1998-99--was a rearrangement of central and regional government authority and revenue. President Habibie signed two companion laws in May 1999.

41. The "Regional Government Administration" law said that governmental authority should devolve to the level of "autonomous regions," in most cases meaning the sub-provincial regency level (roughly equivalent to a U.S. county). Exceptions were foreign affairs, defense, justice, monetary, and religious affairs, and would also include "national strategy" and "regional strategy" issues, not yet defined. The "Fiscal Equalization" law said that the central government would share revenues with regions. It included specific revenue sharing formulas for natural resources such as oil and gas.

42. The laws were to be implemented over two years, but officials at both the central and regional levels were uncertain about that timing and concerned that the laws were mutually inconsistent. Regulations remained to be written. Even so, one Finance Ministry official said, the laws amounted to a "revolution" in that they transferred a great deal of power to regional governments. Activists in restive provinces such as Aceh and Riau had already proclaimed the fiscal sharing law insufficient, and a new government was sure to have to cope with both the logistical and political complications of the issue.

Policy Outlook -- Continuity Expected

43. Though the politics remained uncertain as of mid-1999, the economic policy outlook was less so. That was primarily because of the widespread acceptance among political parties that continued IMF/international financial institution assistance and monitoring was essential during the recovery period. Agreement on the IMF's continued role suggested that the main lines of economic policy would not change drastically in the near term.

Short term

44. Over the short term (roughly 1999-2001), any new government's economic policy would have to focus primarily on financial and real sector recovery. In that context, there were indications from across the political spectrum that the IMF/international institution-assisted program was broadly accepted - despite some dissenting voices calling for an end to what was seen as excessive outside meddling in policymaking -- and needed, both in terms of the technical assistance it provided and the continuing disbursements of loans. The IMF's role in stabilizing the economy starting in mid-1998 was generally acknowledged.

45. The favorable view of the IMF was consistent with, and in a sense a product of, the close working relationship between the GOI and the IMF and other international financial institutions that developed under the Habibie government. Since June 1998, the GOI met its commitments consistently enough to keep the flow of borrowing from the IMF steady (see Table 11 for chronology), and Indonesians could see the results by watching

the exchange rate strengthen and interest rates and inflation decline. This was in marked contrast to the sometimes confrontational relationship between the two during October 1997-May 1998 under President Soeharto. During the earlier period, the economic program appeared to have little stabilizing effect in the context of a destabilizing political situation.

46. In July 1999, it seemed a part of Indonesia's economic policy routine when the government of Indonesia signed a further revision to its August 1998 Extended Fund Facility, which replaced the November 1997 Stand-by Arrangement. In August, the IMF was expected to disburse US$ 200 million in funds, bringing Indonesia's total borrowings from the IMF to US$ 11.3 billion out of a program expected to total US$ 12.4 billion.

47. This background suggested that the IMF, as well as the World Bank and Asian Development Bank, would continue to play an important role during the late 1999 transition to a new government and beyond. That in turn suggested that Indonesia would retain its orthodox economic policies, open trade regime, and free capital flow orientation during the recovery period. However, there were a number of important unknowns. The possibility of a new president, a new set of economic cabinet ministers, and a more active and politically diverse parliament was bound to affect the relationship between Indonesia and the international financial institutions.

Longer term

48. The economy was being restructured, and important aspects of the political system rebuilt as of mid-1999. It was impossible, given the unprecedented scale of change occurring, to predict what the system would look like when the political transition was complete and the economy recovered. Even so, if the IMF's continuing involvement suggested policy continuity over the short term, Indonesia's pre-crisis economic orientation suggested that the economy would retain its marketoriented and trade-oriented character over the longer term.

49. The relevant features of the pre-crisis economy included Indonesia's decades-long experience with a freely convertible currency and open capital account; the steadily increasing role of the private sector in the economy, which become dominant in the mid-1990's after deregulation in the 1980s; and the central role of exports as the engine for growth, which led to growing integration with the world economy and acceptance of trade-enhancing international agreements and substantial foreign investment. Those features suggested that Indonesia would remain private market oriented, open to foreign capital (though perhaps with new strings attached), and broadly internationalist.

50. However, there were unresolved issues that could affect the shape of the new economy and the role of foreign businesses in it. There was an ongoing debate about what kind of market-based system was appropriate in Indonesia. There were calls for a more inclusive system with an increasing role for small and medium enterprises rather than a small number of dominant conglomerates, but questions remained about how this could be achieved fairly.

51. Related to this debate was the discussion of the proper role of foreign businesses in Indonesia. The GOI intended to privatize major state-owned enterprises for economic efficiency, but various parties were uncomfortable with sales of such national enterprises to foreign companies. This discomfort was also reflected in concern that Indonesian banks and business would be sold to foreign investors at fire-sale prices.

52. Another unresolved issue was the decision-making structure that would emerge as democratic institutions gained firmer footing. The Soeharto-era structure, where all roads led to the president, was gone, but it was not yet clear what would take its place.

53. In general, the growing public pressure for a more transparent, accountable government and economic structure was likely to lead to an economy that played more to the strengths of U.S. business practices.

Table 11. Chronology of Indonesia's IMF Program

Date	Disbursements (US$ bn.)	Description
Oct-97		GOI issues Letter of Intent describing Its planned 3-year economic reform program.
Nov-97	3.0	IMF Executive Board approves a 3-yr. "standby arrangement" under which the GOI is to borrow US$ 10 billion (SDR 7.3 billion).
Jan-98		GOI issues Memorandum of Economic and Financial Policies (MEFP) designed to accelerate the program.
Apr-98		GOI issues Supplementary MEFP that, among other changes, strengthens monetary policy in light of inflation concerns.
May-98	1.0	
Jun-98		GOI issues Second Suppl. MEFP after resignation of President Soeharto in May.
Jul-98	1.0	
Jul-98		GOI issues new Letter of Intent and MEFP and requests stand-by arrangement be replaced by an Extended Fund Facility (EFF, lengthening the loan repayment period from 3.25-5 years to 4.5-10 years). IMF Executive Board approves increase in Loan amount by US$ 1.4 billion, bringing total program to US$ 11.4 billion.
Aug-98	1.0	
Sep-98	0.9	GOI issues 1st Suppl. MEFP under EFF.
Oct-98	0.9	GOI issues 2nd Suppl. MEFP under EFF.
Nov-98	0.9	GOI issues 3rd Suppl. MEFP under EFF.
Dec-98	0.9	
Mar-99	1.0	GOI issues 4th Suppl. MEFP under EFF. IMF Executive board approves a further US$ 950 million increase in the program, bringing total program US$ 12.4 billion
May-99		GOI issues 5th Suppl. MEFP under EFF.
Jun-99	0.5	
Jul-99		GOI issues 6th Suppl. MEPF under EFF.
Aug-99	0.2*	
Nov-99	0.2*	
Feb-00	0.2*	
May-00	0.2*	
Aug-00	0.2*	
Oct-00	0.2*	

* Expected disbursement
Source: IMF documents on homepage: www.imf.org

Table 12. General Economic and Trade Statistics

Appendix A: Country Data
Population in 1999: 201 million (projection based on 1990 census)

Population growth rate:
Religions: 1.7 %/year (avg. for 1990-97) Islam, Hinduism, Buddhism, Christianity, Animism
Government System: Transitioning to Democracy
Languages: Indonesian, English, and Regional Languages
Work-week: Monday - Friday

Appendix B: Domestic Economy

	1996	1997	1998	1999 (forecast)
GDP (USD billions)	227	215	99	138
Real GDP growth	9.0%	5.0%	-13.7%	+2.0%*
GDP/capita (USD)	1,146	1,070	492	688
Govt. spending/GDP	18%	21%	27%	20%
Consumer Price Infl.	6.5%	11.1%	77.6%	10.0%
Unemployment**	5%	5%	5%	5%
Foreign Exch. Reserves (USD billions)	25.5	21.4	24.1	26.6
Avg. exch. rate/USD	2,342	2,909	10,014	7,000
Debt service/exports	37%	38%	37%	41%

Appendix C: Trade (USD billions)

Total exports (1)	49.8	53.4	48.8	18.0
non-oil/gas (1)	38.1	41.8	41.0	14.8
oil/gas (1)	11.7	11.6	7.8	3.2
Total imports (1)	43.0	41.7	27.3	9.7
U.S. exp. to Ind (2)	3.8	5.0	3.5	0.6
U.S. imp. fm Ind (2)	6.8	7.1	7.0	2.9

* The forecast for FY1999/2000 (April-March) in the July 1999 GOI supplementary memorandum to the IMF is real GDP growth of positive 1.5 to 2.5 percent.
** Indonesia does not have reliable unemployment data, in part because of the large informal workforce.
note 1: 1999 figure is Jan-May, GOI statistics.
note 2: 1999 figure is Jan-April, USDOC statistics.

Sources: Indonesian Central Bureau of Statistics, Bank Indonesia, Ministry of Finance, World Bank, U.S. Department of Commerce (USDOC).