Statement By the IMF Representative

1. Ladies and Gentlemen, the IMF welcomes this opportunity to report to you on the status of the mission’s discussions with Minister Ramli and the Indonesian economic team over the past two weeks. As you know, during this period, the IMF mission has continued its work with the authorities on the third review of the IMF’s extended arrangement with Indonesia, which had begun in November of last year. The discussions have been constructive and conducted in a very cooperative atmosphere, and were held in close cooperation with the World Bank and the AsDB. This statement summarizes the main areas of progress, areas where more work remains to be done, and the next steps that are planned as we work with the authorities towards completion of the third review.

2. Before doing that, however, it would be useful to provide a brief update on the macroeconomic context in which the mission’s discussions have taken place. At the time we last met in October 2000 in Tokyo, Indonesia’s economic recovery was developing more strongly than expected. And, indeed, real GDP growth reached 4.8 percent in 2000, above the program’s target range of 3–4 percent, helped by buoyant oil and nonoil exports. Already at that time, however, risks to the sustainability of the recovery had begun to appear—specifically, a decline in market sentiment that had led to downward pressure on the rupiah as well as an uptick in inflationary pressures.

3. Since then, downside risks have increased. In particular, market sentiment has continued to deteriorate, bringing the rupiah to an overly depreciated range of over Rp 11,000 and putting further upward pressure on interest rates. Inflation has also re-emerged as a key risk, with the 12-month increase in the CPI reaching over 10 percent in March. Other indicators of market sentiment have also weakened.

4. These developments are beginning to affect the macroeconomic framework—especially the fiscal outlook for 2001—and place Indonesia’s recovery at risk. Therefore, the priority is to restore confidence among domestic and international investors. This will require renewed strong assurances of macroeconomic stability, especially fiscal sustainability, and an acceleration of economic reforms. This was the aim of the mission’s discussions.

5. Let me now turn to those discussions. In the weeks leading up to the mission’s visit, progress was made in a number of areas of the program. The independent panel of experts on the Bank Indonesia Law—jointly appointed by the Government and the IMF—completed its work, principles and timetables to guide IBRA’s corporate debt restructurings were issued, important regulations governing fiscal decentralization were finalized, and Parliament approved the majority sale of IBRA banks BCA and Niaga.

Macroeconomic Framework and Policies

6. The joint work of the IMF mission and the Indonesian authorities in the past two weeks has focused, first and foremost, on establishing an appropriate macroeconomic policy framework for 2001. Agreement on such a framework, together with a supporting and fully quantified financial program for 2001, lies at the heart of the current review.

7. With strengthened policies and consistency in implementation, a satisfactory macroeconomic outcome for 2001 is still within reach. The discussions have been guided by the objective of delivering at least 3 percent growth in 2001, which is still an ambitious target in light of weaknesses in the world economic outlook, and the recent slowing in nonoil exports. The policy framework under consideration for the 2001 program also aims at containing 12-month inflation to the single digit range by the end of the year and maintaining Bank Indonesia’s gross foreign exchange
reserves at their relatively comfortable level close to about $29 billion. Achieving this framework will require an appropriate budget and monetary program—to ensure fiscal sustainability and contain inflation risks.

8. As noted at the Tokyo CGI meeting in October, the IMF supported the authorities intention—approved by Parliament—to target a budget deficit of 3.7 percent of GDP for 2001. This target was viewed as representing an appropriate balance between fiscal stimulus and beginning the crucial process of fiscal consolidation. Indeed, given the sharp increase in government debt associated with the 1997–98 crisis, the restoration of a sustainable fiscal position with a reduction in the government debt burden will be a critical condition for continued growth over the medium term.

9. Against this background, both the IMF mission and the Indonesian authorities view with serious concern the significant deterioration in the fiscal situation that has emerged since the time the 2001 budget was approved by Parliament in December 2000. Owing mainly to a combination of policy changes and the impact of declining market confidence on the rupiah, our joint projections indicate that the budget deficit could rise to about 6 percent of GDP, almost two-thirds higher than the budget target, unless corrective measures are urgently adopted. Such a widening in the deficit can not be justified for a number of reasons. Most importantly: (i) it could further weaken market confidence given the concerns about fiscal sustainability; and (ii) it could not be financed without leading to a serious further increase in inflationary pressures. Addressing the fiscal problem, thus, has been a focal point of the mission’s work with the authorities.

10. We are pleased to say that progress is being made in addressing the fiscal problem for 2001. First, as I have indicated, we have agreed on the size of the problem, namely that, unless action is taken, the deficit for 2001 is likely to reach 6 percent of GDP. Second, we have agreed that it is essential that measures be adopted as soon as possible to keep the deficit broadly at the level approved by Parliament in the budget. Third, key Parliamentary leaders have told the mission that they intend to cooperate with the government toward the passage of an appropriate revision to the budget.

11. The next step, therefore, is for the government to prepare a concrete set of corrective actions in the context of a revised budget for 2001, and submit this proposal to the Parliament for accelerated approval. Here, too, there is progress. The mission has reached agreement on the broad areas where fiscal measures could be taken. However, given the size of the problem, bold initiatives are needed, and these will take some time to be fully formulated. The government has been working very hard to formulate the needed measures in recent days. Carrying this work to completion will be its core task for the coming weeks.

12. At the same time, the government intends to take essential steps to ensure that budgeted levels of domestic financing from IBRA recoveries and privatization receipts can be attained, implying an acceleration of the progress so far in these areas in 2001. Regarding donor financing, I am sure that the international community will continue to strongly support the authorities’ efforts to preserve an appropriate budgetary stance for 2001 and implement the overall economic program. In this way, with strengthened efforts all round, we remain confident that budgetary financing from nonbank domestic sources and from the donor community can still be mobilized to finance a deficit at the budgeted level of 3.7 percent of GDP. In this connection, the government has been considering the issuance of a sovereign bond securitized by natural resource exports. Our advice to the government has been to exclude such financing as it would reduce future flexibility in managing the external debt and risk jeopardizing the seniority of multilateral and official creditors.

13. Moving on to other areas, the mission reached basic understandings with Bank Indonesia on a monetary program for 2001 aimed at reducing inflation, reversing the recent decline in real interest rates, and containing pressures on the rupiah. With the increase in inflation since mid-2000, it will be crucial to maintain a tight monetary stance until inflation risks have been firmly contained, and for BI to be prepared to act flexibly and preemptively for this purpose. A strong and independent central bank is key to this task. In this context, the IMF supports the recently completed report of the independent panel on the Central Bank Law. This report establishes the appropriate framework for strengthening the accountability of Bank Indonesia, while preserving its independence, and the IMF looks forward to working with the authorities toward its full adoption as part of the current review.
**IBRA Reforms**

14. The mission also reached basic understandings on elements of IBRA’s asset recovery and restructuring plans for 2001, a key element in Indonesia’s medium-term growth strategy. It is expected that these will also be finalized and published in the coming weeks. In particular, there is broad agreement on the schedule for sales of IBRA’s corporate assets and loans for 2001, as well as on the framework to carry forward IBRA’s restructurings along with the timebound program for their independent reviews. In the coming weeks, IBRA will also be working to develop timelines for the sales of its stakes in banks BCA and Niaga, in a manner that will maximize returns for the government and also confirm the authorities’ intention to return banking assets to the private sector.

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15. These areas represent the main aspects of the mission’s dialogue with the Indonesian authorities over the past two weeks. Of course, there are other parts of the program that are also crucial to its success and where there is ongoing work. These areas include maintaining the momentum of reforms in the state banks, improving their governance, and raising supervision capacity over the banking system as a whole. Moving ahead with corporate restructuring and legal reforms is also crucial to restoring market confidence and carrying forward the economic program.

16. The mission has also reached broad agreement with the authorities regarding the next steps in the joint work with the Indonesian authorities towards completion of the third review under the extended arrangement. The main area of work relates to the measures to address the budget problem. A program of work in this area in the coming weeks has been agreed. Once the measures to address the budget problem have been fully specified and submitted to Parliament, and further progress made in the other areas, the mission will return to Jakarta to work to finalize a letter of intent for the review. The review can then be completed by the IMF’s Executive Board upon adoption of the revised budget by Parliament, which would help restore fiscal policy to a sustainable course.

17. Adhering to this agenda will require strong commitment by the government and by Parliament to the economic reform process. Notwithstanding the current difficulties in the political environment, the mission is encouraged that all parties agree on the imperative of preserving economic stability. Early confidence building steps in this direction will help accelerate the restoration of macroeconomic stability and final agreement on the economic and financial program for 2001 that is the focus of the current review of the program.

18. Finally, the mission thanks the Indonesian authorities for the atmosphere of mutual trust and shared purpose in which the discussions have been conducted.