EAST ASIA UNDER ECONOMIC GLOBALIZATION: INDONESIAN EXPERIENCE

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Over the past two and one-half years Indonesia has passed through some of the most traumatic experience in its half-century history as an independent nation. The events that began in mid-1997 as a limited problem of currency realignment soon developed into a major economic crisis and then into a full-scale political crisis, leading to the first real political transition in Indonesia in over thirty-two years. With the election of a new President last October and the formation of a new government shortly thereafter, we are looking forward to a rapid resolution of the political tensions that lie at the heart of Indonesia's on-going economic turbulence.

Millions of workers have lost their jobs, banking and financial sectors collapsed, trade and investment sectors struggle to survive, and many market players have lost confidence in the government. These problems have fed on and magnified each other, with the result that Indonesia has suffered far more than any other country in the region.

In this very complicated situation, Indonesia must seek not merely to restore the economy to its previous position of strength but also to bring the economy to improved and sustainable levels of prosperity and equity. The earnest assistance of the IMF, and the World Bank, accompanied by strong support from developed countries joining the Consultative Group on Indonesia, have contributed to significant progress in restoring macroeconomic stability, dealing with the financial crisis, advancing structural reforms, and assuring food security.

In 1998 Indonesia reached its lowest economic and political performance in thirty years. The rupiah lost more than 80% of its value in just twelve months, the US dollar exchange rate rose from Rp.2,600 to Rp.15,000; inflation accelerated from single digit to 82%, real GDP plummeted and became 13% lower than it had been in 1997. But, by the end of 1999 the inflation rate had dropped to only 8%, the rupiah exchange rate had stabilised around Rp.7,300 to the US dollar, the Jakarta Stock Exchange composite index rose above 500 points, and the balance of trade had a sizeable surplus. In total the economy grew 0.34% in 1999.

Based on this progress, the government adopted a medium-term comprehensive economic program that would further accelerate the restructuring of Indonesia's economy. The medium-term strategy has four main flanks. First, to make the macroeconomic policy mix fully supportive of recovery while entrenching basic price stability. Second, to reinvigorate bank, corporate, and other restructuring policies, which are crucial to sustaining economic recovery accompanied by lasting poverty reduction. Third, to rebuild key public institutions, thereby strengthening Indonesia's capacity to implement economic and social policies with popular support, transparency, and good governance. Fourth, to improve greatly natural resource management, arrest the long-term deterioration in the environment, and ensure the sustainable use of natural resources for future generations.

The medium-term economic strategy envisages restoring a growth rate of 5-6 percent over the 2000 to 2004 term, and Bank Indonesia (in the context of the new Central Bank Act) has adopted a target of keeping inflation below 5 percent annually. Although the external current account will weaken over the next several years as investment picks up, official financing and improvements in private capital flows (including the return of flight capital) should offset the deadline in the current account surplus. It is expected that the need for exceptional balance of payments financing would be eliminated by the end of the program period, while the import coverage of liquid reserves would be maintained at about 6 months. The government debt-to-GDP ratio should decline from its recent peak of about 100 percent to about 65 percent by the year 2004, helped by falling interest rates and the asset recovery of IBRA (Indonesian Bank Restructuring Agency).

The key to attaining these objectives will be a range of fiscal reforms, affecting both revenues and expenditures. These reforms will be introduced concurrently with implementing fiscal decentralization by June 2001, consistent with the Regional Governance and Fiscal Balance Laws, and without the general government deficit.

The government budget for the year 2000 was prepared through the consultation with the IMF and the World Bank and approved by the House of Representatives last March. According to this document, for the year 2000 the budget deficit will be 4.8% of GNP, the GDP growth rate will be 3.8%, and the inflation rate 5% to 7%. A restructuring program related directly to the implementation of the budget will be tightly monitored by the IMF and the World Bank.

External forces on the Indonesian economy.

Globalization resulting from free trade and accompanied and enhanced by the revolution in computer technology is pushing each nation to change its production structure. Every country will produce and export goods and services based on its comparative and competitive advantages. Each country will specialize in the production of certain goods and services. And as a result at last each country will gain from the free trade.

But this situation can be attained only in equilibrium, after an economy has passed the transition period of trial and error, when companies enter and leave an industry in the effort to specialize and re-specialize and the fittest companies survive the fierce world-wide competition. Companies lacking funds to invest in new technologies and new capabilities will find themselves out of the domestic market as well as the world market.

The Southeast Asian countries, hit hard by the economic crises, have undergone a very expensive adjustment period which cost them time and capability in preparing for globalization. Most AFTA member countries have been affected by the economic crises and are now in a weak position to fulfil the agreed schedule for free trade.

Even though Indonesia started to deregulate its economy in 1985, at the time of the 1997 crisis a large part of the economy was still protected through high import tariffs, entry barriers in the form of special, or monopoly power held by a certain group of companies. These highly protected companies were hit hard by the crisis and they are not likely to be able reorganize themselves to meet global competition.

The impact of China's entry to the WTO is directly related to the vast size of its labor force, large potential market, and work ethic of its population. On one hand, China's entry to the WTO will create a tough competitor for Indonesian manufacturing products in developed countries' markets. China's exports of lower-end consumer products will also easily penetrate and flood Indonesia's domestic market. On the other hand, China offers a vast potential market for Indonesia's natural resource exports.

Indonesia is surely far behind neighboring countries in response to the IT revolution as it lags in the needed legal foundation as well as in the human investment for the absorption of the new technologies. But industry related to the new technologies is growing quite rapidly, around 20 to 30% last year.

What about our expectation on the role of Japanese corporations? The massive efforts to reform and reconstruct the Indonesian economy have generated a multitude of opportunities for domestic as well as for foreign investors. IBRA, Indonesian Bank Restructuring Agency, now controls a wide range of companies, assets, and equity portfolios ready for sale at favorable prices. Investors may also become involved in the restructuring of non-performing loans, buy securities in our capital market, or make a direct investments. The depreciation of the rupiah against major international currencies has driven the cost of investment in Indonesia down below that in other countries, including the crisis-hit ones in the Asia-Pacific region.

Indonesia is blessed with a rich pool of natural resources and a market of over two hundred million people. World-class entrepreneurs from the United States have already recognized the opportunities provided by an economy in recovery and are reinvesting in Indonesia to capitalize on this momentum. Last wee, a group of economic ministers from countries in the Middle East conducted a meeting in Indonesia to consolidate their intention to participate in buying some companies under the control of IBRA.

This is the right time for Japanese companies to invest heavily in Indonesia.