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Reviving the Indonesian Banking Sector? Indonesia's Economic Crisis: Impact on Financial and Corporate Sectors 1997-1999*

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**REVIVING THE INDONESIAN BANKING SECTOR?
INDONESIA'S ECONOMIC CRISIS: IMPACT ON FINANCIAL
AND CORPORATE SECTORS 1997-1999**

Abstract

This study's objective is threefold. First, to investigate the impact of the current economic crisis on the Indonesian financial sector. Second, to relate how the previous financial policies had contributed to this financial blunder. And third, to discuss and analyze the financial reform efforts in response to the crisis.

There were many different factors acting simultaneously to bring about the downfall of Indonesian economy, both external and internal, which this paper touches on briefly. However, the impact of external factors such as speculative attacks and regional currency imbalances could have been dampened if the domestic financial system was strong. This study discusses the financial policies that contributed to the weaknesses in the financial sector, to which the financial system was unable to respond effectively from the beginning of the crisis in July 1997. Thus, this paper is an inward-looking, retrospective effort, rather than focusing on the external causes of the crisis.

After the July 1997 financial turmoil in Thailand, the contagious effect rolled over to other countries, and this was due to the increasingly large inter-linked derivative transactions in the region. But the impact on the Indonesian economy was so severe that it was even precipitating the collapse of the social and political fronts, and a creating vicious circle in the economy.

Prior to the crisis outbreak, the macroeconomic indicators were strongly positive: high and constant economic growth, large capital inflows, high domestic savings rate, and liquid and plentiful foreign exchange reserves. However, some signs of "growing risks" emerged over the past few years, and these came in the form of growing imbalances: deficits in the current account, rapid expansion of commercial bank credit, and growing foreign debt. There, too, were non-economic key issues which, instead of serving as the underlying structural foundation, inflicted severe damage to the Indonesian economy and increased its vulnerability. Such issues include legal inconsistency, lack of transparency, corruption, collusion, nepotism, inadequate supervision, lack of independence of the central bank, not to mention the political issues such as a centralized political system, and problems of succession and transition.

The failure to overcome the initial pressures on the currency's exchange rate was manifested in the drastic changes in the following indicators: large deficits, property and stock market crashes, deteriorating banking system and corporate bankruptcies — all of which subsequently drove the country into economic and political instability. Aside from the still unstable political

situation in the country, the government, together with international organisations like the IMF, World Bank and ADB continued to carry out financial reforms. The current core issue is the banking system, because of its close connections with the corporate and the real sectors and its important role as financial intermediary.

Despite the extension of the financial liberalisation in the past, several problems with the banking-related institutions were not addressed. Some of these issues include lags in loan monitoring, inadequate banking regulation enforcement and legal certainties, monetary supervision, transparency reporting, creditworthiness criteria.

The banking system, which is the backbone of the financial system, is currently under a recapitalisation scheme. The recapitalised banks are expected to lead the financial restructuring and eventually, economic recovery. However, the prospect of this recapitalisation is still uncertain. How long it is going to get the banking system ready for economic recovery would depend on the government's will and ability, the agencies concerned, the banking system itself, as well as the development of the political situation. We have seen the Indonesian banking flourish during the past decade, and this crisis — if all relevant parties responded positively — gives us the opportunity to see a reform that could rejuvenate the financial sector, provide it with a more solid foundation, higher value and quality. On the other hand, the situation can become worse if the above key issues in the financial sector are not addressed and if the socio-political situation fails to provide the necessary conditions for economic recovery.

Introduction

Since the outbreak of the Asian crisis, Indonesia's economy has been the hardest hit, as compared to those of other Asian countries like South Korea, Thailand, Malaysia and the Philippines. Not only was the economic chaos fuelled by factors like the much-depreciated rupiah, the highly inflated prices and the halt of business activities; the financial crisis also threatened national security and integrity. In May 1998, it brought down the "New Order" regime that had been in power since 1965. Riots were rampant in many parts of Indonesia; racial and religious tensions rose, often with a political agenda behind the scene. This situation had turned the country from being one of the most attractive places for investment, to a worrying place for investors and fly-in travellers.

Prior to the crisis, there were no clear signals of the possibility of an economic crunch. Instead, the major indicators showed "flying colours" figures, making Indonesia one of the most attractive investment destinations. International lenders were zooming in for the high interest yields from short-term lending to Indonesian private

sectors. This helped boost the economic sector. When the regional currencies went into imbalance, this blessing, combined with underlying structural problems, turned into a disaster. The monetary tools failed to respond to a nascent currency crisis, and the Indonesian economy became insolvent. As the currency fell against foreign currencies, the private sector, banks and corporations halted their activities. The inability to service the high level of foreign debt, and the high dependence on imported materials and foreign capital for Indonesia's economic activities, paralysed the overall economy. Financial loans from international institutions such as the IMF, IBRD, and ADB became vital for the survival of the Indonesian government.

This leads us to the confidence issue. While there are external factors that an economy must consider in overcoming such a crisis, Indonesia has first and foremost to look inward. Next comes the question of whether it might be more worthwhile to proceed with economic stabilisation while addressing political and social problems at the same time. In other words, would financial reform work while the political situation is still volatile? On the other hand, would the financial reforms positively affect the social situation, and would the restoration of financial stability restore confidence in the government? This sounds like a chicken-and-egg dilemma. But if efforts in both fields can be implemented synergistically, they are, in fact, complementary with each other. All these questions would soon be answered following the results of the banking recapitalisation program, the corporate debt restructuring, the election in June, and possible changes in the political framework.

This paper is divided into five parts. The first part provides a brief overview of the origin of the crisis, with reference to the financial and corporate sectors in Indonesia. The second part, an assessment of the impact of the crisis two years later, deals with the overall economy and examines the major changes in the economic variables, and the structure and performance of financial and corporate sectors. The third part assesses the financial sector, by examining the key financial policies, key issues, and recent developments among the major players in the Indonesian banking system. The fourth part analyses the government's response, i.e. bank recapitalisation and its implementation. In the conclusion, the surviving players' strategies, their roles and responsibilities are discussed.

Overview of the Origin of the Crisis

The crisis originated from various contributing factors — external and domestic, economic and political — and had existed and festered over the years: current account deficits camouflaged by high capital inflows, growing foreign debt, huge private capital borrowing without proper hedging, ‘connections lending’, lack of monetary awareness, and a centralised government.

Over the past decade, a record of sustained economic growth and development was supported by strong economic fundamentals. Southeast Asian countries had emerged as the “Asian Tigers”, the highfliers of the 1990s. *Table 1* shows the summary of macroeconomic indicators of the Asia-Five: Indonesia, Malaysia, the Philippines, South Korea and Thailand.

The macro-indicators show that the crisis-hit countries’ (the Asia-Five) GDP growth was stable for years, at a high average level of 7 to 8 percent per annum, and that reported inflation was low — one-digit figures, ranging from 4 to 9 percent. Most countries kept either balanced or surplus capital accounts with high private sector savings funding exceptional rates of investment. In some cases like Malaysia, the Philippines, South Korea and Thailand, investment levels had exceeded savings for years, driving account deficits wider. But the fact that economic growth was investment rather than consumption driven, provided a large degree of comfort for these countries.¹

In contrast to this record of economic growth, the figures had reversed direction since 1997, dragging down the regional economy and even affecting the world economy.

Despite the fact that the Asian crisis was sparked by the downturn of the Thai baht, the Indonesia rupiah suffered most among the Asian-5 discussed earlier. This affected whole economic sectors in the country, and triggered the social and political chaos that has continued even after this paper is written. The effect of the depreciation of the rupiah against foreign currencies, combined with the high level of unhedged foreign debt, proved fatal to the economy. When a large proportion of foreign short-term debt was due for repayment, the economic players panicked. Unfortunately, there was a lack of immediate response from the government — an attitude that generated a further crisis in the financial and corporate sectors, and ultimately led to an overall

economic bankruptcy. It was at this time that a series of IMF support packages was announced.

Pre-Crisis: Indonesia's Strong Macroeconomic Indicators

Over-confident assessment?

Until the first half of 1997, reports on the Indonesian economy were still looking pretty good. Since the 1970s, Indonesia had enjoyed consistently high economic growth, with GDP growing at an average 7-8 percent per annum. Inflation was contained and stayed at single digit levels — falling to 6 percent in 1996. The economic structure had been diversified as oil revenue declined and a more export-oriented manufacturing base was strengthened. The dynamic private sector was supported by a high savings rate and domestic investment (both reaching almost 30 per cent of the GDP in 1996), and large capital inflows from foreign investors.

All this was before the onset of the currency turmoil in July 1997, which ultimately devastated the Indonesian economy.

Growing risks neglected

Is it true that there were no early warning signals before the crisis began? Had we been aware of the underlying structural problems but had ignored these early warning signals long before the crisis?

The regional currency crisis and speculative pressure on the rupiah, along with its bandwagon effects, reduced the value of the rupiah by almost 80 percent six months after the crisis began. This indicates that there was a flaw in the system. Besides the persistent issues on the political and social fronts, the crisis revealed the underlying economic and structural weaknesses. It exposed a financially unsound and ill-regulated banking sector, saddled with extremely high non-performing loans in the property sector, where funds were illegally siphoned off from businesses to the owners. The currency crisis was just a symptom rather than the cause of a wider financial crisis.²

Economic factors

- Growing current account deficits
The slowdown in the growth of non-oil exports, falling oil prices and rising imports of goods produced growing current account deficits. Over the years, the deficit was offset by high capital inflows in the forms of foreign aid, direct investment, foreign borrowing and portfolio investment, which created a false sense security about the real account situation.
- Growing foreign debt
The low level of foreign investment in the 1970s and early 1980s encouraged the government to borrow from abroad. Low international interest rates and the encouragement from international financial institutions to developing economies also caused a significant impact on foreign borrowing. Debt instalment payments and interest were increasing significantly, but injection of new (and increasing) loans helped to service this debt.

The relative stability of the rupiah during the 1990s, together with high rates of return on domestic investment and cheap overseas funds, encouraged high levels of private sector offshore borrowing. By 1997, external debt had increased to US\$140 billion (about 60 percent of GDP), of which US\$20 billion was short-term and mostly unhedged. External commercial bank debt owed by Indonesian private corporations reached US\$58.6 billion, of which about 40 percent were owed to Japan.

Non-Economic Issues

- Governance issue
Large private sector conglomerates, many of which had good connections with the government, were able to take up huge loans from state banks and private banks, and offshore loans apparently without limit and proper credit assessments. Reforms are necessary to address these issues of corruption, legal uncertainties and inconsistencies, lack of transparency, collusion between officials and businesspeople, a weak judicial system and monopolies.
- Moral hazard
In both government and private sectors, moral hazards were raging. Companies and banks, feeling secure about the financial stability and expecting that stability to remain, carelessly expanded their offshore borrowings. On the other hand, the central bank's monitoring of the monetary situation was seemingly inadequate, compared to what it should have done. The central bank allowed foreign debt to accumulate over the years without checking for preventive actions such as hedging and swapping.
- Social and political issues
The Indonesian political system, which vested so much authority in one man, was closely linked to the economic crisis. The investors'

uncertainty reflected a substantial degree of political insecurity, in addition to doubts about the economy. Racial and religious tensions were easily provoked and triggered in various regions of the country. Separatist movements in Aceh, Moluccas, Irian Jaya and East Timor demanded freedom. The main issues stemmed from the huge gap in provinces' economic development, and the impending decentralisation and devolution of autonomy.

- Globalisation

Globalisation played an important role in creating the opportunities for expanding economic activities through the inflow of global capital. Had it been a closed economy, Indonesia would not have reached the pre-crisis stage of development. However, tapping into global capital had both positive and negative consequences. On the positive side, the capital inflow helped Indonesia develop its economy. But in July 1997, when Thailand floated its currency, the negative impact of the globalisation finally struck. This was promptly followed by capital flight from the region, which in turn triggered speculation and public panic.

We can conclude here that the origins of the crisis lay in the combined effect of the globalisation of capital flows, the regional currency crisis, deeply rooted domestic economic weaknesses as well as dormant socio-political problems.

Impact of the Crisis on Overall Economy

It has been almost two years since country was swept by economic turbulence. The failure to overcome the initial pressures on the currency's exchange rate was manifested in changes in the various indicators. This chapter looks at the relative decline of Indonesia's major economic indicators, both before and during the crisis. Based on the trend figures and prevailing determinants, we might be able to gauge how much longer the situation would continue, when we expect a more positive change, or whether the crisis has bottomed out and a rebound is around the corner.

Initial Reaction: Wrong Footing?

Before the floating of the rupiah in mid-August 1997, the central bank tried to defend the moving band system from speculative attack by widening the band from 8 percent to 12 percent, and selling dollars in both spot and swap markets. Bank Indonesia also raised its certificate rates (SBI) seven times during the second half of 1997, from 7

percent to as high as 30 percent, to influence the money market, in the hope that high interest rates in the domestic market would stem the capital flight.

When the Indonesian financial crisis broke out in the second half of 1997, the IMF praised the Suharto government its handling of the situation and approved a US\$43 billion rescue package. As part of the package, 16 insolvent banks were closed in November 1997. This led to a series of bank runs. With their confidence in the banking sector shaken, people rushed to withdraw their bank deposits. The rupiah slumped by 80 percent in January 1998 and became one of the worst performing currencies in the world. The stock market also dipped — the stock market index was halved. Rumours of the scarcity of food supply drove up prices as people hoarded stocks. In May 1998, riots broke out and racial and religious tensions were heightened. Demonstrations became a daily fare. A special assembly meeting was convened in November 1998 but racial and religious tensions continued to rise. Capital flight became unavoidable. Foreign investors kept out of the country and adopted a wait-and-see attitude.

In many ways, political factors were now as important, if not more important than economic factors, in affecting the extent of the crisis. Uncertainty about who would lead the country appeared to delay both foreign and domestic investment decisions. The economy was paralysed.

Macroeconomic Indicators

In October 1997, IMF forecasted that the Indonesian economy would grow by 6.2 percent in 1998. Two months later, the Fund revised it to only 2 percent growth. In the end, the actual figure was much lower than forecasted — the 1998 growth was minus 14 percent.

GDP per capita plunged from over US\$1,000 in 1995 to only US\$487 in 1998. Double-digit inflation could not be avoided — inflation was 11 percent in 1997, and rose to 77.6 percent in 1998. Interest rates in 1998 was double the 1997 rate, up to 50 percent per annum, before falling to around 30 percent in May 1999. The exchange rate of the rupiah against US\$ depreciated by almost 30 per cent in 1998 from its 1997 value; and more than 80 percent in early 1998 from its 1997 value, before stabilising at a much depreciated value during the first half of 1999.

High production costs, due to a heavy dependence on imported raw materials, had stymied 60 percent of national production. The abrupt break in the distribution channel between producers and consumers, and the unavailability of bank guarantees for imports, contributed to higher prices of consumer goods. The slowdown of export growth, as a result of slower rate of production, and the flow of large funds from national banks to foreign banks, further exacerbated the cash flow scarcity.

Monetary contraction

In the monetary sector, the expansion of money supply jumped twice at the end of 1998.³ This expansion was partly attributable to the revaluation of foreign exchange savings in rupiah terms. Bank Indonesia (BI) intervened through the SBI and SBPU⁴ to help prevent the rupiah from depreciating further against the US dollar, and to curb inflation. Before the crisis, the normal SBI rates were around 14 percent; by end 1998 it had reached 70 percent. As a result, the amount of inter-bank call money transactions surged steeply by 400 percent, from Rp 0.5 trillion in 1996 to Rp2 trillion in 1998. The sale of SBI also rose by four times in value, while SBPU rose by around 80 percent, for the same period.

The large amount of money flowing into BI, however, seems ineffective in reducing the depreciation of the rupiah and inflation, due to the presence of other factors, i.e. May 1998 riots and the banking sector's loss of credibility. Another reason was the fact that the amount of funds used by BI, in the form of liquidity credits to ailing banks amounting to around Rp150 trillion, was much larger than the money flowing into BI (around Rp 10 trillion).

Instead of stabilising the rupiah, the high interest rate policy had a negative impact on the real sector. The high interest rates on SBI forced banks to raise their own. As a result, no funds flowed out from commercial banks to the business sector. Even if the SBI rates have now been reduced to the pre-crisis rate of 24 percent, the banks are still not channelling new credit to the ailing corporations. Instead, they are now trapped in the problem of accumulated negative spreads, which will be discussed under "Key Issues" in the next chapter.

*Capital market*⁵

Besides increasing the pressure on the money market and real sector, the monetary crisis also accelerated the fall in share prices. Prior to the 1988 deregulation of the capital market, the performance of Jakarta Stock Exchange (JSX) was very unimpressive. The listed companies, numbering 24, had low market capitalisation ranging from US\$68 to US\$117 millions and the value of transactions never exceeded US\$3 million. The 1988 deregulation obviously created a new level of performance for the Indonesian capital market. This was shown not only by the increasing number of listed companies, which leaped from 24 to 125 in 1990, to 288 stocks in 1998; but also big jumps in market capitalisation and value of transactions. Market capitalisation rose significantly from 1989 until 1996 with an average increase of 180 percent year a year, until the crisis led to a fall of 70 per cent in 1997.

Based on the Price Earning Ratios, the average stock market price was halved, from 21.6 to 10.5. Despite the much lower price of stocks, compared to the pre-crisis period, investors were still very cautious about buying shares, particularly because many issuer companies had sustained great losses and debt. Most of the stock prices had plunged. Of the 288 stocks traded on the Jakarta Stock Exchange (JSX), the prices of almost half of them (114 stocks) had fallen to below Rp500; many had nose-dived to below Rp200 per share.⁶ Under the exchange rate of Rp8,500 per US dollar, one share was worth only two cents. Even the blue chips, which were considered liquid, were not exempted from market correction, and managed only a slight recovery a year later:

As share prices fell, the Composite Index plunged from 721 points in July 1997, to only 402 points in February 1998. It recovered to around 492 at the end of April 1999. A comparison of the 1996 and 1998 stock market performance in terms of both volume and value of transactions shows that there was a big increase of 160 percent and 80 percent respectively. But this signified the *selling* activities, which exerted a downward pressure on the share prices. The first half of May 1999 showed encouraging signals that foreign investors were returning through portfolio investments, and the index climbed to almost

600 with active buying. However, uncertainties surrounding the June election might hinder it from further positive development.

Sector-Specific Indicators

Before the crisis, the growth of various sectors had been remarkable, as evident in the development of the companies listed on the Jakarta Stock Exchange (JSX).⁷ From 1994 to 1997, the average growth of assets ranged from 90 percent to 320 percent. Particularly outstanding were the telecommunications and transportation sectors. In 1995, the multi-financing, machinery and wholesale trading sectors increased their 1994 asset values by 2-8 times. In 1996, outstanding growth was registered by the construction and investment funds sectors, as asset values increased 8-10 times over the 1995 period. (Please refer to tables 9-12).

In 1996, the asset growth of the construction sector was 12 times that of the previous year. The growth of in the investment funds sector was more than 80 times. This was when overheating started, with lots of investment in the construction sector. It is also worth noting that the newly established investment companies in that year were all related to the conglomerate groups that also owned the construction and infrastructure businesses. After the crisis, this remarkable growth in assets slowed down by an average of 130 percent and in certain sectors it fell drastically. For example, the growth in the investment funds sector fell drastically to only 1/40 of its previous year's growth.

In terms of sales, growth had been slowing down significantly even before the crisis, from an average of 103 percent to 24 percent between 1996 and 1998, although it was still increasing in absolute figures. The impact of the crisis was evident in sectors relating to the overheated construction sector, i.e. industries such as cement, ceramics, plastics, wood industries, cable, electronics, property and real estate, each of which registered growth in sales of *minus* 30-80 per cent.

As a consequence of declining sales, net income also fell. Prior to the crisis, the average income growth was 75 percent in 1995, which started to slow down to only 30 percent in 1996. During the crisis net income fell steeply by

more than 700 percent. Property and construction-related sectors saw their income decline by an average of 400 percent. Other sectors severely affected included those with high import content in their production such as chemicals, metals, animal feed, automotive, textile, computer, pharmaceuticals, wholesale and retail. As the rupiah depreciated, net income fell by an average of 1500 percent.

In assessing the profitability of these companies, PER and EPS⁸ are used as indicators. Before the crisis in 1995, the EPS in all sectors were positive, with a slight decline in some sectors. But in 1996, the figures showed significant declines, which continued in 1997. The affected sectors, which included animal feed, construction, cable, cement, automotive and textile industries, were noted for their high content of imported raw materials and factory components. The decline in the earnings of these sectors indicated the high cost of investments rather than falling income, since income was still positive in 1995 and 1996. High import costs were part of the weaknesses of Indonesian economy's real sector and contributed to the financial sector's problems.

The weighted average of PER had declined by 1996, from 28 to 24. The decline was accelerated by the crisis, with the PER falling from 24 to 10. Although the value of assets was still high, demand in the capital market certainly affected the closing price, halving the value of the PER.

The financial risk of the listed companies, as indicated by Debt-Equity Ratio (DER), had started to escalate since 1994, with average liabilities twice as high as the average debt. It rose from 2.04 in 1994 to 2.24 in 1995, to 2.57 in 1996 and to 6.11 after the crisis struck. This meant that the average company had equity less than one-sixth of its total debt. Besides the financial sectors, the cement and automotive industries had huge debts of 20-30 times their equity values.

Financial Sector

The financial sector was particularly affected by the crisis. While its assets may still be increasing in nominal terms at the end of 1997, its growth had declined

significantly. It is interesting to note that the assets of the banking and property sectors still registered positive growth after the crisis had struck. As property was often used as collateral for banking credits, the value of assets held by the banking sector was determined by that of the property sector. In the financial reports at the end of 1997, the property sector still recorded inflated asset prices, and the use of foreign loans in the property market by the corporations had not yet been exposed by a transparent financial report.

Net income was more speedily reported than the assets situation. The financial sector's net income fell by 500 percent from its 1996 figure.

Deteriorating banking system

The banking system was a prominent element in the financial sector; it constituted a large proportion of the total assets in the entire financial sector (about 90 percent in 1994). Although other non-bank financial institutions e.g. multi-financing, securities, insurance and investment funds had emerged, the banking system still held around 65 percent of the financial sector's total assets in 1997.

The income of the banking system declined significantly by 300 per cent in 1997, while that of the property sector fell by 660 percent. Banks became incapable of performing their financial intermediary functions. The rupiah depreciation caused investors, who had borrowed in US dollars (accounting for about 30 per cent of bank loans⁹), to default as their collateral was very much below the value of their loans. High interest rates also encouraged defaults, eroding the banks' assets. However, assets growth of banking sector in 1997 was still positive, at 127 percent. This could be explained by the inclusion of the non-performing loans from the property sector as a part of assets in financial reporting. Earnings per share in financial sector fell by 10,000 in 1997, with the banking and property sectors constituting the largest proportion. In contrast to other sectors, the PER of the banking sector tripled in 1997, due to the sudden decline in earnings.

Property gloom

As property was used as a collateral for bank credits, the banking and property sectors were closely linked so that developments in one sector would affect the other. The inflated collateral (property) values had created the illusion that Indonesian banks were in very good financial health, which was reflected in high stock prices and high growth in assets. The increase in property prices led to an increase in the supply of credit from banks to the property sector, which in turn fuelled a further rise in property prices. The spiralling property values enlarged the banks' assets and transferred a huge amount of credit to property sector. When the property companies were unable to repay the loans, the banks were in trouble.

Construction was slowed down or halted altogether due to the crisis. Almost 95 percent of the 1500 property/real estate companies stopped operations totally, because of three reasons: falling demand, huge un-repayable loans and postponed investments. Income fell by 700 percent compared to 1996, since the demand for office space was severely affected as the crisis worsened.¹⁰ Many offices had moved out to cheaper locations outside the business centre, or were hiring or buying small storehouses. Bank closures the past one year left 12,000 sq. m. of office space vacant, adding to the idle number of 600,000 sqm.¹¹

Property credits for construction, real estate and mortgage extended by all commercial banks ballooned to Rp72.7 trillion (US\$6.8 billion) by end 1998, according to Bank Indonesia, of which two-thirds were 'doubtful' loans. The foreign debt of twenty listed property companies amounted to US\$3.4 billion. A report on Indonesia's construction and property¹² mentioned that total investment in this sector would further slide by 75 percent in 1999, from Rp26 trillion to only Rp6.54 trillion.

The review of the past two years does not indicate a good prospect for the economy. The economy is still at a crossroad. This is the hardest time for the investors to decide. While the risk is great, investing now provides a great chance of reaping large profits, as prices are low. There are also first-time

advantages for being the early starters. On the other hand, there are still many uncertainties and unexpected, hidden risks.

There are some signals that show improvements in some economic variables in the first quarter of 1999, such as the currency exchange rate, interest rate, and stock exchange portfolio. But they are still not permanent. Most are on a short-term basis, i.e. due to profit taking in equity investment and foreign exchange. The negative impact of the crisis is much more persistent in the financial system, which had not fully adjusted to the 1983 deregulation. The weaknesses are manifested in some key issues discussed in the next chapter.

Financial and Corporate Sectors: Policies, Key Issues, Government Responses, and Surviving Players' Strategies

Indonesia's financial sector is still dominated by banks. The banks are closely related to the corporate sectors, as most corporations own banks and banks channel huge loans to these corporations. A large proportion of these huge loans was used to finance the property boom before the crisis. Therefore, the subsequent property crash and corporate bankruptcies led to the fall of the banking system. On the other hand, the banking system was essential in helping to develop the corporations. This was especially true of the private banks, which served as an extension of the corporations.

The banking deregulation packages of 1988 lowered the barrier to new market entrants. Since then private banks had started to dominate the market. The deregulation policy had been double-edged. The growth in the number of new bank licenses and branches, and the expansion of commercial credit had been extraordinary, before the currency crisis put a sudden end to it.

We agree that the economic crises was not caused by economic factors alone, but a combination of the economic and the political, domestic and international. However, financial mismanagement was one of the major causes. The burden of the private sector's domestic and external debt, together with the rupiah depreciation, paralysed many enterprises. Banking and corporate sectors, which had been booming in Indonesia since 1980s, became the core problems that triggered the long crisis situation. We certainly do not want the economy "back on track", as the old system was full of the mismanagement and mishandling that largely contributed to the

prolonged crisis. They stemmed from the inadequate response of the financial system itself to financial deregulation: lack of loan monitoring, inadequate enforcement of banking regulations and the creditworthiness criteria.

Structure of Financial Systems

The Ministry of Finance and the central bank (Bank Indonesia) are the primary government bodies regulating and supervising Indonesia's financial system and institutions, including the banks. The Ministry of Finance's principal responsibilities are to establish fundamental policies relating to the banking sector, issue licenses for new banks and to exercise financial management on behalf of the government.

Bank Indonesia's principal functions are to (i) regulate, preserve and maintain the stability of rupiah, and (ii) encourage economic production and development, as well as to create job opportunities to enhance the welfare of the people. To support its basic functions, Bank Indonesia is granted the sole authority to issue and control the circulation of the rupiah. Bank Indonesia also provides guidelines and makes determinations regarding the soundness, solvency and liquidity of banks, regulates credit payment traffic and conducts inter-bank clearing and settlement.

Since the crisis, several institutions have been established to help the two monetary authorities manage the bank restructuring and the recovery of non-performing loans. These new institutions include IBRA (Indonesian Bank Restructuring Agency) and AMU (Assets Management Unit), which is a part of IBRA. In addition, an independent agency will be set up to focus on the supervision of the banking system.

Financial Policies and Implications

Financial deregulation always stimulates financial expansion. Higher interest rates are always accompanied by rapid credit expansion; lifting restrictions on bank lending encourages borrowing in risky sectors such as property and construction; and lowering reserve requirements allow banks to create more loans. Studies of many countries which had experienced a financial crisis reveal a common characteristic i.e. these countries had liberalised their financial sectors for five years or more. Studies have also found that financial phenomena such as rapid credit expansion and loans to risky sectors, can help predict banking crises.¹³

The objectives of the 1980s financial reforms were to transform the financial system from a state-dominated into a market-based system. The role of the banking system as a financial intermediary, to raise savings and investments, stimulate growth and improve the efficiency in channelling funds from depositors to investors, is important to the real sector and the whole economy. With this important objective in mind, the government had continuously deregulated the banking system. The following are some cornerstones relating to the financial sector, and their implications.

Phase I: pre-deregulation phase, 1971-1982. The Indonesian government started freeing up controls on foreign capital in 1971. The rationale for this policy was the scarcity of internal resources for the administrative control of capital flow. Since then foreign capital controls had been lifted and the free movement of capital continued through the years. The disadvantages of this policy included capital flight, huge loans, and consequently, growing current account deficit. During this period, the deficit was partly offset by large inflows from the oil price boom, which represented about 80 percent of Indonesia's total export value until the early 1980s. The deficit situation persisted long after oil prices had gone down, but the deficit was then offset by foreign aid and loans.

Before June 1983, the banking sector was still heavily regulated, even as entry was restricted. The market was dominated by state banks, with Bank Indonesia alone accounting for 35 percent of the total assets of the entire financial system; other state banks holding another 40 percent. Bank Indonesia set ceilings on bank credits for individual banks. Bank Indonesia also channelled substantial amounts of low-interest liquidity credits from oil earnings to "strategic" industries in the private sector. Banks were instructed to finance certain types of investment, particularly import substitution and backward integration of heavy industries, during the economic boom.¹⁴ This "strategic" policy turned out to be one of the root causes of the subsequent failure in credit assessment in the banking sector.

Phase II: financial deregulation phase, 1983-1992¹⁵ As oil revenues began to dwindle with the end of the second oil price shock, the government realised the need to wean the economy from its reliance on oil revenues, and to turn to manufacturing and financial services. Thus, major financial reforms were initiated.

The financial system was deregulated in two stages. The first package introduced in June 1983, or Pakjun, was the cornerstone in Indonesia's financial development. It removed interest rate controls and credit ceilings for all banks, reduced the liquidity credit, and replaced the ineffective credit ceilings with monetary tools and Bank Indonesia certificates. This resulted in significant increases in the deposit rate and lending activities, especially in private banks. The second package in October 1988, also known as Pakto 88, was another cornerstone in the banking system. The reforms included a major reduction in the reserve requirements of commercial banks (from 15 percent to only 2 percent), and licenses for new banks, including joint ventures. The policies encouraged the opening of many new banks and intensified competition between banks, which led to higher interest rates.

Another package of reforms, Pakdes 88, was introduced in December 1988. Under Pakdes 88, capital markets were deregulated, the role of the government in the stock exchange was reduced and foreigners were allowed to buy stocks on the Indonesian stock exchange. Pakdes 88 sparked a sharp rise of the Jakarta Stock Exchange's index. It was further clarified in 1989 that foreign purchase of up to 49 percent of a company's shares was allowed, except in the case of bank shares. Since the privatisation of the stock exchange, the total annual trading volume had skyrocketed from just 1.7 billion shares in 1992 to 29.6 billion in 1997, jumping more than 16 times. The number of listed companies rose 70 percent from 153 in 1992 to 288 in 1998, and market capitalisation grew from Rp 24.8 trillion to Rp 225.2 trillion over the same period.¹⁶

In July 1992, the Banking Law was passed and ratified in October 1992. Foreign new entrants were obliged to establish joint ventures with local equity of at least 15 percent. Under the Banking Law, all banking activities require a license from the Minister of Finance, who issues the licenses based on recommendations from Bank Indonesia. In addition, if a bank faces liquidity problems, which jeopardise its activities, the central bank can ask the bank's shareholders to do the following:

- (1) inject new capital into the bank (recapitalisation);
- (2) change the members of board of directors and commissioners;
- (3) write off its bad loans and cover the losses with its capital;

- (4) merge with another bank, or to let a third party, who is willing to assume the bank's liabilities, purchase the bank.

If those actions are still not sufficient, Bank Indonesia may recommend that the Ministry of Finance revoke the bank's license and liquidate the bank.

Phase III: pre-crisis: 1993–1997. A liberalisation package was unveiled in October 1993, which dealt with import tariff reductions for specific goods and the simplification of existing investment procedures to make the country more competitive in attracting foreign funds, in response to rising global interest rates. The reforms included opening up sectors which were previously off-limits to foreign investment, relaxing ownership and divestment rules, and lifting minimum capital requirements.

New regulations in 1995 raised the minimum equity requirement of banks from Rp 50bn to Rp 150bn by 2001. Smaller banks were encouraged to merge. Minimum CAR¹⁷ was scheduled to rise to 9 percent by Sep 1997, 10 percent by Sep 1999, and 12 percent by Sep 2001. Banks were no longer allowed to report different loan loss provisions in their tax and commercial accounts. The reform encouraged small banks to merge in order to strengthen their capital base. By this stage, the government had realised the need to limit new entry in banking, and to regulate the “deregulated banks”. The government had already perceived potential problems as a result of the previous speedy liberalisation. But as in many cases in the other sectors, policy enforcement was lacking.

The relaxation of banking regulations had a tremendous impact on credit expansion. Between 1987 and 1996, private Indonesian banks' share of total credit more than doubled, from 23 percent to 49 percent, while the foreign banks' combined market share more than tripled, from 3 percent to 10 percent.¹⁸

Phase IV: financial crisis: July 1997–present

- High interest rates and tight money policies
The floating of the rupiah in mid-August 1997 and subsequent policies have turned the economy around. Before floating the currency, the central bank tried to defend the moving band system from speculative attack by widening the band from 8 to 12 percent and selling dollars in both spot and swap markets. It also raised its benchmark. Bank Indonesia Certificate (SBI) rates several times from 7 percent to 30 percent in December 1997, and an astonishing 80 percent in August

1998. The SBI rates were subsequently reduced to 40 percent in March 1999.

The government expected high interest rates to stem the capital flight and prevent further depreciation but they turned out to be ineffective. After the float, the government pursued a tight money policy by absorbing more than Rp 10 trillion (US\$3.8 billion)¹⁹ of public sector funds from commercial banks to discourage people from buying dollars with rupiahs. But this policy measure proved ineffective and the rupiah continued to weaken against the US dollar.

- Bank closing

Enforcement of the Bank Law was finally put to the test. Under pressure from the IMF, non-viable banks were closed, others were recapitalised. Bank restructuring included changes to bank management and ownership, as well as the settlement of outstanding loans.

The government launched a series of reforms in the banking sector, including the closure of ailing banks, take-over of troubled but viable banks, and the recapitalisation of relatively healthy banks. In November 1997, the licenses of insolvent 16 banks were revoked and the banks were liquidated. Financial panic²⁰ ensued, interest rates shot up, and more banks were frozen and taken-over in 1998. Since then, the country's ailing banking sector has been suffering negative spreads, which occurs when the interest on deposits (expenses) is higher than interest on credits (income).

In 1998, seven troubled banks were taken over by IBRA²¹, in addition to the seven banks already under IBRA management. Some other 54 weak banks were put under its close supervision.²² Minimum capital requirements were reduced from Rp1 trillion to Rp250 billion (after loan loss provisions). Sweeping reforms of the banking system in March 1999²³ resulted in the closure of 38 banks and the take-over of 7 banks, leaving 73 banks that were considered healthy.

Banking reform is at the heart of the country's economic recovery program. As stipulated in the Letter of Intent to IMF, the government's bank reform strategy focuses on:

- (i) government-assisted recapitalisation program for potentially viable private banks;
- (ii) resolution of non-viable private banks, through liquidation or take-over;
- (iii) merger, reform, and recapitalisation of the state banks;
- (iv) measures to recover liquidity support previously extended to troubled banks by Bank Indonesia (BI);
- (v) strengthening the banking supervision system.

It is argued that the financial deregulation should be the force correcting macroeconomic policy-making. This is true to the extent that the financial prudentials are enforced and transparency is intact in the system. What happened prior to the

current crisis was the opposite. The financial system was not performing its function. It relied fully on, and was dictated by the macroeconomic policy. When the macroeconomic instruments failed to respond to the currency pressure, the financial system easily broke down to pieces.

Furthermore, the effectiveness of macroeconomic policies is limited as the country becomes more open to capital flows. As Indonesia becomes more internationally integrated in terms of its financial markets, the ability of macroeconomic policy to set both interest rates and the exchange rate is greatly diminished.²⁴ As the globalisation of capital is unavoidable, the possible solution is in the internal system — strengthening the system to dampen external influences.

Key Issues in the Financial System

Key issues in the financial system revealed by the crisis include the over-expansive corporate debt, bad bank loans, failure of credit assessment, the lack of monitoring and inconsistent government policies. These problems were further compounded by speculative attacks and capital flight.

Corporate debt. The private sector has been experiencing distortions in resource allocation, in the form of wealth concentration in some conglomerates with monopolistic and rent-seeking behaviour. Economic inefficiencies were widespread during the 5 years of rapid investment and production growth prior to the crisis.

Corporate foreign debt was US\$60 billion, approximately half of the total foreign debt of the country. The high indebtedness was induced by several factors:

- (i) over-expansion of Indonesian corporations which had easy access to both domestic and overseas loans;
- (ii) overconfidence of the foreign investors, arising from Indonesia's dynamic economic development;
- (iii) the stability of the rupiah during the past few years, a situation that had given corporations a false sense of "security", so that they did not find it necessary to hedge their short-term loans.²⁵

Statistical figures show that the banking system had little foreign debt, compared to the corporate sector. Foreign debt owed by banks amounted to only 9 percent of the total debt; the share of private banks was 4 percent. Private corporate

debt amounted to nearly 91 percent of the total debt. Even in comparison to other crisis-affected countries, commercial bank lending in Indonesia was geared least to the banks, at only 22 percent, with 67 percent lent to private sector corporations.²⁶ By contrast, South Korean banks absorbed almost 75 percent of the total lending, with the chaebols taking up about 30 percent. The public sector owed little debt. If the foreign debt in banking system was so little, why did Indonesia restructure its banking system first, instead of resolving the debt overhang of its corporate sector?

The answer lies in the close connection between banks and corporations in Indonesia:

- (i) Corporations were not only accumulating debt in foreign currency, they had also accumulated domestic debt owed to domestic private banks, mostly related” banks.
- (ii) The banking crisis arose from issues of regulation adherence, in particular, the fragility of the banking prudentials, in terms of screening the creditworthiness of borrowing corporations and their financial reporting.
- (iii) Many Indonesian conglomerate groups circumvented banking regulations by opening their own banks as “money machines” for tapping into public funds. High interest and savings rates under a competitive banking system enabled these banks to access the large pool of domestic savings, to finance the corporate groups’ projects and businesses.

The concentration of capital ownership is obvious. Supported by their large assets, Indonesian conglomerates expanded into diverse economic sectors. *Table 16* lists the major conglomerates, the various kinds of businesses they were involved in, and their affiliated banks:

- Debt resolution effort
Side by side and closely related with bank restructuring is the financial restructuring of the corporate sector (debt resolution), which is another important element for economic recovery. So far the Indonesia Debt Restructuring Agency (INDRA)²⁷ has not been successful. The registration deadline for companies to participate in the INDRA scheme is extended to end December 1999, because even after one year there is hardly any response from the corporate sector. The details of INDRA scheme are presented in the Appendices.

This lack of enthusiasm from corporations might be due to:

- (i) Cash Flow situation
Uncertainties about the inflation rate and the economic-political situation affect the companies' cash flow. Companies are reluctant to participate in the INDRA scheme, as they are not confident that they are able to adhere to the INDRA schedule, given their current cash flow situation. Under the scheme, companies must restructure their huge debts with their foreign lenders within three years, after which they have to repay the debt within five years. Although the debts are to be repaid in rupiah, the inflation rate is currently too high for most companies. It seems that companies would prefer to wait for a relatively lower inflation rate and the possibility of a more favourable (lower) exchange rate.
- (ii) Another possibility is the companies' lack of confidence in INDRA's ability to help resolve their debt problem. To overcome these obstacles another intervention, the "Jakarta Initiative", was launched in September 1998 with technical assistance from the IMF, ADB and World Bank.²⁸ The initiative is intended to complement and to support the INDRA scheme, and to establish principles to guide and streamline corporate structuring out of the court. The Jakarta Initiative Task Force is trying to open negotiations on issues such as:
 - (i) extending the period of repayment, with a grace period for the principal instalment;
 - (ii) lowering the interest rate;
 - (iii) offering debt-equity swaps to lenders; and
 - (iv) a new working capital program.

The government has implemented the following policies in its efforts to restructure the corporate debt

- (i) introducing regulations to remove the impediments and disincentives to debt-equity conversions. This has produced some results as lenders are agreeing to swap debt for equity in companies with good prospects.²⁹
- (ii) passing a decree to remove tax disincentives to mergers and corporate restructuring, which facilitates debt forgiveness and debt-equity swaps by limiting the tax on current income from such activities.

The Jakarta Initiative seems to be more fruitful. It is currently handling 170 companies with debt of over US\$21 billion.³⁰ Fifteen companies have reached some form of debt restructuring arrangement with creditors, amounting to about US\$1.5 billion in foreign debt, through debt-equity swap, reduction in interest rates, or an extended repayment period.

Corporate restructuring and banking reform are interdependent. A sound banking system would be able to play the role of financial intermediary to facilitate the

operations of the corporate sector. A strengthened corporate sector would put the economy into higher gear and help reverse the negative spread in surviving banks. As in banking reforms, corporate restructuring must be allowed to proceed. Obstacles to corporate restructuring must be removed. Legal and regulatory changes to this end include tax neutrality for mergers and reorganisations, removal of tax disincentives to restructuring and debt-to-equity conversion, and removal of restrictions on foreign investment in domestic equity and domestic banks. To avoid another currency crisis in the future, corporate hedging practices must be improved.

Bad bank loans. Financial liberalisation since 1983 had indeed strengthened the competitiveness of banks and their ability to attract domestic savings and investment, and had helped the overall economy in credit and investment allocation. However, financial liberalisation also spawned several negative developments, which gave early warnings of an impending banking crisis. One such development was the steadily increasing loans.

The rapid entry of new banks squeezed profit margins and crowded the banking market. Pressed to fight for a larger market share, banks blindly or submissively accepted risky loans. On top of this, inadequate information about the borrowers' financial status due to a lack of transparency in accounting and political pressure from well-connected borrowers, all contributed to generous bank loans and easy credit. That bad loans should result was perhaps unavoidable.

Sub-indicators of those loans were equity and real estate prices. Equity and real estate were frequently used as collateral in bank loans. Equity and real estate prices had been booming for several years before the crisis (see Sector-specific Indicators) and this encouraged a large supply of bank credit. When prices eventually plummeted, loans became unrecoverable.

The balance of bank loans and deposits has shown an interesting pattern over the years. Prior to crisis, credits always exceeded bank deposits in state banks, foreign and joint venture banks, and in most private domestic banks.³¹ This was indicated by the loan-deposit ratio over the years 1996-1999, which was above 1.0 (*see Graph 3*)

This meant that banks were healthy in terms of positive spread, that interest income from credits extended was greater than the interest payments to depositors. As financial intermediaries, banks helped to allocate and reinvest deposits in productive

sectors in the form of credits. Yet there is another perspective on this “credit-greater-than-deposit” positive spread.

There are two serious issues to examine. The first involves overstated bank capital. Bad loans would gradually erode banks’ capital. When extending credits, the ability of banks to assess credit worthiness is just as important as the ability of debtors to repay the loan. Unfortunately, the former was very much lacking. Loans were usually classified only on the payment status, rather than the borrower’s creditworthiness and the market value of the collateral. Therefore, loan losses were understated by various means of subterfuge or accounting devices. Consequently, the bank’s net income and capital were overstated. This explains the diminishing capital of banks, which was immediately apparent after the crisis broke out. The state and private domestic banks are cases in point (*see Graph 4*).

The second issue concerns the debtors. Bank deposits might have come from footloose savings. Footloose savings arise when, given the high interest rates and low collateral requirements in Indonesia, corporate owners prefer to “invest” in savings rather than in the real sectors. By doing so, they could obtain interest, even as they used it as collateral for getting a loan for their business expansion. If loan applications were accompanied by a letter of recommendation from politically connected people, or if the banks were owned by the same group, the loans would generally exceed the collateral value and the interest charges would be low. Under such circumstances, these depositors could have their cake and eat it too — enjoying the twin benefits of instant access to savings and high interest income. Big loans were obtained easily and the risks were transferred to the creditor banks.

- Deposits compared to bad loans level
Domestic funds accumulated by all commercial banks amounted to approximately US\$60 billion (based on a savings rate of 30 percent per annum). The NPL increased significantly within one year from 9 percent to almost 60 percent because of the bad loans problem. The NPL of private and state banks was especially significant. In private banks, the NPL rose from 3.3 percent in 1997 to 72 percent in 1998; in state banks, the NPL rose from 11 percent to over 50 percent. That corresponded to the level of bad loans amounting to 40 percent of the total bank deposits and total credit (*see Graph 5 and Table 17*).

So far, the government has no plans to offer a haircut³² for bad loans of troubled banks. Two alternatives for debt restructuring are preferred. First, IBRA confirmed its policy to convert loans into equity, wherever possible. Second, assets are to be sold, if the first option is not feasible. The debts of non-viable and bankrupt companies are transferred to IBRA. Their assets would be sold by AMU, a subsidiary of IBRA, to repay their debts. Bad debts of Rp200 trillion have so far been transferred to IBRA from liquidated and or taken-over banks. IBRA and AMU are therefore required to have the ability to manage these assets, to obtain the best prices for the sale of assets, and to decide who should take over the bankrupt companies.

The sale of assets and the repayment of debt are to be carried out immediately to refinance the troubled banks, as part of the bank recapitalisation program. The results of due diligence³³ showed that the real value of loan collateral was only 20 percent of its previously reported value. In other words, the proportion of bad loans which can be recovered is around 20 percent, or about Rp 40 trillion out of a total of Rp200 trillion. The recapitalisation fund would compensate for the rest of the Rp160 trillion. This is where the Rp300 trillion-bank recapitalisation program has drawn criticism. The scheme seems to bail out bankers at the expense of the people because the interest rate on bonds issued to finance the scheme is paid from the state budget, thus reducing the people's share of the budget. Monetising the largest debts immediately will certainly reduce the burden on the state budget, so that more money can be allocated to the other sectors. This issue was followed up in the latest agreement with IMF, in the Letter of Intent of 14 May 1999, which emphasised the resolution of the largest debts. It also means selling the large companies with huge loans, such as the infamous companies related to the Suharto family: the Chandra Asri olefin factory and the Timor national car (*refer to the list of 50 companies and the corresponding amount of loans from state banks — appendix 1*). Again, this will depend on the ability of AMU of IBRA to carry out monetisation in a timely and optimal manner.

High interest rates. Even before crisis, interest rates in domestic private banks were already soaring, at around 20-25 percent. When domestic interest rates were high, and international funds were easily obtained at low rates, the banking and corporate sectors preferred to use short-term foreign currency debt to fund longer-term loans, as was the usual practice in the interbank market. When the value of the rupiah fell, these

banks and corporations were caught up by the currency de-alignments and were unable to repay their short-term foreign debt.

During the worst period of the economic crisis, the interest rates peaked at around 70-80 percent in August 1998, before declining gradually to around 40 percent. The high interest rate policy was intended by the central bank to stabilise the exchange rate, although its negative impacts were keenly felt:

- (i) negative spreads which eroded the banks' profit and capital base.
- (ii) high capital, and hence production, cost in the real sector.
- (iii) little effect on discouraging capital flight or attracting capital inflows.

Other factors such as the ongoing political instability and security problems proved to have a greater impact on the inflow of foreign investment and the outflow of capital.

Failure of credit assessment. Non-transparency in corporate financial auditing and disclosure of asset quality made it difficult to accurately assess just how weak or how strong the companies were. While there may have been widespread doubts about asset quality of banks and companies before the crisis, this was hard to quantify, especially when the banks were linked with corporate groups with diversified businesses. Overlapping of ownership complicated the accounting report.

With this lack of transparency, it was impossible to have a reliable assessment about the risk status of companies applying for credit. This was a significant distortion in the financial system and lay at the core of the crisis.³⁴ Even if the corporations' financial status and the value of loan collateral were known to be much lower than reported, banks would still extend credit to them since they all belonged to the same conglomerate. Credit decisions were often made on the basis of inflated asset prices of the collateral, rather than risk assessment.

Central bank regulations on the maximum exposure to a single borrower were completely violated. Under the regulations, the maximum credit to affiliated companies was placed at 20 percent of the bank capital. In practice, however, private banks affiliated to a conglomerate group channelled up to 90 percent of its capital to the group.

Other issues that made a fair credit assessment impossible were nepotism, connection to “the right person”, and recommendations from a “big person” in the political arena. Loan decisions were made based on these explicit or implicit recommendations. State banks were used to channel credit into special projects in which the ruling political group had a vested interest, without a sufficient assessment of the companies’ creditworthiness. There was no clear distinction between formal financial assessment and the politics. History has shown that resources will not be efficiently allocated when the state and cronies of the state, instead of market forces, direct the management of bank assets and asset allocation decisions. These ill practices continued unchecked until the currency crisis began. Regulatory control is urgently needed to curtail “concentrated” and “insider” lending.

Lack of government monitoring & inconsistencies. The lack of monitoring by the government with regard to supervising the banking activities was also another element in the failure of financial deregulation. Among them was the failure to punish banks that failed to submit accurate financial reports, and to publish key financial data in their financial reporting.

This failure in supervision would hopefully be addressed with the setting up of an autonomous agency, independent of the Ministry of Finance and Bank Indonesia. An agreement has been reached between the government and the House of Representatives to set up this independent body by the end of 2002. Until then, Bank Indonesia, the central bank, will continue to carry out its duty as the country’s banking supervisory body. Giving the authority of banking supervision to an independent body has the advantages of avoiding conflict of interest and a better defined job description. Bank Indonesia will continue to manage and formulate monetary policies, while the Ministry of Finance will focus on fiscal policies.

Inconsistencies

As far as the financial sector is concerned, the government is still not consistent in its policy, even after the announcement of recapitalisation. A case in point is the recent plan for joint venture banks that are planning to recapitalise.³⁵ The categorisation of banks based on their CAR has been changed without explanation. Previously, national banks were placed in category B if they had

CAR between minus 25 percent to 4 percent. But for joint venture banks, this criterion has now been changed to 0-4 percent. The implication is that those nine national banks applying for recapitalisation program would never be eligible³⁶ under this criterion. The criterion of 0 percent instead of minus 25 percent, was proposed by Econit prior to the launching of the program, with the rationale that a CAR of minus 25 percent meant a higher recapitalisation cost. This proposed amendment was adopted only after private national banks were already *inside* the program.

Another example concerns the state banks and regional banks. There is no CAR limit for state banks and they are going to be completely recapitalised, without being penalised for their failure to comply with banking regulations. If the intention is to set up a market-based financial system, and if state banks are to be privatised, then no bank should receive any privilege or special treatment.

Speculative attacks³⁷ and capital flight. The primary cause of the speculative attacks was the expansion of domestic credit creation. The government financed itself partly through some domestic credit creation by the central bank. Domestic credit creation was used to maintain a high level of employment in the economy and to make up for the shortfall between planned government expenditure and tax revenue. In addition, there was an urgent need to finance the sudden bailout of the banking system. The growing domestic credit created an inflationary pressure that was initially contained by a “managed” float exchange rate (a bandwidth system), but eventually the government had to abandon the managed float exchange system in August 1997, and to finance itself by printing money. As the currency depreciated, the speculators got in. Capital flight followed.

The pre-crisis level of international interest rates had drawn international lenders to invest in Indonesia, attracted by the promising economic indicators. This induced a surge in private capital inflows over the years, beginning in 1991. The size of private capital inflows, relative to the size of the official capital and equity markets, should have alerted the country’s policymakers to

the fact that commercial borrowing must be dangerously large. This was apparently overlooked.

The impact of the crisis was in terms of capital outflow. People deposited their money in foreign banks, and parked them overseas. However, according to the figures below, capital flight had actually started in 1993, long before the crisis, and Indonesia ranked top among Asian countries affected by the crisis. After 1992, capital outflow from Indonesia has peaked for the last five years and averaged about 3 percent of GDP. In dollar terms this was a cumulative outflow of about US\$40 billion (*see Table 19*).

The level of foreign investment has declined from US\$34bn in 1997 to only US\$ 13.6 (only 40 percent of it) in 1998. It was estimated to slide further to US\$0.2 in 1999. Internal factors have certainly discouraged both foreign and domestic investors from putting their capital back into Indonesia.

Reviewing all the key issues above brings us back to the crux of the problem: confidence. Restoring confidence is the first step on the government's to-do list. Policy responses are planned and partly implemented. During the crisis, only the fittest players survive when the environment reached a new equilibrium. It is the government's responsibility to provide a new framework for this new equilibrium in order to establish a sound foundation for the economy.

The plan for recapitalising the surviving banks will be discussed in the next chapter.

Survival of the Fittest: Government Responses, Implementation of Banking Reforms

A strong banking system is essential to a country's economic growth and development. Efficient financial systems help countries grow by mobilising financial resources and allocating them the best uses. Banks are the primary mechanism for the transmission of monetary policy, thereby playing an important role in determining the money supply in the economy. Banks also perform a vital financial intermediary function in a market economy. When the banking system fails, public confidence and the whole economic

system are severely affected. The core functions of the banking system are the reasons why we need to restore the national banking system.³⁸

1. To mobilise domestic savings in a safe and efficient manner
2. To channel those savings, through the credit decision making process, to the most efficient uses. The credit decision making process must be rigorous, objective, and impartial — only then will national savings be channelled into the most productive investments, which will in turn promote growth and permit borrowers to service their debt in a timely fashion, thereby ensuring the safety of depositors' funds.
3. To provide efficient, low-cost, safe, and widely available means of making and receiving payments. Public trust in the banking system will only flourish in a setting in which bank clients — small and large — are confident that they can make and receive payments in a safe and timely manner.

These core functions constitute a mutually dependent package and must not be separated one from the other. A failure to achieve any one of them will ultimately produce failure in the other two. These functions should not be confused with social or political objectives, disguised as “national interest”, that often seek to direct banking activities, especially lending, toward particular projects, because this is where the failure of banking functions begins. And this is why the Indonesian banking badly needs restructuring, with or without the crisis. The crisis just helped to accelerate the restructuring.

The objective of the restructuring of the banking system is to resolve the financial difficulties of weak banks and to establish a sound banking system quickly. The strategy involves the infusion of new capital into weak banks, bank mergers and the closing non-viable banks.

The government policy for restoring the banking system consists of five steps. Only the fittest players would remain. The first step is to identify unhealthy financial institutions. Healthy banks with a liquidity problem are to be assisted. Unhealthy banks will be advised to merge. In extreme cases where nothing can be done, the banks will be liquidated. The second step is to restructure the healthy private banks in need of some assistance, through the recapitalisation program. Within this recapitalisation program, not only will these banks be injected with new capital, there will also be changes to the management. The focus is on a viable business plan for the future. The third involves state-owned banks, including the regional banks. The large credit given

by state banks to big projects needs to be restructured and repaid.³⁹ The level of capital adequacy of the state banks, which ranges from minus 140 percent to minus 50 percent, needs to be improved.⁴⁰ There are also plans for the merger and privatisation of state banks. The fourth step involves reviewing the need for regulatory reform.

Strategy I: Bank Categorisation & Selection Criteria

The recapitalisation process started with the categorisation of banks. The main focus of the banking reform is on potentially viable private banks. Banks wishing to participate in the recapitalisation program must:⁴¹

- (i) presently have a CAR, after full provisioning for all impaired loans (based on the findings of recognised auditors), of more than minus 25 percent but less than 4 percent of assets;
- (ii) inject 20 percent of the new capital needed to achieve CAR above 4 percent, with the rest injected by the government by taking a commensurate equity position;
- (iii) update related parties on all NPLs and reduce their level to within the new regulatory requirements;
- (iv) prepare an acceptable business plan showing how it can achieve medium-term viability, and compliance with all BI regulations;
- (v) finalise agreements with former bank owners for repayment of obligations; and
- (vi) pass the “fit and proper test” of its owners and management.

Banking restructuring goes beyond issues about capital. Good services, extensive networks, excellent human resources and management are important criteria for a good bank. For the category B banks which do not contribute its 20 percent additional capital, and has been taken over by the government, their extensive branch networks is an important reason for not liquidating them. On the other hand, it is not fair to use the state budget to save banks that had channelled loans irresponsibly or failed to comply with banking regulations. However, any disruption to the national payment system can be minimised as the government owns 100 percent of the banks and, if necessary, changes the former management. In addition the former owners must settle their ‘connected lending’ speedily, even if it means dipping into their private assets to do so. On the latter, moral hazard must be strictly avoided, as there is a possibility of former owners returning to the old pattern of “easy escape” — avoiding

responsibilities or trying to maintain ownership of these giant banks, by way of using “behind the scenes” practices. The government and IBRA must relentlessly pursue the objective of restoring confidence and keep such moral hazard problems firmly in sight.

Therefore, IBRA policies must be consistent with the objectives to restructure these giant banks, improve their financial performance, reduce budget burden, and prepare them for privatisation under a wider ownership.⁴²

Strategy 2: Private Banks Program — Recapitalisation, New Shareholders

A healthy financial system is a precondition for economic recovery. The banking sector must be healthy and able to perform its function as a financial intermediary, in order to restore the foundation of the financial system and support the real economy. The banking recapitalisation program is the core activity in financial restructuring.

Relatively sound banks that achieve the specified capital adequacy ratio of 4 per cent will sell their bad loans to the AMU at fair prices, thereby improving their risk-weighted capital adequacy, and receive injections of capital from both the government and the owners. These banks are expected to achieve 8 percent CAR by end 2001.

Before the March 1999 reforms, there were 127 private banks. Under the reforms, 73 of them had a CAR of at least 4 percent and therefore would not be included in the recapitalisation program; 7 (which included the three largest private banks) would be taken over by the government; 9 would be recapitalised, subject to their providing 20 per cent of additional capital to reach 4-percent CAR; 38 banks were closed.

The “stronger” 73 banks in Category A are those banks meeting Bank Indonesia’s minimum capital adequacy standard of 4 percent and are not going for the recapitalisation program. The average CAR of these banks is 15 percent, although the actual individual CARs vary widely. At the top end, 6 banks have CAR of 40 percent or more, with the top three having 148 percent, 80 percent and 54 percent respectively. Mid-range are 7 banks with CAR between 20-40 percent; and 16 banks with 10-20 per cent. Down the scale, 30 banks have CAR between 5-10 percent, while at the bottom are 14 banks with CAR of 4-5 percent.

Recent capital injections into these banks have already been verified and approved by Bank Indonesia, the Ministry of Finance and IBRA. These are relatively

small banks with limited networks. They will be reviewed regularly every six months to ensure that they stay in good financial health and continue to observe all rules and regulations, focusing on three main criteria: their business plans, the “fit and proper” test of their owners, and the nature of any capital injection.

Second, are the 9 banks⁴³ in Category B that have been determined as eligible for recapitalisation by the government, to bring them to the minimum capital requirement. All of these banks (out of 48 banks originally in Category B) were chosen based on an assessment of their financial position, quality of management, and future prospects. The average CAR is minus 16 percent, ranging from best case of –8.2 percent to worst case of –23.1 percent. This evaluation process was conducted according to international best practice, with assistance from international consulting firms, and in consultation with the IMF, World Bank, and ADB. The total amount of new capital needed for them to reach 4 percent-CAR is Rp 20,115 billion (US\$2 billion). The owners of these 9 banks will inject 20 percent of the banks’ capital requirement and the government will provide the remaining 80 percent of the capital.

These nine banks together hold 12 percent of total bank deposits, and are considered the big players in the banking system. Their combined assets amount to almost US\$11 billion, and they have over 6 million depositors and 24,500 employees. Given these large numbers, the government had decided that these banks should be allowed for recapitalisation. New capital will be injected so that they can attain the 4 percent CAR in April, with 20 percent coming from the former owners and 80 percent from the government, in the form of issued bonds. Although the government holds the majority shares, the former owners would be fully responsible for any business decision and are given priority in buying back the government shares within three years (see *Table 22*).

Seven banks in Category B were taken over by the government and managed by IBRA. These are the largest Category B banks, with extensive branch networks, and were taken over out of public interest to minimise disruption to the payments system. The average CAR is –21.08 percent, with best case showing –15.6 percent and the worst, –24.61 percent. Total new capital required for all 7 banks to attain the 4-percent CAR is Rp 5,210 billion (around US\$0.5 billion). These banks had 1 million depositors and total assets worth Rp 21.6 trillion, and manage Rp 15 trillion third-party

funds. With 100 percent ownership by the government, former owners will be required to settle excess 'connected lending'. These banks are to be restructured to improve their financial performance, reduce their burden on the budget, and to prepare them for privatisation.

Thirty-eight banks were liquidated. Since twenty one of them were actually in Category B, with CAR above minus 25 percent, they could have qualified for recapitalisation. Six of them were unable to submit the required 20 percent additional capital, and 15 of the banks failed to meet the criteria of being able to improve the overall quality of assets and to produce a viable working plan. The remaining 17 banks — Category C banks with CAR below minus 25 percent — were very much insolvent and had no prospect of regaining financial viability.

The ten banks frozen in April and August 1998, which had used Bank Indonesia liquidity credit in excess of 500 percent of their paid-up capital or equivalent of more than 75 percent of their total assets, are also in the process of liquidation. The remaining four banks still in operation will be restructured, due to their large depositor bases and branch networks. These banks will have their management restructured, financial performance improved and their non-performing loans transferred to AMU, as part of the preparation for their privatisation.⁴⁴

With this restructuring, the configuration of Indonesian banks would return to that before the 1988 banking deregulation (Pakto 88) — the number of banks had grown from less than 70 (pre-1988) to 235 has now returned to below 100. To meet their need for capital, more bank mergers would occur in the future, so that the number of banks would be even lower. But when the economy starts recovering, more banks may be set up again.

Strategy 3: State Banks — Merger & Privatisation

The problems of state banks are addressed as one of the key issues. The large assets of the seven state banks underline their importance in the financial system, and the huge non-performing loans they have calls for urgent financial resolution. In December 1997, the government announced the plan to merge four state banks (Bapindo, Bank Bumi Daya, BDN and Bank Exim) — with a heavy burden of non-performing loans — and BTN, the national savings bank, to form a subsidiary of BNI, one of the healthy

banks. BRI is left to serve as a “small-scale” bank. The merger plan for the four banks will result in the downsizing of the operations and lead to the sale of redundant facilities and closing of bank branches, to maximise the benefits from the merger. The new bank would eventually be privatised. Privatisation would introduce “public control” into the bank and prevent the bank from extending credit to risky projects and to encourage the bank to comply with regulations on assessing the credit worthiness of borrowers.

The recapitalisation of the state banks would require a huge amount of funds. To reach the CAR standard of 4 per cent, the total capital needed for the four merging banks is approximately US\$12.3 billion (*see Table 23*).

The merger process will be followed by the integration of operational structures, with implications such as staff downsizing, branch closures, complementary functions, and an inventory of assets. The recapitalisation of these state banks is scheduled to be completed by the end of March 2000. Part of the large loans of the four banks, individual and the syndicated ones, and consisting mostly of bad loans extended to the biggest 50 debtors amounting to US\$5.7bn (see appendix 1) was to be transferred to AMU by May 1999. The likelihood of the recovery of these loans would depend on AMU’s rigorous effort. The question is whether the loans can be recovered in time for recapitalisation to be completed on schedule.

Regional banks, each of which is owned by one of the 27 provincial governments, are not free from financial trouble. Twelve of these 27 banks are in need of capital injection, with the largest four of them having a CAR below minus 25 per cent. A total of Rp 1.5 trillion, or US\$200 million, is needed for recapitalisation (*see Table 24*).

Strategy 4: Recapitalisation Costs — Who Pays?

Total funds needed to cover at least the initial costs of recapitalisation amount to almost Rp240 trillion (approx. US\$30 billion, with exchange rate of Rp8, 000).⁴⁵ The breakdown is shown in *Table 25*.

How would the government fund this large cost? Oil income, which is an important component in the state budget, has been declining as the price of oil per barrel fell almost 60 percent, from US\$21 in 1996 to current US\$9. The IMF loan of

US\$43 billion is given in stages, and is still dependent on the result of discussions on the Indonesia's political and social development.

Alternative sources of funding for recapitalisation have been discussed: government bonds, the use of state budget, investment portfolios, foreign direct investments, and other external sources such as IMF, ADB funds. In the first stage, the program cannot rely on the foreign private capital. Funds from the market and foreign investors can be obtained only after there is a certain sign of success in the recapitalisation scheme. Therefore, the government itself will have to provide for the cost of recapitalisation, in the form of bonds. In order to finance IBRA, the government issues Rp 80 trillion of bonds which IBRA is expected to sell in the first instance to BI, as well as additional bonds of approximately Rp75 trillion for restoring the financial viability of banks that the government had taken over.

In May 1999, bonds with a total value of Rp 157.6 trillion were issued. They consisted of three kinds: variable rate (3-10 years, with an interest rate equal to 3-month SBI rate), fixed rate (5-10 years, interest rate of 12-14 percent interest rates) and CPI-linked rate (20 years, interest rate of 3 percent above the inflation rate). At a later stage, when the recapitalised banks are ready for privatisation, in a healthy financial position and having no more bad loans, both domestic and foreign investors would be invited through direct or portfolio investment to invest in the listed banks.

Before selling those bonds, the government must ensure that some important things are done:

- (i) all banking problems and loans are handled properly; banks are taken over or new shareholders found;
- (ii) corporate assets are disposed of to make provisions for unrecoverable loans;
- (iii) guarantees from international institutions are obtained to ensure the bank's rating.

State banks absorb almost half the total recapitalised funds. Six of the seven state banks are in desperate conditions, with CARs ranging from minus 136 per cent to minus 35 per cent.⁴⁶ The assets of the liquidated banks are considerably below their reported values.⁴⁷ Due diligence conducted by international auditing companies revealed that their assets were worth only around 20 percent of the value reported by the previous auditing companies. In other words, the AMU is saddled with bankrupt

companies, whose real values are well below their outstanding debts. This implies a higher recapitalisation cost.

Pessimists argue that recapitalisation is wasteful,⁴⁸ that the huge amount of money used to recapitalise the ailing banks would only help them attain the capital adequacy ratio temporarily. There are two important factors to consider: negative spread and non-performing loans.

The negative spread has seriously affected banks, and a continuing negative spread would consume the recapitalisation fund. With an average interest rate of 50 per cent and an SBI rate of 37 per cent, banks have to compensate for losses amounting to as much as US\$ 2 billion every month (see footnote for calculations).⁴⁹ This figure is expected to keep growing and consume the banks' capital. Thus the new capital injected into these banks could compensate for the negative spread losses for a few months.

In conclusion, the factors that might limit the effectiveness of recapitalisation are:

- (i) the inability of corporations to repay their debt means there is no income for banks, even though they still have to pay interest on deposits;
- (ii) the accumulated burden of negative spread for more than one year — an interest rate differential of 40 percent between August 1997 and November 1998;
- (iii) banks' reluctance to issue new credit to corporations in need. As their ability to repay debt is questionable, no credit is given to corporations; banks purchase SBI and substitute the interest payments for credit income. The recapitalisation plan *might* work if the gap between the interest rates changes from zero to positive.
- (iv) uncertainty at the political front. The June 1999 election does not guarantee stability. In fact the election itself introduces various uncertainties which might affect the recapitalisation program. Until the election is over, high interest rates will be maintained to prevent the depreciation of the rupiah.
- (v) the seemingly unclear definition of the timetable for the recapitalisation of each bank, and its details unavailable to the public. The specification of targets to be achieved within a certain time frame is very important to ensure the implementation of the eventual privatisation program. When the schedule for each individual bank is publicised, the public owners (if listed), the general public, and the depositors can help to keep the implementation on track, if only to protect their own vested interests.
- (vi) the dependence of the prospect of selling bonds to finance the recapitalisation on the factors earlier mentioned: the handling of banks and corporate loans, and international guarantees.

If post-election Indonesia is one of security and stability, and the government regains domestic and international confidence, the interest rate may be lowered, negative spread overcome, and the exchange rate strengthened, so that the real sector could begin its recovery. Only then does the recapitalisation scheme have a chance to succeed.

Strategy 5: Legal & Regulatory Framework

The legal framework in the financial system is needed to ensure that every public decision reflects the evaluation of cost and benefit to the public, and not the interests of some social groups at the expense of the general public. The Indonesian financial system is poorly managed and lacks adequate enforcement and supervision. Although financial liberalisation started almost two decades ago in the 1980s, they were not followed up with regulatory and enforcement measures. When Indonesia liberalised its financial system, it opened the economy to more financial externalities. To prevent the financial system from becoming too vulnerable to these externalities, banking regulation, supervision and enforcement are a must.

To establish the requisite institutional infrastructure in banking, the government should implement:

- (a) a system of laws and rules for corporate governance. Areas of focus should include bankruptcy law, banking disclosure, and regulations on liquidity management and foreign currency exposure.
- (b) transparent financial reporting. A uniform set of transparent accounting standards for statements, schedules and reports. Banks should be required to publish audited financial statements annually, and publish comprehensive data on their operations regularly.
- (c) supervisory regulations on bank lending, including loan classification, loan loss provisioning, 'connected lending', and penalties for violating the regulations.

The bankruptcy law is currently being updated in a number of important aspects. First, the law will allow qualified professionals from the private sector to act as receivers and administrators in managing the estates of bankrupt and reorganised companies. Second, procedural rules are introduced to ensure consistency and transparency in the proceedings, specifically to prevent unjustifiable delays in the adjudication of bankruptcy. Third, a number of substantive rules are updated, including

stronger safeguards against insider and fraudulent transactions undertaken by a debtor prior to the adjudication of bankruptcy.⁵⁰

Regulations on liquidity management and foreign currency exposures must include a relevant and sufficiently high reserve requirement for banks. The central bank must be cautious about liquidity assistance to commercial banks and must ensure proper reporting and continuous monitoring of the banks. When the banks' liquidity requirements cannot be fulfilled by domestic sources and the central bank, an unlimited access to foreign exchange may lead banks to develop a high dependence on foreign currency, thus exposing themselves to currency shocks.

A realistic valuation of collateral must be conducted in order to prevent problem loans from arising. Some countries have a loan-to-value ratio that is changed according to the economic situation to prevent over-expansive loans. For example, banking systems in Hong Kong and Taiwan reduced the ratios from 80-90 percent in 1990 to 60-70 percent by 1993.⁵¹ Limiting the risk of credit expansion can also be done by imposing stricter regulations on collateral that is linked to risky sectors, particularly those that are interest-rate sensitive, such as equity and property.

A uniform set of transparent accounting standards is needed to ensure that there is no delay in recognising bad loans or other inconsistencies in financial reporting. The quality of information on financial disclosure must be made part of the banks' responsibilities. The government must ensure that the quality of information is of international standard and that the supervising body would promptly recognise any inaccurate and unqualified information. Schedules of reports must be accompanied by penalty enforcement for any delay. Regulations on bank lending must be enforced, and should cover areas such as loan classification, loan loss provisioning, 'connected lending', and penalties for violating those regulations. Greater transparency in financial reporting and accurate accounting standards would prevent widespread 'connected lending', as loans would have to be disclosed to the public for their consent.

The legal and regulatory framework falls under government control, but it is vital to the bank performance. Therefore, it must be properly instituted in the system, with full co-operation between the bankers and the government.

Lessons Learned

When we analyse an economic issue, we cannot ignore the impact of the political situation on the economy. The ongoing financial crisis is caused by rapid changes in the macro-financial and macroeconomic environment, together with inadequate internal controls and procedures, poor supervision and undeveloped regulatory practices, and last but not least, concentrated credit risk exposure. The crisis is prolonged due to the unstable political situation and hitherto latent social problems.

The good news is that the economic crisis has brought to the surface the ill practices in businesses, banking operations and politics, forcing us to deal openly with them. In particular, the corporate sector had borrowed very heavily abroad, mostly without hedging their foreign currency loans; the banking system had been poorly supervised, with widespread violations of the legal lending limits; and microeconomic policies were compromised by poor governance. If the fundamentals of business, banking and politics were solid, there would not have been a loss of confidence in the financial system, and even if it did happen, the crisis would not have lasted so long. Indonesia's economic recovery requires the relevant parties to play their part in discharging their responsibilities, and that all parties synchronise their activities and efforts toward a common objective of restoring confidence in the economy.

This crisis once again proved close inter-linkages between economics and politics. In fact, any effort toward economic recovery would never be effective without political stability. On the other hand, economic recovery could contribute towards political stability. When political reforms get started, economic and financial reforms, can begin.

Apart from the political chaos and other non-economic governance issues, the fundamentals of the Indonesian financial system are not strong enough to support such a large and complicated economy as Indonesia. The liberalisation of the financial sector would only work if banking regulations are effectively enforced.

Who Does What?

This economic crisis is a good opportunity for all the players rectify their past mistakes and lay a solid foundation for the future. The government can correct wrong practices in financial management by supervising of short-term foreign borrowing, and ensuring

timely policy responses. Domestic players should co-operate with the government by being prudent in managing their offshore loans through hedging, in their choice of investment and in business expansion. For the banking system, the creditworthiness criteria must be clarified, in order to make sure that the credits given are for eligible businesses, which are backed by collateral with a market value commensurate with the loans ((see Table 26).

Parallel to the politics-economic relationship, a causal relationship exists between good governance and financial restructuring. Improved governance can prevent banking blunders; banking and corporate restructuring can also have a crucial impact on better governance, and thus helps to sustain the recovery process. The recapitalisation program for private banks will retain the important element of private ownership and management in the banking system. Periodic checks on the soundness of the banking system is a must for the successful restoration of the banking system. The recapitalisation of state banks should be undertaken only after financial restructuring is completed. The sound and transparent restructuring of the state banks is critical to the success of economic stabilisation and the reform program.

Corporate debt restructuring must be followed up with clear and early implementation of bankruptcy process. Foreign debts and bad loans must be quickly resolved. Companies that are unable to repay their loans by the pre-set deadline should be declared bankrupt. State banks and IBRA must independently and aggressively pursue the repayment of the largest loans and intensify efforts for asset recovery. These agencies must be capable of discharging their responsibilities and maintaining their integrity since the cost of financial reform and corporate restructuring is too high to admit failure. A sense of urgency is also needed. Procrastinating the restructuring would incur a much higher cost, both monetary and non-monetary.

In view of the current situation, the success of banking recapitalisation is far from a foregone conclusion. Reform efforts are moving very slowly. Banks that are relatively healthy and which meet the minimum requirements have limited capital and network, and so they have little impact on the national banking system. Big banks that are eligible for recapitalisation are mired in financial trouble and there are signs that they may be renegeing on their agreement to contribute 20 percent of the additional capital. Since government bonds will be sold to cover the 80 per cent of the additional

capital, government ownership of the banks essentially consists of “false” equity. However, only when the government shows its commitment to restore confidence in the economy, will the domestic economic players and foreign investors invest in the economy.

The performance of IBRA and AMU in handling the taken-over and liquidated banks must be strengthened. Funds for the recapitalisation program are not yet forthcoming, as the capital inflow is still low and the corporations’ foreign debt resolution shows little progress. A lot remains to be done.

Surviving Players’ Strategies

In the meantime, the surviving players’ strategy would revolve around:

1. Pending New Credit
Banks would not issue new credits until the recapitalisation process is fully completed or favourable signals appear in the banking system. New credits would bring new risks to bank assets, and would affect the CAR.
2. Overcoming Negative Spread
High SBI interest rates make it difficult for banks to issue credit for the real sector, because the negative spread would consume the banks’ capital base and profit. That is why banks invest their funds in Bank Indonesia by buying SBI and channelling their funds to other banks, both of which bring greater income.
3. Business Focus
The collapse of the big corporations creates more opportunities for the medium and small companies. Some of the banks are turning to retail banking, while others are concentrating on core (corporate) banking. Other corporations sell their assets in non-core businesses.⁵²
4. Restructuring For Sale
Banks and corporations are restructuring and reorganising their company structure, credit and the financial performance. The next step would be to find new shareholders. In fact, many foreign investors are eyeing these banks and corporations and are hoping to acquire a stake in them at low prices (*see Table 27*).
 - (i) Wider Ownership
 - (ii) In place of ‘concentrated ownership’ in banks, wider ownership would allow some ‘public control’ over the banks to prevent violations of banking regulations. It would force banks to practice impartiality in fund management, prevent banks from being biased to certain corporations and from channelling funds to “own projects”, as well as to release the banks from bureaucratic pressure to finance “strategic projects” with insufficient collateral or little prospect of profitability.

In conclusion, there are no easy solutions. Financial sector restructuring is essential to restoring the national financial system, through restructuring the banking sector and strengthening the legal enforcement of regulations and banking supervision. But it must complement other developments in the country. Financial restructuring needs to be complemented by sound macroeconomic policies as well as structural reforms in the real sector and provision of a social safety net. Policy continuity after the June elections, supported by a clear vision and political will for reform, will be crucial to retaining confidence in the recovery program and to strengthen the prospect for growth. The Indonesian economy will gradually recover if these conditions are met. But before that, a lot of effort must be put into resolving the various outstanding issues. In the meantime, the Indonesian economy will have to be prepared for much slower economic growth.

NOTES

1. "Global Emerging Markets", Deutsche Bank Research, 1998.
2. BIES, Survey of Recent Developments, March 1998, p.7.
- 3.
4. SBI (Bank Indonesia Certificates) and SBPU (Money Market Securities) are the monetary tools. The total amount of money in circulation is affected by the selling and buying of SBIs and SBPUs.
5. Data Consult, "Capital Market", Feb 1998.
6. For example, the price of Sierad Produce shares, which was Rp 825 per unit at the end of July 1997, crashed to Rp 125 per unit on 17 February 1998. The price of some property shares, also nosedived to between Rp150 and Rp175 per share. In the banking sector, prices ranged from Rp 200-225 per share in early 1998, recovering slightly in 1999 for a few banks, due to foreign acquisition.
7. JSX data is considered to be reflective of the financial status of the Indonesian companies, financial and corporate sectors. Most of the listed companies were related to the conglomerate groups, with big assets and broad markets. Thus it is a useful tool for assessing the overall financial situation.

8. Price Earning Ratio (PER) is the ratio of the regular closing price over the earnings per share. The larger the earnings of a company, the smaller the PER. Earnings per share (EPS) is derived by dividing net profit (after taxation) by number of shares issued.
9. Jakarta Post, 23 December 1997.
10. Jones Lang Wootton Research on Indonesian office building property, Kompas, 26 December 1998.
11. Especially those office buildings that used US-dollar denomination for its space rent, around 9-15 US dollars per sqm per month, with an exchange rate much lower than the central bank's rate (between 40-50 per cent). A lower category of building, using the rupiah rate of equivalent US\$6 per sqm per month. Still, more than 30 per cent of the office space in the business centre was vacant by the end of 1998. There is no new construction of office buildings.
12. Kompas, 22 December 1998.
13. Goldstein, Morris, BIS Economic Papers — October 1996, page 17.
14. Goeltom, Miranda, Indonesia's Financial Liberalisation, 1981-1988.
15. This part is synthesized from The Role of the Private Sector in Indonesia, Mari Pangestu, 1990.
16. JSX Statistics.
17. Capital Adequacy Ratio (CAR), ratio of total capital to risk-weighted assets. In 1991 Bank Indonesia introduced a minimum CAR of at least 8 per cent, based on the Basle Accord. This minimum was scheduled to increase to 9 per cent by 30 September 1997, 10 per cent by September 1999, and 12 per cent by September 2001. The economic crisis has prevented the Bank from keeping to this time schedule. The current minimum CAR is 4 per cent.
18. BI Financial Statistics.
19. Jakarta Post, 23 December 1997.
20. This is a case of a lack of confidence, despite the fact that all deposits (rupiah and foreign currencies) in the liquidated banks are guaranteed by the government, deposit withdrawals continued. The guarantee will remain in place for at least two years (government statement, January 15, 1998) and will not be

terminated before the soundness of the banking system restored, with at least six months notice before the withdrawal of the guarantee.

21. IBRA, the Indonesian Bank Restructuring Agency, is established through Presidential Decree No. 27/1998 on January 26, 1998. It is an autonomous agency, operating under the auspices of the Ministry of Finance, with two main functions: (1) supervise banks in need of restructuring and restore them to soundness at least cost to government; and (2) to be the asset management agency in the course of bank restructuring. AMU, the asset management unit was later formed as part of IBRA to perform the second function. IBRA will have a limited lifespan, and will be wound up once the bank rehabilitation program is completed.
22. Criteria for putting banks under IBRA supervision is that it has over 75 per cent of BI liquidity support and has borrowed more than 500 per cent of their capital.
23. BI Press Release, and Kompas daily, March 13, 1999.
24. Grenville, Stephen: "Comments on Prof. Wardhana's Paper", Indonesia Assessment 1994, ANU.
25. Peregrine's fall illustrates the case of overconfident foreign lenders and careless and opportunistic Indonesian corporations. Peregrine Investments Holdings, Asia's premier investment bank based in Hong Kong lent US\$260mn — in the form of an unsecured bridge loan — to an Indonesian taxicab company, Steady Safe. The promissory note was made shortly after the devaluation of the Thai Baht in July 1997 when the rupiah was pegged at Rp 2,500 to US\$. The owner of Steady Safe, which was set up only in 1993, enlisted Tutut Suharto, Suharto's eldest daughter, as its equity investor and planned to create a system of car ferries linking the islands of Indonesia's archipelago. Peregrine extended the loan, which represented a third of its capital, through underwriting bonds issued by Steady Safe. The situation changed for the worse following the Indonesian currency and stock market slump. When the rupiah fell to Rp 10,000 to the Dollar in Jan 8, 1998, Steady Safe was unable to repay this unhedged loan. Its stock plunged, together with the stocks of other Indonesian companies, from Rp 3,000 to only Rp 300 per share in Jan 1998. Peregrine was left with Indonesian stocks that no one wanted to buy and was unable to repay its loan prior to Jan

- 13, as its major creditor, First Chicago, could not extend the credit line. On Jan 12, 1998, Peregrine was liquidated (source: *Asiaweek* 23 Jan 1998, *Jakartanet* 2 Feb 1998; *Washington Post* 13 Jan 1998).
26. World Bank, "Indonesia in Crisis, a Macroeconomic Update", July 1998 p2.3.
 27. INDRA is an agency supervised by Bank Indonesia. It is established by Presidential Decree 95, 2 July 1998, to assist Indonesian companies/debtors in fulfilling their obligations to foreign creditors. Through INDRA, the companies can pay their foreign debt in rupiah at the most favourable exchange rate between August 1998 and June 1999 (now extended to December 1999), at real interest rate of 5.5 per cent. Firms must first restructure their foreign debt within 3 years and the loan principle has to be repaid over a 5-year period, with interest payable on the indexed principal.
 28. Indonesia Letter of Intent, September 11, 1998.
 29. A sample case is the Bakrie Group. MSPV, Master Special Purpose Vehicle, a group of 200 creditors of the Bakrie Group, has finally agreed to take two-thirds of Bakrie's 51 per cent share in its group, in lieu of a US\$1.02 billion debt.
 30. Conference on "The Importance of Corporate Governance", *Kompas*, April 20, 1999, and the Jakarta Initiative press releases.
 31. In private banks, credits extended to members in their own group were not reported. Thus the LDR was below 1.0, which meant that deposits were greater than credits. But, negative spread "were never a problem", as these banks know that the source of their negative spread was capital channeled into the conglomerate's business expansion.
 32. Under a haircut, debtors repay their loans with discounts.
 33. Due diligence is done by JP Morgan and Lehman Brothers, *Kompas*, 19 April 1999.
 34. Problem loans arising from the failure of credit assessment are "common" cases both in the state banks and private banks. For details, see Richard Robison, in "Indonesia Assessment 1994" of ANU publication, pp.63-68: cases include Bank Bumi Daya financing petrochemical project Chandra Asri, Bank Indonesia loan to clove trading monopoly, Bapindo's loan to Golden Key Group, Bank Summa's loan to its own group.

35. *Kompas* daily, 19 April 1999.
36. See the financial status of the nine recapitalizing banks. All CARs ranged from minus 23 to minus 8 per cent.
37. Speculative Currency Attacks — A Historical Perspective, by Peter Garber, in *Global Emerging Markets*, Deutsche Bank Research, June 1998.
38. Corrigan, E. Gerald, “Building a Better and Safer Banking System”, EDI of World Bank.
39. Refer to the list of largest debtors of the four state banks.
40. Refer to the financial sheet of state banks.
41. Letter of Intent, October 19, 1998.
42. The eight banks chosen for recapitalisation program is being re-audited by internationally-recognized auditors: KPMG (B. Bali, Universal, Bukopin, and Lippo), Ernst & Young (B Prima Express and Artha Media); Price Waterhouse (B Patriot), Deloitte Touche Tomatsu (BII), *Kompas*, 13 April 1999.
43. One of these banks, Bank Niaga, later withdrew from the recapitalisation program and was taken over by the government, so that in total, 8 banks are taken over and 8 are to be recapitalisationd.
44. BCA is going to be privatised, and B Tiara and PDFCI will be sold or merged with B Danamon.
45. To reach the international minimum of 8-per cent CAR as stipulated by IBS, the government of Indonesia needs much more than US\$30bn. In an estimate by S&P, US\$87bn would be needed for Indonesian banks to achieve 8-per cent CAR. *AFX News*, 9 June 1999.
46. BRI (-35%), BDN (- 48%), BNI (- 52%), BBD (- 55.6%), Bank Exim (-102%) and Bapindo (-136%) BTN is the only state bank with CAR above 4%t.
47. Kwik Kian Gie, *Analysis on Auditing*, 19 April 1999. Reported asset values are higher than “the real” value because taxation in Indonesia is not strictly enforced. High asset values would instill confidence in the investor, who did not have to worry about taxation.
48. Anwar Nasution’s comments as quoted in *Swa*, March 1999. Calculated based on the Loan-Deposit of all banks and the difference between interest rates. See appendix-2 for total loan and deposits of all banks and appendix-4 for Interest

Rates. Total Deposits (Rp trn) 590 – Bank pays deposits at 50per cent (in average). Total Loan (Rp trn) 490 – Banks receive interest income at 25% (on average).

49. The difference is the negative spread of approximately US\$2bn every month.
50. Memorandum of Economic and Financial Policies, 10 April 1998.
51. Goldstein, “Banking Crises in Emerging Economies”, BIS, Oct 1996.
52. Case of Astra, one of the then “blue-chip” companies, is a good example of debt restructuring and efforts to concentrate on “core business”. Its debt of Rp 11 trillion (US\$1.4bn) is restructured in 3 phases: (phase 1) 3-years guaranteed bonds of value US\$200m and Rp190bn. With interest rates at 3% above SIBOR for US\$, and maximum of 35% for rupiah; (phase 2) 6.5 years guaranteed bonds of value US\$705.4mn, and Rp701.7bn, with interest rates at 3% above SIBOR for US\$, and the average deposit rate of two state banks and two private banks; (phase 3) 7.5 years of guaranteed bonds of value US\$ 100mn, and Rp99.4bn, with interest rates of 6.5% for US\$ and 15% for the Rp. Astra International, with total assets of Rp9 trn, is now focusing on “core business”. It has sold its non-core businesses in 3 phases: (1) its ownership in Astra Microtronics Technology to New Bridge for US\$ 90 mn, (2) its share of 25% stake in Daihatsu Indonesia at Rp450bn, and (3) its ownership of 17.5per cent share in Makro Indonesia, valued at value US\$7mn. — Rini Soewandi, President Director of Astra International, Kompas, 13 April 1999..

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Table 1. Macroeconomic Indicators of Asia-5**GDP Growth (per cent per annum)**

	1991	1992	1993	1994	1995	1996	1997	Avg. (90-97)
Indonesia	8.9	7.2	7.3	7.5	8.2	8	4.6	7.4
Malaysia	8.6	7.8	8.3	9.2	9.5	8.6	7	8.4
Philippines	-0.6	0.3	2.1	4.4	4.8	5.7	4.3	3
South Korea	9.1	5.1	5.8	8.6	8.9	7.1	5.1	7.2
Thailand	8.1	8.2	8.5	8.9	8.7	6.4	-0.4	7.1

Inflation (percent per annum)

	1991	1992	1993	1994	1995	1996	1997	Avg. (90-97)
Indonesia	9.4	7.5	9.7	8.5	9.4	7.9	8.3	8.7
Malaysia	2.6	4.7	3.5	3.7	3.4	3.5	3.7	3.6
Philippines	18.7	8.9	7.6	9	8.1	8.4	5.2	9.4
South Korea	9.3	6.2	4.8	6.3	4.5	4.9	4.4	5.8
Thailand	5.7	4.1	3.4	5.1	5.8	5.9	5.6	5.1

Savings (percentage of GDP)

	1991	1992	1993	1994	1995	1996	1997	Avg. (90-97)
Indonesia	28.7	27.3	31.4	29.2	29	28.8	27.3	28.8
Malaysia	28.4	31.3	33	32.7	33.5	36.7	37	33.2
Philippines	18	19.5	18.4	19.4	17.8	19.7	21	19.1
South Korea	35.9	35.1	35.2	34.6	35.1	33.3	32.9	34.6
Thailand	35.2	34.3	34.9	34.9	34.3	33.1	31.8	34.1

Investment (per cent of GDP)

	1991	1992	1993	1994	1995	1996	1997	Avg. (90-97)
Indonesia	27.0	25.8	26.3	27.6	28.4	28.1	26.5	27.1
Malaysia	36.4	36.0	38.3	40.1	43.0	42.2	42.7	39.8
Philippines	30.0	20.9	23.8	23.6	22.2	23.2	25.1	22.7
South Korea	38.4	36.6	36	35.7	36.6	36.8	36.6	36.7
Thailand	41.6	39.2	39.4	39.9	41.8	40.8	35.8	39.8

Current Account (per cent of GDP)

	1991	1992	1993	1994	1995	1996	1997	Avg. (90-97)
Indonesia	-3.4	-2.2	-1.5	-1.7	-3.3	-3.3	-2.9	-2.6
Malaysia	-8.8	-3.8	-4.8	-7.8	-10.0	-4.9	-5.8	-6.6
Philippines	-2.3	-1.6	-5.5	-4.6	-4.4	-4.7	-4.5	-3.9
South Korea	-3.0	-1.5	0.1	-1.2	-2.0	-4.9	-2.9	-2.2
Thailand	-7.7	-5.6	-5.0	-5.6	-8.0	-7.9	-3.9	-6.2

Table 1 (continued)
Balance of Payment (per cent of GDP)

	1991	1992	1993	1994	1995	1996	1997	Avg (90-97)
Indonesia	0.9	1.3	0.5	0.5	0.7	1.9	1.0	1.0
Malaysia	2.6	11.3	17.7	-4.3	-2.0	2.5	-3.2	3.5
Philippines	4.6	2.8	-0.3	2.8	0.9	4.9	-4.1	1.7
South Korea	0.4	-1.2	-0.9	-1.2	-1.5	-0.3	2.8	-0.3
Thailand	4.2	2.7	3.1	2.9	4.3	1.2	-4.6	2.0

SOURCE: IMF, *Global Emerging Markets*, June 1998

Table 2 Timeline of Indonesian Financial Crisis
July-1997 to April-1999

Stage	Date	Outcome
	1997	
Initial Shock	Jul-97	Baht floated, as a reaction to heavy speculative attack in May Bank Indonesia widens rupiah intervention band from 8 to 12 % Early fall of rupiah exchange rate by 7 %
	Aug-97	Rupiah floated, determined by market Tight money policy
Aftershock	Sep-97	First government package announces that: 49% foreign ownership in stocks is lifted Second government package: Budget to be revised; projects postponed; tax and tariff policy; Insolvent banks to be liquidated if M&A fails
Crisis continues	Oct-97	Rupiah falls further to Rp 3900/US\$ Government seeks IMF assistance Jakarta stock market plummets First agreement with IMF signed, US\$43billion standby facility
	Nov-97	16 banks liquidated, detailed reform package announced
	Dec-97	Serious rumors about Suharto's health, rupiah and the stock market Indexes fall further Banking reform announced: merging of state banks, Resolution of bad debts, greater participation of foreign investments
	1998 Jan-98	State budget introduced Rp 4,000/US\$, 4% -growth, 9% -inflation Rupiah breaks "psychological" Rp 10,000/US\$ threshold Second IMF agreement signed with more detailed reform package Suharto announces Presidency bid, with Habibie as VP Rupiah reaches Rp 17,000/US\$ Revised state budget at Rp 5,000/US\$, 0% -growth, 20% -inflation Establishment of IBRA (Indonesian Bank Restructuring Agency)
Reform process	Feb-98	IBRA intervention in 54 weak banks, whose BI emergency borrowings exceeded 200% of their capital and whose capital was less than 5% of assets. Currency board system considered.
	Apr-98	IBRA suspends 7 banks whose BI borrowings exceeded Rp 2 trn and another 7 banks whose borrowings exceeded 500% of capital, and more than 75% of their assets.

Table 2 Timeline of Indonesian Financial Crisis (Continued)

Jun-98	Frankfurt agreement reached between Indonesia and principal bank creditors on 3 elements: — framework to reduce real exchange risk on payments following the restructuring of external debts — a scheme to restructure interbank debt — arrangement to maintain trade finance facilities
Jul-98	AMU (Asset Management Unit) is established as part of IBRA, to handle non-performing loans from banks
Aug-98	INDRA established to assist in restructuring of corporate debts Revised bankruptcy law effective, include the procedural rules Draft Banking Law submitted to Parliament Transfer of assets of seven banks frozen in April, to AMU
Sep-98	The Jakarta Initiative — a framework to assist corporate debt restructuring out-of-court, and to complement the newly amended bankruptcy law and INDRA scheme

July-1997 to April-1999

Stage	Date	Outcome
	1999	
	Mar-99	Sweeping bank reforms: closing of 38 banks, 9 banks recapitalized and 7 banks taken over by IBRA
	Apr-99	MOU on recapitalizing banks First full review on 73 healthy banks

SOURCE: Bulletin of Indonesian Economics Studies (BIES), Survey of Recent Developments, March 1998; Letters of Intent, Bank Indonesia, Kompas daily

Table 2.A Timelines of the Government of Indonesia's agreement with IMF

Letter of Intent and Supplementary Memorandum of Economic and Financial Policies	14-May-99
Letter of Intent and Supplementary Memorandum of Economic and Financial Policies	16-Mar-99
Letter of Intent and Supplementary Memorandum of Economic and Financial Policies	13-Nov-98
Letter of Intent and Supplementary Memorandum of Economic and Financial Policies	19-Oct-98
Letter of Intent and Supplementary Memorandum of Economic and Financial Policies	11-Sep-98
Letter of Intent and Memorandum of Economic and Financial Policies	29-Jul-98
Memorandum of Economic and Financial Policies	24-Jun-98
Memorandum of Economic and Financial Policies	10-Apr-98
Memorandum of Economic and Financial Policies	15-Jan-98
Letter of Intent and Memorandum of Economic and Financial Policies	31-Oct-97

SOURCE: IMF website, June 1999

Table 3 Indonesia's Balance of Payments (US\$ Billion)

Year	Current Account	Aid	Direct Investment	Debt Repayment	Portfolio Inv.	Balance
1994	-0.939	1.514	0.758	-1.868	1.131	0.596
1995	-1.204	1.432	1.26	-1.666	3.049	2.871
1996	-1.053	1.493	1.54	-1.437	2.272	2.815
1997	-0.226	4.186	-0.324	-0.916	-7.6	-4.88
1998	0.67	2.913	0.367	-0.68	-1.405	1.865

SOURCE: Ministry of Finance website, June 1999

Table 4. Government Foreign Borrowing ((in Rp Trillion)

Year	Installment + Interest	New Loan	Loan Surplus/Deficit	Short-term (US\$bn)	Long-term (US\$bn)
1984	2.7	3.4	0.7	26.2	5.4
1985	3.3	3.5	0.2	30.6	6.0
1986	5.1	3.8	-1.3	36.4	6.5
1987	8.2	5.4	-2.8	45.4	6.4
1988	10.9	7.9	-3.0	46.7	6.7
1989	11.9	8.4	-3.5	50.8	8.0
1990	13.4	8.5	-4.9	58.3	11.1
1991	15.6	9.1	-6.5	65.1	14.3
1992	17.0	10.8	-6.3	70.0	18.0
1993	18.3	9.8	-8.5	71.2	18.0
1994	20.5	9.0	-11.5	88.4	19.5
1995	22.9	11.9	-11.0	98.4	26.0
1996	28.1	23.8	-4.3	96.8	32.2
1997	64.3	114.6	50.3	119.8	20.1

SOURCE: State Budget 1984-1997; ADB Key Indicators, 1984-1997

Table 4. Indonesian External Debt, end 1997 (US\$ bn)

	Short Term	Long Term	Total
Government	—	52.9	52.9
Non-Financial Public Enterprises	0.1	3.8	3.9
Banks			
State-owned	1.8	4.4	6.2
Private	2.4	4.0	6.4
Private Corporations	6.8	51.8	58.6
Securities	9.0	2.9	11.9
Total	20.1	119.8	139.9

SOURCE: Bank Indonesia Statistics, March 1998

Table 5. Corporate Debt: Source of Debt, end 1997

Country	Total (in US\$ bn)	Japan (% of total)	UK (% of total)	US (% of total)	Other EU (% of total)	Others (% of total)
Indonesia	58.7	39.4	7.4	7.8	30.9	14.5
Malaysia	28.8	36.4	7.0	8.3	37.0	11.3
Philippines	14.1	14.9	7.6	20.0	40.5	17.0
S. Korea	103.4	22.9	5.9	9.6	29.3	32.3
Thailand	69.4	54.4	4.1	5.8	24.5	11.3
Total	274.5	33.6	6.4	10.3	32.4	17.3

SOURCE: Bank for International Settlements, *Emerging Global Markets*, June 1998

Table 6. Indonesia: Macroeconomics Profile

Indicator	Unit	1995	1996	1997	1998	1999e	2000e
Growth and Inflation							
GDP Nominal	Rp trillion	452.38	528.96	624.34	1023.4	1248.6	1448.3
GDP Nominal	US\$ billion	197.37	223.76	208.11	99.37	131.43	181.04
GDP Growth	% yoy	8.21	7.82	4.7	(13.7)	(4.0)	1.0
GDP Per Capita	US\$	1023	1128	1030	487	634	863.55
CPI Inflation	% yoy	8.6	6.47	11.05	77.63	25	15
Balance of Payment							
Export	US\$ billion	47.45	50.19	53.44	48.63	49.6	51.09
Import	US\$ billion	40.92	44.24	41.66	26.66	25.86	26.38
Trade Balance (X-M)	US\$ billion	6.53	5.95	11.78	21.96	23.74	24.71
Current Account	US\$ billion	(6.76)	(7.80)	(3.50)	4.54	3.53	1.67
Current Account	% of GDP	(3.42)	(3.49)	(1.68)	4.57	2.69	0.92
Capital Account	US\$ billion	(6.80)	(7.80)	14.10	-11.6	-3	-1.4
Direct Investment	US\$ billion	1.26	1.99	6.50	1.8	0.9	0.5
Overall Balance	US\$ billion	2.87	0.26	6.10	-13.3	2.5	2
Foreign Reserves & Debt							
Gross Official Foreign Assets	US\$ billion	18.79	25.53	26.60	16.4	25.7	28.6
Of which: Liquid reserves	US\$ billion	14.70	19.10	25.80	10.7	20.3	22.6
In months of imports	months	5.50	6.90	5.10	2.2	5.7	6
Foreign Debt	US\$ billion	116.457	121.374	133.7	144.3	150	155
Foreign Debt	% of GDP	59.00	54.24	64.24	145.20	87.60	85.60
Foreign Debt/Export	% ratio	39.29	35.02	36.70	41.00	40.00	38.00

Table 6. Indonesia: Macroeconomics Profile (Continued)

Savings and Investment								
National savings	% of GDP	27.6	27.5	26.70	26.00	18.90	17.60	
Private savings	% of GDP	15.5	16.0	19.90	20.60	18.60	19.00	
Domestic investment	% of GDP	29.0	28.0	30.00	27.10	14.00	15.50	
Private investment	% of GDP	25.1	26.2	24.30	20.80	9.50	10.30	
Interest Rate	% annum	17.15	17.26	25.00	50.00	40.00	30.00	
Exchange Rate	US\$/Rp	2292	2364	3000	10299	8000	8000	

SOURCE: Bank Indonesia, Annual Report, 1995-1998; Central Bureau of Statistics, Annual Report, 1995-1998; IMF Annual Report, 1995-1998

Table 7. Development of Indonesian Capital Market Before and After 1988 Capital Market Deregulation

Year	# stocks	Market Cap (US\$ millions)	Market Cap per cent change	Value Traded (US\$ millions)	Value Traded Per cent change	Index	Index per cent change	P/E Ratio (IFCG Index)	Exchange Rate (Rp/US\$)
1984	24	85	na	2		63.5	-20.9	na	1074
1985	24	117	38%	3	50%	66.5	4.7	na	1125
1986	24	81	-31%	1	-67%	69.7	4.8	na	1641
1987	24	68	-16%	3	200%	82.5	18.4	na	1650
1988	24	253	272%	4	33%	305.1	269.7		1717
1989	57	2,254	791%	541	13425%	399.7	31	56.6	1797
1990	125	8,081	259%	3,992	638%	417.8	4.5	20.3	1889
1991	141	6,823	-16%	2,922	-27%	247.4	-40.8	11.6	1984
1992	155	12,038	76%	3,903	34%	274.3	10.9	12.2	2063
1993	174	32,953	174%	9,158	135%	588.8	114.6	28.9	2103
1994	216	47,241	43%	11,801	29%	469.6	-20.2	20.2	2198
1995	238	66,585	41%	14,403	22%	513.8	9.4	21.4	2286
1996	253	91,016	37%	32,142	123%	637.4	24	21.6	2362
1997	282	29,105	-68%	41,650	30%	401.7	-37	10.5	5495

SOURCE: International Financial Corporation, Emerging Markets Database, 1995-1998

Table 8 Price of Blue Chip Shares

Blue Chip shares	Price per share		
	Jul-97	Feb-98	8-May-99
PT Telkom	4,050	3,650	3,850
Bank BNI	1,475	275	550
Astra International	8,000	1,625	2,425
Semen Cibinong	3,925	425	400

SOURCE: Jakarta Stock Exchange statistics, May 1999

Assets Growth (in per cent)

	1995	1996	1997
All	89	323	291
Financial	72	1685	876
Banking	30	70	127
Property	55	32	88

Net Income Growth (in per cent)

	1995	1996	1997
All	75	30	-777
Financial	36	57	-524
Banking	7	69	-302
Property	20	34	-661

Source: Jakarta Stock Exchange statistics, 1995-1997

Earning Per Share (EPS)

	1995	1996	1997
All	9429	8774	-63600
Financial	1037	1107	-9165
Banking	303	245	-421
Property	195	143	-821

Price Earning Ratio (PER)

	1995	1996	1997
All	22	18	10
Financial	9	14	9
Banking	8.2	10.2	36.75
Property	16.7	19.3	1.37

Debt Equity Ratio (DER)

	1995	1996	1997
All	2.24	2.57	6.11
Financial	8.02	8.1	12.32
Banking	10.22	11.1	10.85
Property	1.15	1.3	4.5

SOURCE: Jakarta Stock Exchange, 1995-1997

Table 9. Indonesian Corporations' Assets, Sales, Net Income

Table 9A.

ASSETS (% change yoy)

Sector	1995	1996	1997	1998
Agriculture	127%	200%	419%	24%
Mining	50%	50%	334%	35%
Cement	53%	29%	51%	35%
Ceramics, Glass, Porcelain	415%	-32%	257%	20%
Metal	39%	-78%	215%	26%
Chemicals	109%	-52%	189%	19%
Plastics, Packaging	27%	3%	112%	76%
Animal Feed	24%	41%	201%	6%
Wood Industries	16%	10%	194%	-1%
Pulp & Paper	32%	33%	355%	34%
Machinery, Heavy Equipment	277%	-27%	155%	177%
Automotive	78%	22%	183%	22%
Textile, Garment, Footwear	-12%	162%	141%	39%
Cable	37%	6%	81%	8%
Electronics	-76%	-15%	-15%	15%
Food & Beverages	78%	23%	134%	16%
Tobacco	20%	29%	62%	15%
Pharmaceuticals	68%	10%	93%	-2%
Consumer Goods	-11%	92%	69%	12%
Property, Real Estate	55%	32%	88%	10%
Construction, Infrastructure	-3%	1172%	212%	7%
Telecomm & Transportation	887%	33%	58%	15%
Bank	30%	70%	127%	19%
Multi-Finance	305%	-2%	354%	-91%
Securities	-12%	216%	2884%	-88%
Insurance	37%	51%	812%	-75%
Investment Fund		8088%	201%	0%
Wholesale	237%	53%	56%	5%
Retail	24%	87%	156%	10%
Hotel, Restaurant & Tourism	-4%	14%	136%	9%
Computer		55%	784%	-3%
Others	-55%	-29%	219%	0%
Total	2855%	10345%	9319%	394%
Average Growth	89%	323%	291%	12%

Source: JSX Yearly Statistics, 1994-1998

Table 9B
SALES (% change yoy)

Sector	1995	1996	1997	1998
Agriculture	580%	48%	50%	234%
Mining	167%	56%	-4%	285%
Cement	274%	25%	-81%	279%
Ceramics, Glass, Porcelain	203%	-13%	-41%	266%
Metal	72%	-65%	34%	263%
Chemicals	98%	-43%	-7%	302%
Plastics, Packaging	29%	-6%	-39%	325%
Animal Feed	19%	9%	-7%	220%
Wood Industries	-11%	44%	-27%	284%
Pulp & Paper	97%	-16%	31%	314%
Machinery, Heavy Equipment	702%	30%	-17%	82%
Automotive	45%	8%	-41%	189%
Textile, Garment, Footwear	14%	64%	22%	213%
Cable	40%	-9%	-47%	88%
Electronics	-84%	-29%	-86%	165%
Food & Beverages	18%	37%	-29%	262%
Tobacco	17%	25%	-56%	261%
Pharmaceuticals	61%	-3%	-15%	99%
Consumer Goods	13%	39%	-38%	188%
Property, Real Estate	62%	-5%	-53%	91%
Construction, Infrastructure	64%	103%	-18%	320%
Telecomm & Transportation	279%	14%	-35%	231%
Bank	45%	63%	4%	269%
Multi-Finance	100%	13%	53%	164%
Securities	-42%	247%	1164%	-86%
Insurance	42%	28%	-43%	323%
Investment Fund			75%	32491%
Wholesale	282%	15%	-39%	179%
Retail	54%	67%	-19%	76%
Hotel, Restaurant & Tourism	12%	19%	-28%	165%
Computer		-19%	217%	141%
Others	31%	19%	193%	0%
Total	3282%	764%	1076%	38683%
Average Growth	103%	24%	34%	1209%

Source: JSX Yearly Statistics, 1994-1998

Table 9C
NET INCOME (% yoy)

Sector	1995	1996	1997	1998
Agriculture	112%	361%	-159%	207%
Mining	334%	32%	-75%	1063%
Cement	57%	39%	-638%	27%
Ceramics, Glass, Porcelain	236%	-21%	-208%	-154%
Metal	43%	-93%	-2614%	111%
Chemicals	106%	-46%	-890%	-37%
Plastics, Packaging	20%	-5%	-337%	97%
Animal Feed	14%	-29%	-3961%	-63%
Wood Industries	-61%	48%	-227%	-109%
Pulp & Paper	144%	-57%	58%	434%
Machinery, Heavy Equipment	307%	16%	-53%	0%
Automotive	88%	17%	-1024%	94%
Textile, Garment, Footwear	1%	83%	-1443%	35%
Cable	7%	-45%	-3887%	-8%
Electronics	-82%	-65%	-805%	64%
Food & Beverages	27%	30%	-237%	-76%
Tobacco	44%	42%	-155%	134%
Pharmaceuticals	61%	1%	-506%	67%
Consumer Goods	-12%	56%	-69%	327%
Property, Real Estate	20%	34%	-661%	24%
Construction, Infrastructure	236%	53%	-473%	74%
Telecomm & Transportation	217%	51%	-109%	427%
Bank	7%	69%	-302%	-401%
Multi-Finance	140%	1%	-1064%	-118%
Securities	-53%	189%	167%	43%
Insurance	86%	26%	2%	101%
Investment Fund			-1420%	-84%
Wholesale	228%	46%	-594%	40%
Retail	25%	122%	-343%	-46%
Hotel, Restaurant & Tourism	-3%	9%	-812%	-54%
Computer		-40%	-1887%	-115%
Others	55%	38%	-137%	0%
Total	2405%	962%	-24862%	2103%
Average Growth	75%	30%	-777%	66%

Source: JSX Yearly Statistics, 1994-1998

Table 10. Indonesian Corporations' PER, EPS, DER

Table 10A
PER (x)

Sector	1994	1995	1996	1997	1998
Agriculture	12.8	7.7	13.74	10.77	4.78
Mining	18.5	10.6	12.26	3.68	1.95
Cement	28.6	20.9	14.63	13.79	7.38
Ceramics, Glass, Porcelain	14.8	14.9	16.35	2.69	9.56
Metal	20.4	15.9	40.94	54.82	9.25
Chemicals	11.7	10.4	8.16	3.17	0.7
Plastics, Packaging	14.8	25.4	20.42	-2.59	10.17
Animal Feed	11.3	8.1	13.11	-0.04	-0.05
Wood Industries	20.1	25.3	29.38	7.27	8.49
Pulp & Paper	19.7	4.7	13.57	1.46	0.44
Machinery, Heavy Equipment	16.5	10.5	6	70.78	7.95
Automotive	12.6	8.2	14.41	-0.69	-0.16
Textile, Garment, Footwear	29.8	22.3	13.15	15.45	5.23
Cable	20.4	17.1	21.99	-0.85	-0.12
Electronics	9	8.7	84.22	-1.79	-1.4
Food & Beverages	16	9.3	16.4	1.75	8.59
Tobacco	16	21.8	22.81	4.54	8.62
Pharmaceuticals	7.5	13.4	10.62	6.83	-11.6
Consumer Goods	16.5	13.2	11.91	-0.24	3.07
Property, Real Estate	14.4	16.7	19.27	1.34	-9.02
Construction, Infrastructure	1.8	6.2	8.13	-1.27	-0.9
Telecomm & Transportation	16.5	35.7	18.91	11.27	16.4
Bank	12.3	8.2	10.2	36.75	15.7
Multi-Finance	17.4	7.3	14.55	0.79	30.8
Securities	12.3	8.3	15.69	7.11	36.22
Insurance	34.9	11.1	12.96	3.02	8.73
Investment Fund	0	10	17.16	-0.44	-2.12
Wholesale	26.4	14.4	12.87	-3.7	-1.89
Retail	26.4	20.3	22.56	0.19	2.19
Hotel, Restaurant & Tourism	14.4	22.7	21.8	0.42	18.8
Computer	0	3.6	27.93	-0.55	-0.39
Others	36.6	15.3	11.51	-0.49	0
Weighted Average PER	19	28	24	10	9.3

Source: JSX Yearly Statistics, 1994-1998

Table 10B
EPS (Rp)

Sector	1994	1995	1996	1997	1998
Agriculture	301	412	196	-2406	-1567
Mining	223	408	289	-409	361
Cement	230	367	179	-3416	-925
Ceramics, Glass, Porcelain	188	246	215	13	9
Metal	271	212	61	-1031	124
Chemicals	215	143	216	-1282	-630
Plastics, Packaging	271	170	164	-338	30
Animal Feed	378	268	171	-13043	-6399
Wood Industries	229	73	72	-20	-3
Pulp & Paper	204	333	103	-1678	-488
Machinery, Heavy Equipment	194	202	268	200	23
Automotive	272	275	188	-2038	-637
Textile, Garment, Footwear	237	79	124	-2855	-356
Cable	271	171	88	-4087	-1461
Electronics	332	354	72	-1633	-196
Food & Beverages	552	534	441	-1768	-605
Tobacco	552	1096	1031	-2120	268
Pharmaceuticals	663	723	748	-2604	-2885
Consumer Goods	1216	897	1314	291	-6693
Property, Real Estate	313	195	143	-821	-111
Construction, Infrastructure	2199	348	260	-5385	188.25
Telecomm & Transportation	296	203	241.5	370	-177.6
Bank	301	303	245	-421	-765
Multi-Finance	210	260	183	-2260	-1705
Securities	325	87	107	110	55
Insurance	204	387	394	530	252
Investment Fund	0	0	178	-7124	-3548
Wholesale	358	227	208	-2966	-745
Retail	0	147	113	-786	-145
Hotel, Restaurant & Tourism	313	55	122	-493	-118
Computer	0	214	305	-2735	-1586
Others	358	40	334	-1395	0
Total	11676	9429	8774	-63600	-30435
Average EPS	364.9	294.7	274.2	-1987.5	-951.1

Source: JSX Yearly Statistics, 1994-1998

Table 10C
DER (x)

Sector	1994	1995	1996	1997	1998
Agriculture	0.42	0.84	0.89	2.85	3.51
Mining	0.50	0.41	0.53	1.04	1.09
Cement	0.87	0.94	1.17	21.13	13.61
Ceramics, Glass, Porcelain	0.64	0.91	0.75	4.14	5.98
Metal	0.64	1.02	1.11	4.31	3.75
Chemicals	1.36	1.54	0.87	6.62	14.24
Plastics, Packaging	0.60	0.88	1.16	4.49	3.89
Animal Feed	1.03	1.62	1.69	- 9.13	- 4.04
Wood Industries	0.40	0.53	0.44	1.31	3.46
Pulp & Paper	1.59	1.59	1.71	1.50	1.47
Machinery, Heavy Equipment	0.84	1.08	0.96	2.89	2.76
Automotive	2.18	2.12	2.38	29.93	10.42
Textile, Garment, Footwear	1.23	0.92	1.52	5.94	6.88
Cable	0.99	1.51	1.36	- 12.27	- 8.05
Electronics	0.89	1.35	1.14	1.00	3.51
Food & Beverages	0.43	1.15	1.04	7.08	12.04
Tobacco	0.82	0.83	0.92	1.52	1.59
Pharmaceuticals	1.68	1.65	1.42	9.02	2.67
Consumer Goods	0.72	1.11	1.36	1.55	1.68
Property, Real Estate	1.22	1.15	1.27	4.45	6.09
Construction, Infrastructure	0.28	0.72	0.97	2.94	3.70
Telecomm & Transportation	0.37	1.09	0.82	1.27	1.60
Bank	9.30	10.22	11.10	10.85	204.18
Multi-Finance	1.70	5.28	7.70	42.76	- 27.90
Securities	0.40	0.23	0.69	9.88	0.47
Insurance	0.63	1.05	1.02	7.45	1.08
Investment Fund	-	-	2.06	0.03	- 20.09
Wholesale	1.14	1.64	1.59	18.95	13.56
Retail	1.51	1.45	1.27	2.28	2.67
Hotel, Restaurant & Tourism	0.29	0.51	0.60	4.15	4.28
Computer	-	0.87	0.81	4.05	3.22
Others	0.78	1.23	0.94	2.00	-
Average DER	2.04	2.24	2.57	6.11	8.47

Source: JSX Yearly Statistics, 1994-1998

**Table 11 Indonesian Financial Sector
ASSETS (% change yoy)**

Sector	1995	1996	1997	1998
	(% change)	(% change)	(% change)	(% change)
Bank	30%	70%	127%	19%
Multi-Finance	305%	-2%	354%	-91%
Securities	-12%	216%	2884%	-88%
Insurance	37%	51%	812%	-75%
Investment Fund		8088%	201%	0%
Total	361%	8423%	4378%	-235%
Average Growth	72%	1685%	876%	-47%
SALES (% change yoy)				
Sector	1995	1996	1997	1998
	(% change)	(% change)	(% change)	(% change)
Bank	45%	63%	4%	269%
Multi-Finance	100%	13%	53%	164%
Securities	-42%	247%	1164%	-86%
Insurance	42%	28%	-43%	323%
Investment Fund			75%	32491%
Total	145%	352%	1254%	33161%
Average Growth	29%	70%	251%	6632%
NET INCOME (% change yoy)				
Sector	1995	1996	1997	1998
	(% change)	(% change)	(% change)	(% change)
Bank	7%	69%	-302%	-401%
Multi-Finance	140%	1%	-1064%	-118%
Securities	-53%	189%	167%	43%
Insurance	86%	26%	2%	-101%
Investment Fund			-1420%	-84%
Total	182%	285%	-2618%	-663%
Average Growth	36%	57%	-524%	-133%

Source: JSX Yearly Statistics, 1994-1998

**Table 12 Indonesian Financial Sector
PER (x)**

Sector	1994	1995	1996	1997	1998
Bank	12.3	8.2	10.2	36.75	15.7
Multi-Finance	17.4	7.3	14.55	0.79	30.8
Securities	12.3	8.3	15.69	7.11	36.22
Insurance	34.9	11.1	12.96	3.02	8.73
Investment Fund	0	10	17.16	-0.44	-2.12
	77	45	71	47	89
Average PER	15	9	14	9	18
EPS (Rp)					
Sector	1994	1995	1996	1997	1998
Bank	301	303	245	-421	-765
Multi-Finance	210	260	183	-2260	-1705
Securities	325	87	107	110	55
Insurance	204	387	394	530	252
Investment Fund	0	0	178	-7124	-3548
Total	1040	1037	1107	-9165	-5711
Average EPS	208.0	207.4	221.4	-1833.0	-1142.2
DER (x)					
Sector	1994	1995	1996	1997	1998
Bank	9.30	10.22	11.10	10.85	204
Multi-Finance	1.70	5.28	7.70	42.76	(28)
Securities	0.40	0.23	0.69	9.88	0
Insurance	0.63	1.05	1.02	7.45	1
Investment Fund	-	-	2.06	0.03	(20)
Average DER	6.85	8.02	8.10	12.32	528

Source: JSX Yearly Statistics, 1994-1998

Table 13. Financial Policies: Some Cornerstones & Implications

Indonesia, 1971-1999

Phase		Date	Policies	Implications
Phase I	Pre-Deregulation Phase 1971-1982		<ul style="list-style-type: none"> • Restricted entry • Heavy regulation 	<ul style="list-style-type: none"> • State-dominated • Strategic and prioritized projects decided by the state
Phase II	Financial Deregulation Phase 1983-1992	Jun-83	<ul style="list-style-type: none"> • Interest rate controls removed • Credit ceilings removed • Liquidity credit reduced • Monetary tools: SBI-SBPU 	<ul style="list-style-type: none"> • Significant rise in deposit rates • Much higher lending activities
		Oct-88	<ul style="list-style-type: none"> • Reserve requirements reduced from 15 per cent to 2 per cent • New licenses for new banks 	<ul style="list-style-type: none"> • New banks opening • Stronger competition • Higher interest rates
		Dec-88	<ul style="list-style-type: none"> • Government's role in the capital market reduced; foreigners allowed to participate in stock-buying 	<ul style="list-style-type: none"> • 49 per cent foreign participation • large increase in: <ul style="list-style-type: none"> – number of listed companies – trading volume – market capitalization
Phase III	Pre-Crisis: 1993-1997	1995	<ul style="list-style-type: none"> • Minimum equity requirement raised. • Smaller banks to merge • Minimum CAR scheduled 	<ul style="list-style-type: none"> • Entry barrier raised. • Entry barriers to restrict the establishment of new banks. • Existing banks: 7 state, 27 regional, 166 private, and 44 foreign & JV banks.
Phase IV	Financial Crisis July 1997 - present	Aug-97	<ul style="list-style-type: none"> • High interest rates and tight money policy • 16 banks liquidated 	<ul style="list-style-type: none"> • High production cost • No new credit to the real sector • Financial panic, bank runs. • Public confidence shaken
		Nov-97 Dec-97	<ul style="list-style-type: none"> • Banking reforms announced: state banks to merge 	
		Feb-98	<ul style="list-style-type: none"> • 54 weak banks placed under government monitoring • SBI rates raised 	<ul style="list-style-type: none"> • High interest rates • Negative spread

Table 13. Financial Policies: Some Cornerstones & Implications (cont'd)
Indonesia, 1971-1999

Phase	Date	Policies	Implications
	Apr-98	<ul style="list-style-type: none"> 14 banks suspended due to their large borrowings and insufficient capital. 	<ul style="list-style-type: none"> Uncertainty about the banking system Liquidity drain from local banks to foreign banks
	Mar-99	<ul style="list-style-type: none"> 38 banks liquidated, 8 banks to be recapitalized 8 banks taken over by the government Foreign banks allowed to own 99.0 per cent of local banks 	<ul style="list-style-type: none"> Loan recovery process Bank recapitalization program Greater foreign influence

Table 14. Key Issues in Financial & Corporate Sectors — Areas to Improve

Key Issues	Areas Affected and To Improve	
	Legal & Regulatory	Operational
Corporate Debt	<ul style="list-style-type: none"> Law limiting monopolistic and rent-seeking behavior. Limit on the concentration of corporate ownership and corporate ties with banks. Tax neutrality for mergers. Regulation on debt-equity swap. Remove restrictions on foreign ownership. 	<ul style="list-style-type: none"> Debt restructuring negotiation Encourage debt-equity conversion. Wider ownership. Improve hedging management.
Bad Bank Loans	<ul style="list-style-type: none"> Put an end to the practice of lending on basis of 'connections' Clarify eligibility criteria for loans Enforce regulations on collateral Law on recovery of loans 	<ul style="list-style-type: none"> Improve valuation process for assets and collateral Accuracy and transparency in accounting and financial reporting Speed up loan recovery process
High Interest Rates	<ul style="list-style-type: none"> Regulations to prevent banks and corporations from maneuvering foreign debt for interest margins. 	<ul style="list-style-type: none"> Responsive and flexible interest rate policy.

Table 14. Key Issues in Financial & Corporate Sectors — Areas to Improve (Continued)

Failure of Credit Assessment	<ul style="list-style-type: none"> • Improve risk management capacity • Regulate disclosure of assets • Penalty for insider lending activities • Separate ownership to prevent conflict of interest 	<ul style="list-style-type: none"> • Improve the risk analysis competency of banks • Incentives for impartial decisions on lending
Government Monitoring And Consistencies	<ul style="list-style-type: none"> • Strengthen supervision of banks by establishing an independent regulatory body 	<ul style="list-style-type: none"> • Ensure competent risk analysis and loan controls by the regulatory body. • Consistency in policy enforcement.

Table 15. Foreign Debt of Financial & Corporate Sectors (US\$ bn)

Sector	Short Term	Long Term	Total
Banks	4.2	8.4	12.6
State-owned	1.8	4.4	6.2
Private	2.4	4.0	6.4
Private Corporations	6.8	51.8	58.6
Total	11.0	60.2	71.2

Source: Bank Indonesia Financial Statistics, March 1999

Table 16. Major Conglomerates with Close Inter-linkages with Local Banks

Group	Business	1996 Assets (Rp trn)	# companies	Affiliated Banks
Salim	Cement, Finance, Automotive, Food	43.1	600	B Central Asia, B Windu, Alfa, RSI
Astra	Automotive, Agri-business	23.7	125	Universal, Pertiwi
Sinar Mas	Agro-industry, Paper, Finance	41.1	200	BII, Credit Lyonnais, Fuji BII
Lippo	Finance, Property	21.1	70	B Lippo, Bahari, BNP Lippo Tokai Lippo, B Dagang Industri, Alfa
Bimantara	Trading, Property, Manufacturing	4.04	50	B Andromeda (renamed B Alfa)
Gajah Tunggal	Tyre industry, Finance, Property	36.3	80	BDNI, Namura Internusa, SGP
Ongko	Property, Finance	12.9	55	BUN
Nusamba	Wood, Agri-business, Finance	6.7	90	BUN, Bukopin, Tugu, Muamalat

SOURCE: Warta Ekonomi, Nov 1997; Kompas; Swa

Table 17. NPL Ratio (Dec, 1998)

	(trillion)	NPL as per cent of total credits
Total NPL	212.3	44per cent
Total Credits	480.5	38per cent
Total Deposits	563.0	

SOURCE: Bank Indonesia Financial Statistics, March 1999

Table 19. Capital Flight (as per cent of GDP)

Country	1991	1992	1993	1994	1995	1996	1997	Avg 1993-1997
Indonesia	1.63	-1.87	3.3	9.07	4.95	0.93	1.73	2.85
Korea	0.13	-0.03	3.28	2.55	3.34	2.34	0.13	1.66
Malaysia	-0.15	-1.63	2.42	0.59	-0.16	-0.31	-0.64	0.27
Philippines	-1.31	-3.38	8.6	6.33	4.43	-2.46	-0.4	2.36
Thailand	-3.07	-0.67	3.12	1.33	2.03	-2.07	1.13	0.79

Source: Institute for International Finances, Global Emerging Markets, June 1998

Table 20. Banking Restructuring

	Aspects of program	Detailed Actions	Outputs
1	Bank Categorization Category A: CAR of 4% or greater Category B: CAR between – 25% and 4% Category C: CAR less than – 25%	To qualify for recapitalization, banks must: <ul style="list-style-type: none"> • Be in Category B, provide 20% of new capital • Attain a minimum CAR of 4% • Have an approved business plan and repay loans • Pass ‘fit and proper’ test 	Results of due diligence on financial status of banks: <ul style="list-style-type: none"> • 73 Category A banks • 30 Category B Banks • 24 Category C Banks
2	Private Banks Program Recapitalize eligible banks Close ineligible banks	Consideration beyond CAR: <ul style="list-style-type: none"> • nation-wide network • impact on overall economy due to large deposit outreach 	Government’s decision: <ul style="list-style-type: none"> • 73 healthy banks to continue operations • 8 banks to be taken over by government • 8 banks under recapitalization program • 38 banks to be closed

Table 20. Banking Restructuring (Continued)

3	State Banks Merger & Privatization	<ul style="list-style-type: none"> • No CAR criterion due to national and economic reasons for 7 state banks and 27 regional banks • Integrate operation, management of merged banks; • Recapitalization • Resolution of bad loans • Privatization 	<ul style="list-style-type: none"> • 4 banks to merge • 12 regional banks to be recapitalized • Privatization only after merger and recapitalization program completed.
	Aspects of program	Detailed Actions	Outputs
4	Sources of Fund	<ul style="list-style-type: none"> • Total capital needs of US\$ 29 bn • First source of funds: government bonds • Banks to resolve negative spread problem before recapitalization. 	<ul style="list-style-type: none"> • State banks and taken-over private banks to have 40% of total recapitalization funds each. • Remaining 20% of funds for liquidated banks and banks eligible for recapitalization.
5	Legal & Regulatory Frameworks	<ul style="list-style-type: none"> • Update bankruptcy law <ul style="list-style-type: none"> - Hire qualified personnel - Transparent procedures - Protection from illegal transactions • Better liquidity and foreign currency management <ul style="list-style-type: none"> - Impose relevant reserve requirements - Access to liquidity assistance - Monitoring of foreign currency liquidity • Improve collateral valuation <ul style="list-style-type: none"> - Loan-to-value ratio - Change collateral in risky sectors • Transparent accounting standards <ul style="list-style-type: none"> - Improve assets and liabilities classification - Improve quality of information - Clarify lending classification - Banks to submit schedule of reports 	<ul style="list-style-type: none"> • Speedy loan recovery through bankruptcy process • Prevent abuse of liquidity assistance <ul style="list-style-type: none"> - Ensure banks' solvency - Prevent banks from exposing themselves to foreign currency shocks • Prevent over-generous loans at an early stage • Prevent problem loans from arising • Early detection of bad loans <ul style="list-style-type: none"> - Ensure timely and accurate reporting

Table 21 Private Banks – Result of Categorization

From 127 private banks,		CAR Average	Range		Capital needed for CAR 4%	Total Assets (Rp bn)	Third party funds (Rp bn)	No. of depositors	No. of employees
			Best	Worst					
73 banks	CAR 4% or more	15.4%	148.0%	4.0%	0	Na	na	na	Na
7 banks	Taken over by government	-21.1%	-15.6%	-24.6%	5,210.40	21,622.60	15,452.60	1,051,084	10,314
9 banks	To be recapitalized	-16.1%	-8.2%	-23.1%	20,114.90	98,359.30	76,593.60	6,115,289	24,488
38 banks	Liquidated	-40.2%	-10.9%	-101.8%	23,131.10	49,472.90	na	1,147,495	16,463

SOURCE: Bank Indonesia website <http://www.bi.go.id/ind/rekap/profilbank.html>, March 1999

Table 22 Recapitalized Private Banks: Financial Status of Nine Recapitalized Banks, as of Dec-98

No	Bank	Capital Needs (Rp bn)	Bad Loans (Rp bn)	CAR (per cent)	CAR Projection 2001 (per cent)	Liabilities to BI (Rp bn)	Inter-Bank Liabilities (Rp bn)
1	Bukopin	767.2	630.5	(17.2)	4.1	1,095.0	
2	Bank Bali	1,821.8	1,663.4	(8.2)	6.1	96.7	622.0
3	Bank Arta Media	150.0	69.2	(9.3)	4.5		25.5
4	Bank Patriot	32.1	3.9	(23.1)	6.0		
5	Bank Universal	2,421.9	1,097.5	(21.8)	4.7	151.4	765.8
6	Bank Lippo	3,356.7	81.1	(16.1)	5.4		
7	BII	7,612.5	4,922.6	(15.9)	5.0		
8	Bank Prima Express	252.7	16.5	(15.6)	5.2		132.3
9	Bank Niaga	3,700.0	728.2	(17.4)	6.4	703.0	936.3
	Total	20,114.9	9,212.9	na	na	2,046.1	2,481.9

SOURCE: Bank Indonesia, Due Diligence Report, March 1999

Table 23 Financial Situation of the Four Merging State Banks

(in US\$m)	BBD	BDN	Bapindo	Bank Exim	TOTAL
Credit Extended	5,922	5,856	3,450	1,850	17,077
Third Party Fund	7,125	7,741	3,004	2,019	19,889
Total Asset	7,828	9,814	3,530	3,139	24,310
CAR	-55.88	-48.96	-136.4	-101.83	
Capital Needs for 4per cent-CAR	3,512	2,710	1,535	4,553	12,310

SOURCE: Kompas, 23 Feb 1999

Table 24 Recapitalization Cost for Regional Banks (BPD)

No	Bank	Capital Needs (Rp bn)	CAR (per cent)
1	BPD Nusa Tenggara Timur	0.6	6.9
2	BPD Bengkulu	6.2	(2.0)
3	BPD Lampung	14.0	(5.0)
4	BPD Nusa Tenggara Barat	18.2	(2.3)
5	BPD Sulawesi Utara	23.0	(10.0)
6	BPD Kalimantan Barat	59.0	21.8
7	BPD Jawa Timur	76.0	3.0
8	BPD DI Aceh	85.0	(29.0)
9	BPD Maluku	174.4	(91.0)
10	BPD DKI Jakarta	216.0	(11.0)
11	BPD Sumatera Utara	379.0	(35.0)
12	BPD Jawa Tengah	486.8	(30.0)
	Total	1,538.2	

SOURCE: Ministry of Finance, May 1999

Table 25. Total Recapitalization Cost (estimate)	(US\$ billion)
State Banks & Regional Banks	12.50
Taken-Over Banks	12.00
Eight Category-B Banks	3.00
Liquidated Banks	2.35
Total	29.85

Source: Ministry of Finance, May 1999

Table 26 Conclusion: Who does What?

Institutions	Clearing up the Mess	Laying Foundation for the Future
Government	<ul style="list-style-type: none"> • Debt restructuring: facilitate negotiations with international lenders for speedy resolution of debt. • Begin recovery of loans. 	<ul style="list-style-type: none"> • Rectify wrong practices in financial management. • Supervision of foreign borrowing • Ensure right policies at the right time. • Ensure that the proper institutional foundation is in place before deregulation.
Corporations	<ul style="list-style-type: none"> • Return to core businesses • Restructure debts with lenders • Debt-equity conversion 	<ul style="list-style-type: none"> • Prudent management of offshore loans. • Prudence in choice of investment and business expansion.
Banks	<ul style="list-style-type: none"> • Restructured banks to become more specialized. • Improve overall management • Debt-equity conversion 	<ul style="list-style-type: none"> • Lending criteria to be made clear, transparent and duly enforced. • Desist from irresponsible lending.

Table 27 Recent Asset Buying by Foreign Investors, February - April 1999

Foreign Buyer	Indonesian Company	Deal	Impact
Standard Chartered Bank (SCB)	Bank Bali	US\$ 56 million	For 20 per cent ownership SCB holds management control SCB has option to buy remaining 80 per cent of shares after recapitalization, 3 years later.
ANZ - Panin Bank	Bank Papan	Rp 39.3 billion	For credit card business
First Pacific	PT Indofood Sukses Makmur	US\$ 285 million	For 30 per cent ownership
Newbridge Capital	Astra Microtonics	US\$ 90 million	Electronic (IC) producers
Cemex	Semen Gresik	US\$ 115 million	For 14 per cent ownership
Grosbeaks, Hkg of Hutchison Whampoa	Pelindo II, shipping	US\$ 215 million	For 49 per cent ownership
P&O, Australia	Pelindo III, shipping	US\$ 174 million	For 49 per cent ownership

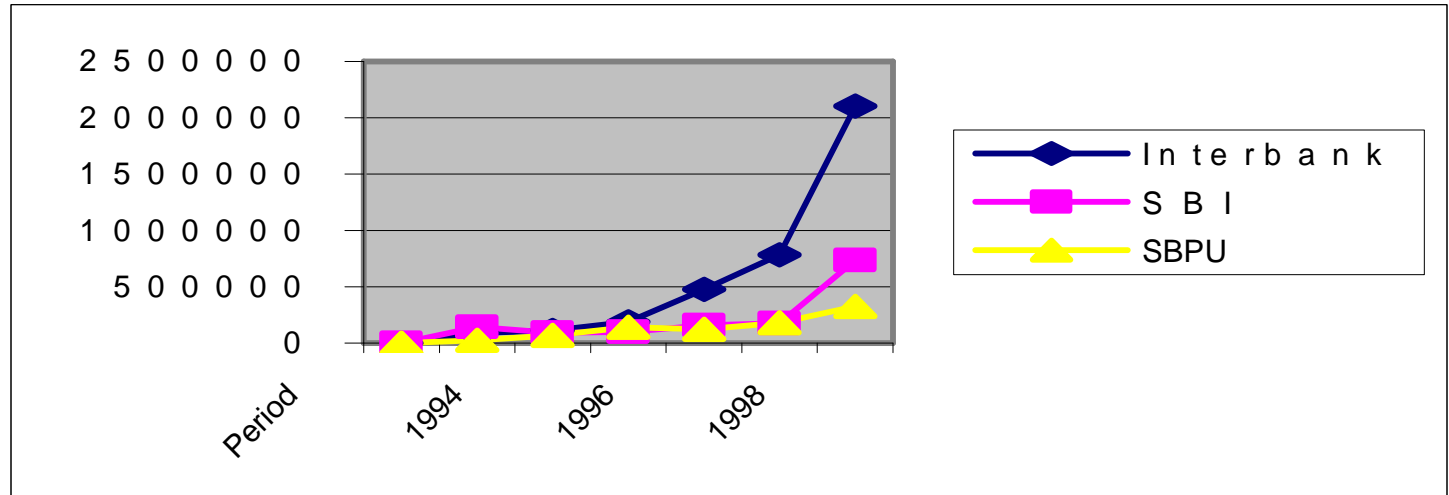
SOURCE: Lehman Brothers, Kompas website, May 1999

**Jakarta Stock
Exchange (JSX)
Companies by Sector**
(No. of companies)

Sector	1994	1995	1996	1997	1998
Agriculture	2	3	5	6	6
Mining	1	3	4	6	6
Cement	3	3	3	3	3
Ceramics, Glass, Porcelain	3	4	3	4	4
Metal	8	9	8	11	11
Chemicals	7	8	8	9	9
Plastics, Packaging	9	9	7	7	7
Animal Feed	6	5	6	6	6
Wood Industries	3	2	3	4	4
Pulp & Paper	6	6	6	6	6
Machinery, Heavy Equipment	1	3	2	2	2
Automotive	7	9	10	12	12
Textile, Garment, Footwear	23	21	24	24	24
Cable	6	6	6	6	6
Electronics	7	2	2	2	4
Food & Beverages	16	15	18	19	19
Tobacco	3	3	3	3	3
Pharmaceuticals	9	9	9	9	9
Cosmetics, Household	0	4	7	4	4
Property, Real Estate	19	19	19	24	24
Construction, Infrastructure	1	2	3	3	3
Telecomm & Transportation	6	7	7	9	9
Bank	22	22	24	32	32
Multi-Finance	10	13	11	13	13
Securities	1	1	1	3	3
Insurance	10	10	10	11	11
Investment Fund	1	1	5	7	7
Wholesale	10	16	18	20	20
Retail	0	3	5	6	6
Hotel, Restaurant & Tourism	5	11	11	11	11
Computer	0	3	2	2	2
Others	2	2	2	2	2
Total	207	234	252	286	288

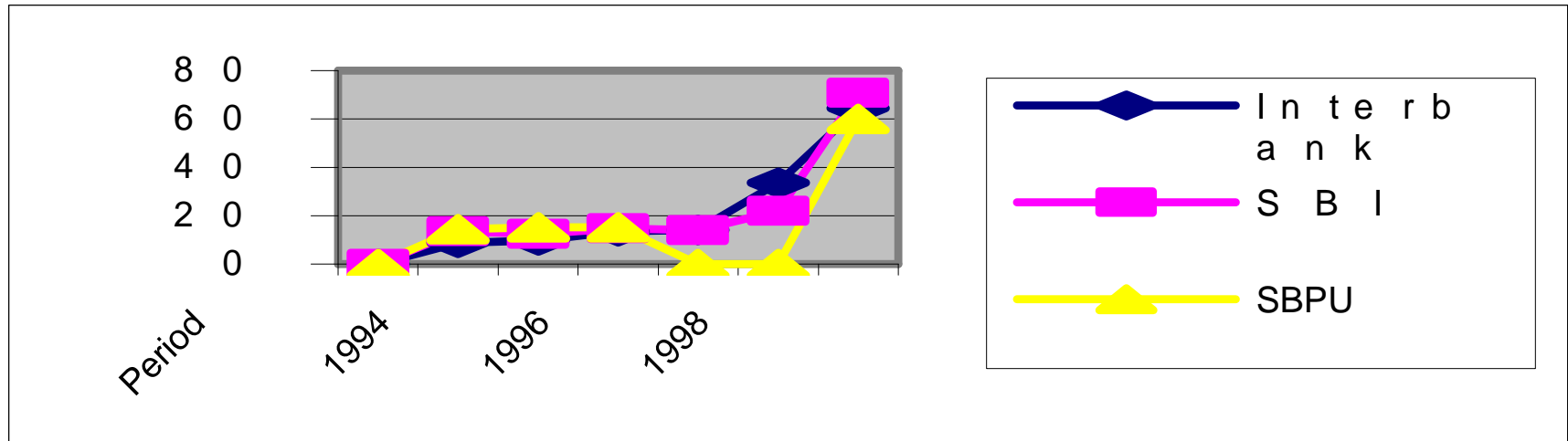
Source: JSX Yearly Statistics, 1994-1998

Figure 1. Monetary Contraction, 1994-1998 (in Rp billion)



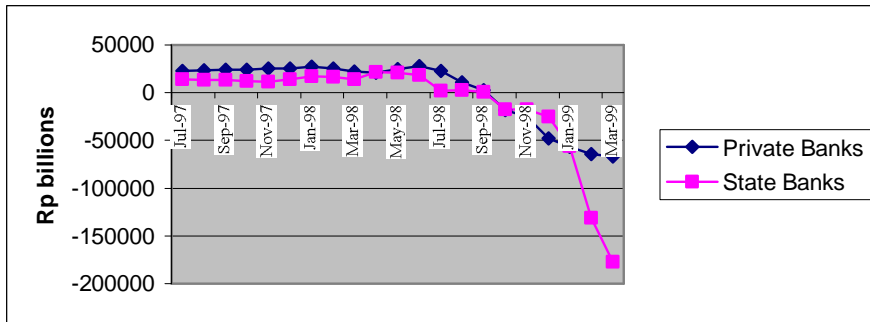
Source: Bank Indonesia, Financial Statistics, March 1999

Figure 2. Discount Rates (percentage per year)



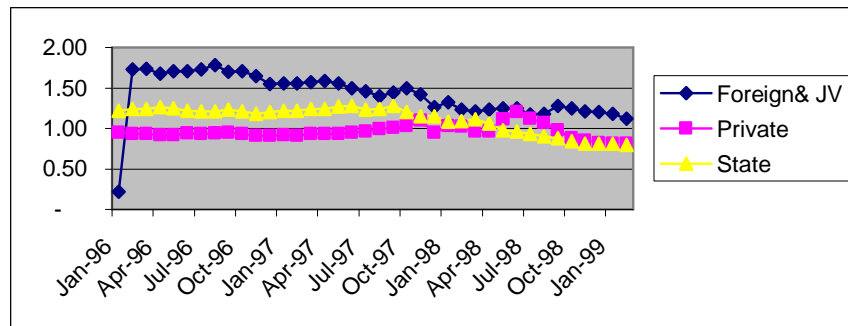
Source: Bank Indonesia, Financial Statistics, March 1999

Figure 3. Loan-Deposit Ratio of Indonesian Banks



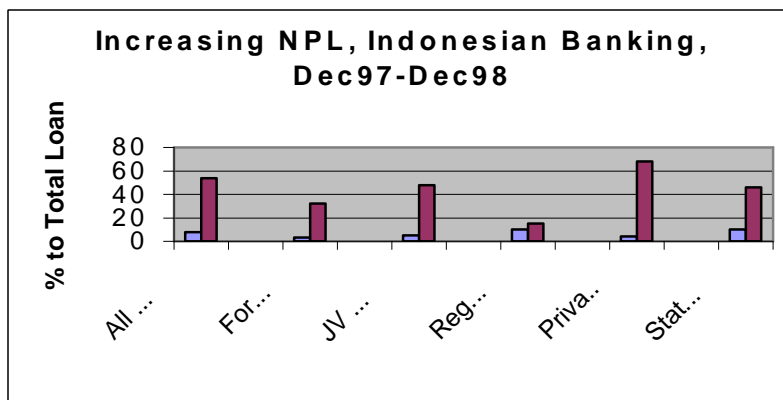
Source: Bank Indonesia Financial Statistics, March 1999

Figure 4. Diminishing Capital of Indonesian Banks



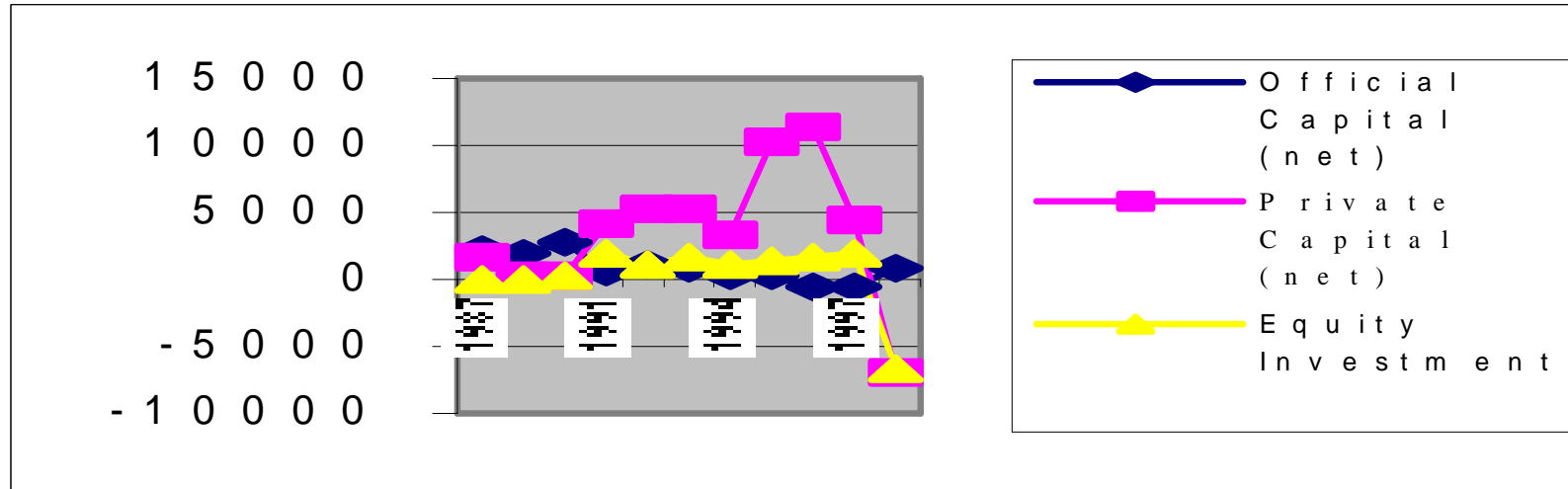
Source: Bank Indonesia Financial Statistics, March 1999

Figure 5. Increasing NPL, Indonesian Banking, Dec. 97-Dec. 98



Source: Econit Advisory Group, Bank Indonesia Financial Statistics, March 1999

Graph 6. Capital Inflow to Indonesia (US\$ m)



Source: Bank Indonesia Financial Statistics, March 1999

Appendix 1				
Top-50 Largest Debtor of State Banks				
Debtor Companies		Owner	Debt (Rp bn)	Debt (US\$ bn)
Bank Bumi Daya				
1	Great River Int'l	Sunyoto Tanujaya	11.4	
2	Indofood Sukses Makmur	Sudono Salim	10.7	
3	Timor Putra Nasional	Tommy Suharto		0.2
4	Sempati plus Humpuss	Tommy Suharto	1,500	
5	Catur Swasakti + Seamless Pipe	Aburizal Bakrie	1,100	
6	Arooban	Prajogo Pangestu	2,500	
7	Trans Pacific Petrochemical Indotama	Hashim S. Djojohadikusumo	500	
8	Astra Int'l	Public	64.8	
9	Apac Centertex Corp	Bambang Tri Suharto	598.6	
10	Bakrie Brothers	Aburizal Bakrie	105.8	
11	PT Matahari Putra Prima	Hari Darmawan	17.4	
	TOTAL		6408.7	0.2
Bank Dagang Negara				
12	Barito Pacific Timber	Prajogo Pangestu	102.3	
13	HM Sampoerna	Putera Sampoerna	77.3	
14	Indofood Sukses Makmur	Sudono Salim	37.9	
15	Astra Int'l	Public	993	
16	Mustika Ratu	Moorjati Soedibjo	3.7	
17	Hanson Industri Utama	Benny Tjokro	41	
18	Timor Putra Nasional	Tommy Suharto		0.1
19	Sumalindo Lestari Jaya	Astra Int'l	694	
20	Bimantara Citra	Bambang Tri Suharto	10	
21	Plaza Indonesia Realty	Bambang Tri Suharto & cs	150.5	
22	Bakrie Brothers	Aburizal Bakrie	21.4	
23	Smart Corp	Eka Tjipta Wijaya	79.8	
24	Bukaka Teknik Utama	Ahmad Kalla	67.2	
	TOTAL		2278.1	0.1
Bapindo				
25	Golden Key	Eddy Tansil	1,300	
26	Astra Int'l	Public	97.9	
27	Ciputra Development	Ciputra	103.4	
28	Apac Centertex Corp	Bambang Tri Suharto	865.4	
29	Bimantara Citra	Bambang Tri Suharto	1.6	
30	Indofood Sukses Makmur	Sudono Salim	49.7	
31	Bukit Sentul	Tommy Suharto	208.1	
32	Indocement Tunggal Prakarsa	Sudono Salim	50.2	
33	Bakrieland Development	Aburizal Bakrie	46	
	TOTAL		2,722	0

Appendix 1 (cont'd)				
Top-50 Largest Debtor of State Banks				
Debtor Companies	Owner	Debt (Rp bn)	Debt (US\$ bn)	
Bank Exim				
34 Putra Surya Perkasa	Triyono Gondokusumo	1,111		
35 Argo Manunggal Group	The Nin King	355.4		
36 Timor Putra Nasional	Tommy Suharto		0.1	
37 Argo Pantes	The Nin King	165.4		
38 Dharmala Sakti Sejahtera	Suhargo Gondokusumo	15.3		
39 Astra Int'l	Public	17.8		
40 Apac Centertex Corp	Bambang Tri Suharto	32.8		
41 Indofood Sukses Makmur	Sudono Salim	3		
42 Bakrie Brothers	Aburizal Bakrie	20.4		
43 Modern Photo	Samadikun Hartono	4.6		
TOTAL		1,726		
			0.1	
Syndicate of Four State Banks				
44 BPPC	Tommy Suharto	900		
45 Chandra Asri	Bambang Tri Suharto & cs		2.7	
46 Citra Marga Nusaphala Persada	Tutut Suharto	145		
47 Ciputra Development	Ciputra	1,375		
48 Duta Pertiwi	Eka Tjipta Wijaya	386.2		
49 Duta Anggada	Dasuki Angkosubroto	361.7		
50 Bimantara Citra	Bambang Tri Suharto	259		
TOTAL		3426.9		
GRAND TOTAL		16,562		
			3.1	
GRAND TOTAL (in US\$ billion)			5.17	US\$bn
GRAND TOTAL (in Rp trillion)			41.5	Rp trillions

SOURCE: Kompas, 23 February 1999

Appendix 2. Loan Deposit Ratio (LDR)
(in Rp trillion)

Period	Foreign/JV Banks			Private Banks			State Banks			
	Credits	Deposits	LDR	Credits	Deposits	LDR	Credits	Deposits	LDR	
1996	Jan	3.075	14.2	0.22	112	118	0.95	93.4	76.3	1.22
	Feb	25.1	14.5	1.73	113	122	0.93	94.8	76.6	1.24
	Mar	25.2	14.5	1.74	116	125	0.93	95.6	76.8	1.24
	Apr	25.1	14.9	1.68	120	130	0.92	98.1	78	1.26
	May	26	15.2	1.71	123	133	0.92	99.3	79.6	1.25
	Jun	26.5	15.5	1.71	128	137	0.94	100.4	82.1	1.22
	Jul	27	15.6	1.73	131	140	0.93	101.01	83.6	1.21
	Aug	27.2	15.3	1.78	132	140	0.94	102.6	84.7	1.21
	Sep	27.1	15.9	1.70	136	144	0.95	104.1	84.8	1.23
	Oct	27.4	16	1.71	140	150	0.93	104.4	86.2	1.21
	Nov	27.5	16.7	1.65	143	156	0.91	105.4	89	1.18
	Dec	27.6	17.8	1.55	150	165	0.91	108.9	90.4	1.20
1997	Jan	27.9	17.9	1.56	152	166	0.92	108	88.5	1.22
	Feb	28.4	18.2	1.56	155	169	0.91	108	88.8	1.22
	Mar	28.8	18.3	1.57	159	171	0.93	110.9	89.6	1.24
	Apr	29.4	18.5	1.59	162	175	0.93	112.9	90.9	1.24
	May	29.7	19	1.56	166	178	0.93	114.8	90.7	1.27
	Jun	30	20	1.50	174	183	0.95	117.1	91.8	1.28
	Jul	32.1	22	1.46	180	188	0.96	120	97.9	1.23
	Aug	35.3	25.2	1.40	188	189	0.99	126.8	102	1.24
	Sep	37.4	26	1.44	192	191	1.01	131.8	102.9	1.28
	Oct	41.6	27.8	1.50	198	192	1.03	137.1	114.5	1.20
	Nov	42.2	29.7	1.42	186	169	1.10	140.3	122.2	1.15
	Dec	48.6	38.6	1.26	169	177	0.95	153.3	133	1.15
1998	Jan	91.7	69.7	1.32	209	203	1.03	203.3	188.6	1.08
	Feb	78.8	64.1	1.23	197	194	1.02	196.9	180.3	1.09
	Mar	75	62.2	1.21	192	200	0.96	202.6	183.1	1.11
	Apr	72.6	58.8	1.23	187	194	0.96	202.6	190.3	1.06
	May	91.3	72.8	1.25	209	189	1.11	219.6	223.7	0.98
	Jun	121.3	97.2	1.25	242	202	1.20	256.4	266	0.96
	Jul	106.2	90.4	1.17	227	203	1.12	241.6	260.5	0.93
	Aug	92.4	78.5	1.18	214	201	1.07	230.3	255.3	0.90
	Sep	88.8	69.5	1.28	209	213	0.98	231.3	262.5	0.88
	Oct	66.8	53.5	1.25	189	215	0.88	208.4	249.4	0.84
	Nov	63.7	52.8	1.21	187	221	0.85	212.1	261.7	0.81
	Dec	66.75	55.4	1.20	193	236	0.82	220.7	271.6	0.81
1999	Jan	71.7	61.01	1.18	199	246	0.81	226.8	278.4	0.81
	Feb	69.8	62.6	1.12	198	245	0.81	225.5	282.3	0.80
Total Credits		493								
Total Deposits		590								

SOURCE: Bank Indonesia, Weekly Report, April 1999

Appendix 3. Diminishing Capital of Indonesian Banking (in Rp trillion)						
Period	All Banks	Foreign	JV Banks	Regional	Private Banks	State Banks
Jul-97	43497	1441	3967	1145	22,679	14,264
Aug-97	43757	1557	4117	1159	23,318	13,604
Sep-97	44785	1659	4178	1204	24,374	13,370
Oct-97	44105	1852	4287	1246	24,340	12,380
Nov-97	44838	1866	4396	1261	25,535	11,780
Dec-97	46713	1731	4359	1299	25,521	13,803
Jan-98	53602	2532	4669	1422	27,495	17,483
Feb-98	50782	2884	4698	1403	25,215	16,583
Mar-98	44192	2177	4081	1377	22,390	14,167
Apr-98	50311	2673	3997	1216	21,036	21,389
May-98	54850	3040	4587	1332	24,621	21,271
Jun-98	54370	2178	4121	1350	28,179	18,541
Jul-98	32944	2406	4038	1347	22,939	2,215
Aug-98	21454	2542	3886	1367	10,938	2,720
Sep-98	10830	2276	3684	1413	2,418	1,039
Oct-98	-28549	2683	3404	1415	(18,473)	(17,578)
Nov-98	-43594	2520	3033	1419	(25,330)	(17,578)
Dec-98	-98542	1514	-3083	1515	(47,765)	(25,236)
Jan-99	-112887	2050	-3575	1403	(56,511)	(56,254)
Feb-99	-198019	233	-4329	1421	(64,192)	(131,152)
Mar-99	-244554	2085	-4072	1416	(66,854)	(177,128)

SOURCE: Bank Indonesia Financial Statistics, May 1999

Appendix 4. Various Interest Rates
(percent per annum)

End period	SBI rate	Interbank callmoney	3-month deposit	Working Capital	Investment Lending
Dec-93	9	9	12	21	17
Dec-94	12	10	14	18	15
Dec-95	13	14	17	19	16
Dec-97	12	14	17	19	16
Jan-97	11	13	17	19	16
Feb-97	10	13	17	19	16
Mar-97	8	11	16	19	16
Apr-97	8	13	16	19	16
May-97	9	13	16	19	16
Jun-97	8	13	16	19	16
Jul-97	9	15	16	19	16
Aug-97	11	61	22	25	20
Sep-97	15	51	26	26	20
Oct-97	18	39	28	27	20
Nov-97	17	40	27	26	20
Dec-97	17	40	24	25	19
Jan-98	16	57	23	26	19
Feb-98	24	64	24	26	19
Mar-98	27	51	27	28	20
Apr-98	45	71	29	29	22
May-98	51	64	33	33	23
Jun-98	56	65	41	34	23
Jul-98	56	75	43	34	23
Aug-98	70	81	44	35	24
Sep-98	61	66	47	36	25
Oct-98	59	60	55	36	26
Nov-98	60	65	53	35	26
Dec-98	37	39	49	35	26
Jan-99	38	38	46	35	26
Feb-99	36	39	38	35	26
Mar-99	34	38	38	-	-

SOURCE: Bank Indonesia, Weekly Statistics, May 1999

Appendix 5

Timetable of Economic Reform Target Dates

The following is the target dates for Indonesia's economic reform package under the latest agreement between the government and the International Monetary Fund.

Updated Financial Sector Reform Agenda:

Policy Action	Status/Target Date
I. Loan collection and asset recovery	
1. State banks and AMU	
• Complete setting the monthly asset collection targets for all banks.	June 30
• Identify and publicly invite 20 largest consolidated non-performing borrowers of each state, IBRA and the AMU for negotiations.	Initiated
• Develop resolution strategies for the largest borrowers	June 30
• Take appropriate legal action against recalcitrant borrowers	August 30
2. IBRA.	
• Draw up a quarterly timetable for the resolution of AMU and other assets through March 2000.	June 30
• Complete classification of assets by resolution strategy (sale, foreclosure, or negotiated restructuring).	June 30
• Complete transfer of shareholders' assets from 1998 BTO and BBO banks to holding companies.	June 30
• Begin recruiting private sector specialists to assist with loan recovery.	June 30
II. State Bank and IBRA Banks restructuring	
1. Bank Mandiri	
• Implement voluntary severance scheme for staff of component banks. (to be completed by March 31, 2000)	On track
• Establish centralized treasury unit and credit function.	
• Treasury already centralized; large corporate credits to be centralized.	By end-May
• Include international banks in management of loan recovery, and to sign performance contracts with top management, which incorporate collection targets.	May 28
• Recapitalize Bank Mandiri in line with progress in operational and financial restructuring.	May 1999-March 2000
Other state banks (BNI, BRI, and BTN):	
• Strengthen top management.	Underway
• Engage international firms to provide management and advisory services.	June 30
• Include international banks in management of loan recovery.	June 30
• Prepare business plans, in consultation with advisors.	August 15
• Sign performance contracts with top management.	August 30
• Recapitalize in line with progress in restructuring.	Sept. 1999-March 2000

- 3. Original BTO banks (BCA, Danamon, PDFCI, Tiara)**
- Finalize acceptable business plans for all four banks. June 30
 - Sign performance-based management and regulatory contracts for BCA and Danamon. July 15
 - Legally merge PDFCI and Danamon. July 31
 - Operationally merge PDFCI and Danamon. September 30
 - Dissolve Bank Tiara After midyear
 - Offer BCA and Danamon for sale. By March 2000
- 4. New BTO banks (March 13)**
- ❖ Commence negotiations for settlement of ‘connected lending’ with former controlling shareholders. May 28
 - ❖ Remove majority shareholder’s rights. Effectively done
 - ❖ Develop least cost resolution strategies, excluding stand-alone recapitalization. July
- III. Private bank restructuring**
- 1. Recapitalization of viable private banks**
- ❖ Settle eligible inter-bank claims. May 28
 - Sign recapitalization agreements. May 28
 - Issue government bonds to banks whose private owners have provided the necessary share of capital. May 28
 - Issue additional bonds to raise recapitalization funds to the amount specified in the updated financial reviews by international auditors June 30
- 2. Comprehensive Review of Category A banks**
- Ensure that all owners, managers and directors of Category A banks conform to the ‘fit and proper’ test. July 31
 - Take appropriate action against individuals who have failed the fit and proper test (by violating laws or BI regulations). July 31
 - Complete review of business plans. May 28
- IV. Legal, Regulatory, and Supervisory Framework**
- Establish the Independent Review Committee for IBRA. Done
 - Sign implementing regulations for Banking Law amendment. Done
 - Complete strategic plan for strengthening BI’s regulatory, supervisory, and examination activities. June 30
 - Complete detailed review of banking laws and regulations. Sept. 30
 - Issue new regulations on commercial banks, foreign branches, license revocation and bank liquidation. Sept. 30
 - Complete diagnosis of the offsite supervision system. Sept. 30
- Loan Recovery Strategy for the 20 Largest Non-performing Loans**
- Borrowers of the 7 State Banks, the 12 IBRA Banks, and IBRA’s AMU
- Institutional framework (May 1999)**
- Establish a loan recovery unit in each bank and start setting monthly recovery targets.
 - Intensify loan collection efforts, focusing on the 20 largest borrowers of each bank.
 - Establish an inter-agency committee chaired by the Ministry of Finance on loan recovery to ensure a consistent and coordinated approach to loan recovery and restructuring.
 - Complete the transfer of all loan documentation (on transferred assets) to IBRA.
 - Sign agreement between IBRA and state banks regarding the custodian role for the original collateral document.

Development of strategy (May 1999)

- Identify and complete the documentation of 20 largest borrowers by each bank.
- Consolidate accounts according to borrowing group.
- Classify groups into one of four categories, based on financial prospects and expected degree of cooperation, and devise a suitable resolution strategy.
- Finalize monthly loan recovery targets for each bank and the AMU.
- Prioritise cases by total size of debt.

Implementation of strategy (June 1999)

- By June 1, publicly invite borrowing groups to resume debt service, or to agree to start negotiation within two weeks.
- Form creditor committees, with external creditors, in accordance with the Jakarta Initiative.
- Recommend standstill, when appropriate.
- Appoint financial advisors, auditors, and legal advisors to help develop strategies.
- Start due diligence.
- Publish names of borrowing groups who do not cooperate.
- Start negotiations on restructuring.

August 1999

- Establish timetable for remaining rounds of debt negotiation or take appropriate legal action (including bankruptcy filings) against uncooperative borrowers.
- Review strategy with the IMF, World Bank, and the ADB.
- Repeat above strategy for the next 20 largest 'non-performing' borrowers of each bank.

- **Updated Corporate Restructuring Agenda**

- **Corporate Restructuring** **Target Date**

- Issue consolidated Directorate Circular on tax treatment of corporate restructuring and Ministry of Finance decree on tax treatment of land/buildings transfer. May 28
- Conduct high-level meeting of member agencies of one-stop facilitation processes, formulate overall strategy, and establish rules and procedures for approval of regulatory filings. Initiated
- Complete conditions for effectiveness of World Bank technical assistance loan. May 28
- Retain at least 20 facilitators for Jakarta Initiative Task Force. June 30
- Submit draft law on transactions to Parliament for approval. Done

- **Updated Bankruptcy Reform Agenda**

- **Bankruptcy Reform** **Target Date**
- Sign into law anti-KKN (corruption, collusion and nepotism) legislation. May 28
- Issue decrees and regulations to implement law. June 30
- Issue Steering Committee's proposed procedures for assignment of ad hoc judges to cases before the Commercial Court. June
- Implement judicial salary proposal of the Commercial Court Steering Committee. June

Appendix 6

IBRA

(Indonesian Bank Restructuring Agency)

Established by Presidential Decree No. 27/1998, IBRA is an independent body reporting to the Ministry of Finance, Government of the Republic of Indonesia.

IBRA is charged with returning the Indonesian banking sector to complete health, with an ongoing role to maintain and regulate the sector at an internationally accepted standard.

In the wake of the collapse of the rupiah and the subsequent financial crisis which took hold during the second half of 1997, IBRA was established as a key initiative to improve the national banking sector shortly after the issuance of the Government's guarantee to depositors in January 1998. The guarantee covers all banks, including banks placed under IBRA supervision or management control.

IBRA comprises over 500 staff, mainly seconded from Bank Indonesia, the Ministry of Finance and other public and financial institutions.

IBRA is organized into four dedicated rehabilitation units and a coordination unit for administering the Government's guarantee program.

AMU, Asset Management Unit

An **Asset Management Company** is under the direct control of IBRA. In addition, IBRA has a number of external consultants drawing upon the experiences of banking reform from a wide range of other markets.

To return the banking sector to solvency, building both stability and strength for long term growth in line with macroeconomic policy, IBRA has a three-pronged strategy:

- To conduct a bank normalization program - identifying, controlling and resolving the conditions of banks which pose the greatest threat to the safety and soundness of the financial system
- To manage the operation of the Government's guarantee
- To resolve bad debts using a specially-formed Asset Management Company

The Bank Normalization Program

Given that the entire banking system has been affected by the financial crisis in Indonesia, IBRA has chosen to focus on the banks which are in the poorest condition and which can do the most damage to the functioning of the overall system.

The criteria for selection are as follows:

- Category A Banks – Liquidity support needed in excess of 500 per cent of total equity and equal to or in excess of 75 per cent of total assets

Action to be taken – the immediate freezing of the banks operations, transfer of all liabilities to a healthy bank, suspension of shareholders' rights and a replacement of management. IBRA will function in place of the former shareholders with full control over the bank.

- Category B Banks – Liquidity support needed in excess of Rp. 2 trillion and in excess of 500 per cent of total equity

Action to be taken – the immediate suspension of shareholders' rights and a replacement of management. IBRA will function in place of the former shareholders and a governance contract is drawn with a state-owned financial institution to provide new management with full control over the bank.

The Government's Guarantee

Under Presidential Decree No. 26/1998 the Government has provided a guarantee for the liabilities of 212 commercial banks and confers the process of administering the guarantee to IBRA. The guarantee covers rupiah as well as foreign currency obligations. Among the conditions to be fulfilled, payment under the guarantee can be realized once commercial banks have failed in making payments to creditors. It obliges commercial banks to recognize the authority of IBRA and to submit reports as requested by IBRA.

The Asset Management Company

To address the difficult conditions facing the banking sector as a whole, IBRA will establish an Asset Management Company (AMC) which will focus its entire effort on debt recovery.

AMC will serve as the primary recovery vehicle for loans booked in failed banks. AMC will be fully operational from the second quarter of 1998.

Appendix 7

INDRA

(Indonesia Debt Restructuring Agency)

INDRA is a government agency supervised by Bank Indonesia. It is established pursuant to Presidential Decree No. 95, dated July 2, 1998.

Purpose

INDRA is created to assist Indonesian debtors to fulfil their obligations to foreign creditors.

Basic Principles

- The debtor remains responsible for his financial obligations to the foreign creditor, but INDRA allows the debtor to fulfill that obligation by making rupiah payments directly to INDRA
- INDRA will not assume private sector debt or "bail out" Indonesian companies, but it provides debtors with access to foreign exchange at a guaranteed exchange rate.
- INDRA will be self-financing.

Advantages of the INDRA Program

For the Debtor:

- Protection from further decline in the exchange rate.
- Access to foreign exchange at a guaranteed real exchange rate.
- A framework for restructuring its foreign currency debt.
- Cash flow relief as foreign currency debt is rescheduled over not less than 8 years.

For the Creditor:

- Assurance that dollars will be available to pay the debtor's obligations.
- An increased likelihood that the debtor will be able to repay his obligations.

For Indonesia:

- A reduction in short-term demand for US dollars, thereby easing pressure on the exchange rate and balance of payments
- Support economic reform in Indonesia by strengthening Indonesian companies and improving the climate for foreign investment

Conditions for Entry

- Both the debtor and creditor voluntarily agree to enter the program. The Government will not compel either party to join.
- The original loan agreement was executed on or prior to April 30, 1998, and the debtor has registered all of its foreign currency obligations with Bank Indonesia as required by the law.
- Both the debtor and creditor agree to restructure the debtor's foreign currency obligations such that the principal is repaid in not less than 8 years, with a three year grace period.
- The original debt (i) is the obligation of an Indonesian private or public entity (other than a commercial bank), (ii) is denominated in a currency other than Indonesian Rupiah, and (iii) is not guaranteed by the Government.
- The original debt is owed to (i) creditors located outside of Indonesia, (ii) Indonesian joint venture banks controlled by non-Indonesians, or (iii) Indonesian branches of foreign banks.
- If a creditor suffers any deferral of cash flow as a result of loan restructuring through INDRA, the creditor cannot accelerate payments for other existing loans with the debtor to compensate for such deferral.
- The debtor and the creditor must comply with all other requirements of the INDRA program.

Basics Elements of the INDRA Program

- INDRA sells dollars to the debtor. The exchange rate for the sale is the best market rate (over a span of 20 consecutive trading days) between August 1998 and June 1999. The exchange rate may be adjusted again in mid-2000 if the exchange rate continues to improve. INDRA retains the dollars to pay the creditor.
- The debtor may pay INDRA directly for the purchase of dollars, or it may finance the purchase by borrowing rupiahs from INDRA. The outstanding principal balance of the rupiah loan will be indexed to inflation, and interest will be payable on such indexed principal. The interest rate is 5.5per cent per annum or 5.0per cent per annum if the debtor elects to repay the rupiah loan over a 5-year period; in both cases the interest rates are adjusted quarterly for the inflation component of LIBOR. The interest rate is reduced by 0.5 per cent for the first two years of the rupiah loan for debtors who enter the program before January 31, 1999. Payments of principal and interest are made monthly over the life of the restructured debt.
- INDRA pays interest to the creditors in dollars at the rate of LIBOR plus a margin of up to 3 per cent, and the principal (after at least 3 years). Payments are made quarterly over the life of the restructured debt.

Payment Under INDRA Scheme

- Grace period (years 1 to 3); repayment scheme from year 4 to Maturity
- Debtor pays principal and interest in rupiahs to INDRA
- INDRA pays principal and interest in US\$ to creditor.

Administrative Agent

- Chase Manhattan Bank is the administrative and paying agent for the INDRA program as well as INDRA's financial advisor.
- For participation in the INDRA program, each debtor must pay an acceptance fee of US\$ 3,000.00 per loan.
- Monthly fee: USD 300.00 per loan

Entry Period

INDRA began registration on August 3, 1998, and shall continue to do so until June 30, 1999 (later extended until December 30, 1999)

Eligible Debt

- Foreign currency debts must be restructured to mature after a minimum of eight years, inclusive of a three-year grace period.
- External creditors shall include overseas creditors and locally incorporated joint venture banks or branches of overseas-based banks. For joint venture banks, eligibility applies to a non-Indonesian individual/institutional creditor or an affiliated group of individual/institutional creditors owning a majority of the capital or voting stock, or controlling the management.

In-eligible Debt

- Debt that is not registered at Bank Indonesia or at the Ministry of Finance, or already guaranteed by the Government of Indonesia

Exchange Rate Determination

- The exchange rate will be determined on the basis of a moving average, calculated over 20 consecutive trading days.
- At the beginning of every month, INDRA will announce the most viable real exchange rate for use in calculating the rupiah debt value.
- With every installment of principal and interest (starting 1 month after registration) will be adjusted by the most viable real exchange rate that has occurred since August 3, 1998.

- The monthly CPI figure published by Indonesia's Central Bureau of Statistics will be used as the basis for adjustments to reflect the real exchange rate. When a current CPI is not available, INDRA will use CPI figures from the preceding month
- Starting on 1 July 1999 INDRA will be using the most viable exchange rate calculated based on the moving average over 20 consecutive trading days.
- Reset window. Should the most viable real exchange rate over the period of May - July 2000 be better than that prevailing during the entry period, the outstanding debt will be adjusted accordingly as of August 1, 2000.

Rupiah Interest Rate

- The real interest rate for the 8-year rupiah denominated debt is 5.5 per cent per annum.
- If a debtor opts for a 5-year term rather than an 8-year one, a 5 per cent p.a. rate is offered.

The Calculation of Rupiah Interest Rate

Monthly Rp interest payment = The real rupiah interest rate x [previous Rp balance x (1 + monthly Indonesian inflation rate)]

Example :

Monthly inflation rate is 6 per cent

Interest payment = (5.5% p.a./12) x 1 + 6% (previous balance)

= 0.4583% x 1.06 (previous balance)

= 0.4858% x previous balance,

or

= (5.83% p.a./12) x previous balance

- Note : Inflation is not added directly to the rupiah real interest rate, but is capitalized to the principal amount of rupiah loan.

Early Registration Incentives

A debtor registering in the first 6 months of the registration period will be awarded a 0.5% reduction in the real interest rate over the first two years to result in a net 5% rate for an 8-year debt, or a net 4.5 per cent rate for a 5-year debt.

Real Interest Rate Parity

- Real rupiah interest rate paid by the debtor to INDRA is 5.5 per cent p.a.
- However, the real rupiah interest rate will be adjusted to reflect changes in the USD real interest rate, i.e., US CPI changes will be taken into calculation. This calculation will be conducted on a quarterly basis as follows:

5.5% + USD real interest rate

where the formula for calculation of USD real interest rate is as follows :

US real int (t+1) = [(1 + LIBOR t+1) / (1 + US inf t+1)] - 1

US real int t = [(1 + LIBOR t) / (1 + US inf t)] - 1

Note: t stands for time

US real interest rate = US real int t+1 - US real int t

Example : LIBOR 3 month on August 3, 1998, was 5.6875% p.a.

US inflation in July 1998 (July '97 - July '98) was 1.70%

US real interest rate [(1 + 5.6875%) / (1 + 1.70%)] - 1 = 3.92%

USD Interest Rate Payment

- The base interest rate for USD payments from INDRA to creditors is the flat LIBOR.
- Any higher interest rate (not exceeding 3%) agreed between the debtor and creditor will necessitate an adjustment to the Rp/USD exchange rate under the following formula:

LIBOR + 1% adjusted by (+) 4,17%

The interest rate over LIBOR + 1% is adjusted with the formula:
Rp/USD. Exch. Rate x {1+ [4.17% x (margin over LIBOR x 100)]}

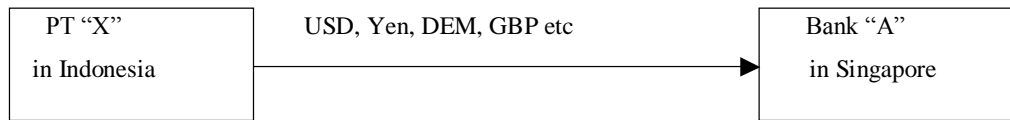
Example : Assume USD.1 = Rp.10.000

- LIBOR + 1% adjustment (+) 4.17% or Rp.10.000 x {1+ [4.17per cent x (1% x 100)]} = Rp.10.417
- LIBOR + 1.25% adjustment (+) 5.21% or Rp.10.000 x {1+ [4.17% x (1.25% x 100)]} = Rp.10.521
- LIBOR + 2% adjustment (+) 8.34% or Rp.10.000 x {1+ [4.17% x (2% x 100)]} = Rp.10.834
- LIBOR + 3% adjustment (+) 12.51% or Rp.10.000 x {1+ [4.17% x (3% x 100)]} = Rp.12.510
- Any excess over 3% on top of LIBOR must be settled outside the INDRA scheme.

Month	Indonesian CPI (per cent)	INDRA Exchange Rate 1 USD/Rp
July'98	8.56	-
August'98	6.30	13,233
September'98	3.75	12,314
October'98	(0.27)	11,216
November'98	0.08	8,501
December'98	1.42	7,931
January'99	2,97	7,589
February'99	1,26	7,815
Maret'99	(-0.18)	7,913
April'99	-	7,899

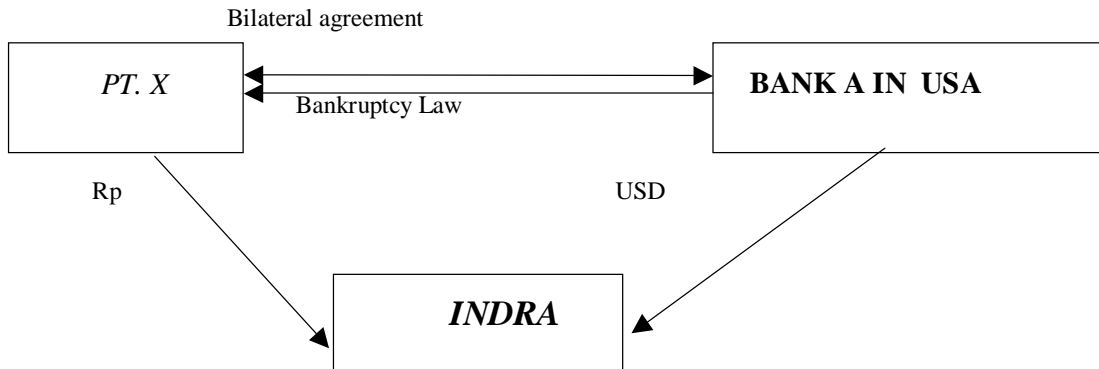
THE INDRA SCHEME

In Normal Economic Conditions



Under normal economic conditions, PT X, an Indonesian debtor, has no problem paying foreign currency-denominated installments of its external debt to Bank A (external creditor in Singapore) in terms as stated in the agreement and at any prevailing market exchange rate.

II. In Abnormal Economic Conditions



However, in the current monetary crisis, where the rupiah exchange rate has been under pressure, debtors like PT X face difficulties making installment payments of their external debts. As such, there are 3 alternatives to address the external debt settlement:

- Bilateral Agreement, in which debtors and creditors negotiate to resolve the issue.
- The INDRA Scheme.
- Bankruptcy Law, where a debtor is declared bankrupt in court as requested by a creditor and/or debtor.

III. Principles of the INDRA Scheme

- Basic principles of INDRA Scheme:
 - Denomination of external debts in any foreign currency other than USD has first to be converted into USD.
- Restructured maturity of external debts consists of:
 - A 3-year grace period during which INDRA pays USD interest to creditors on a quarterly basis.
 - A 5-year repayment period during which INDRA services USD payment of interest and principal to creditors on a quarterly basis.
- Debtors pay principal and interest (in rupiahs) to INDRA on a monthly basis, effective one month after registration. The funds received from interest and principal payments by debtors accumulates because:

- Rupiah payment by debtors is monthly while INDRA's USD payment to creditors is quarterly.
- During the grace period, INDRA receives rupiah payments of interest and principal, but only pays USD interest to creditors.

This accumulated fund will be used as a cushion against fluctuations of the USD exchange rate. INDRA will also invest the fund in instruments that meet prudential principles.

4. Debtor's maturity options for debt repayment in rupiah to INDRA vary from 8 years to 5 years, with interest rates ranging from 5.5% p.a. to 5% p.a. However, should the rupiah exchange rate strengthens, causing market exchange rate to be stronger than the rate applied by INDRA, debtors have leeway to exit from the program at any desired time.
5. The rupiah payment system by debtors to INDRA adopts an annuity system, in which the real fixed installment is adjusted to the monthly rate of inflation.
6. The rupiah value of the debtor's USD denominated debt is correlated with:
 - the rate of exchange;
 - Indonesia's monthly inflation rate;
 - the margin on top of LIBOR applied to restructured debts;
7. Rupiah interest payment applied to debtors is real, while the ongoing inflation rate is capitalized in the rupiah debt value.

IV. Conversion Exchange Rate

At the beginning of every month, INDRA sets a conversion exchange rate derived from a moving average of market rates over 20 consecutive working days. The market exchange rates are accumulated on a daily basis by averaging exchange rates in the Dow Jones Tele-rate from 8 a.m. to 2 p.m. The objectives of applying this method are to obtain the best proxy of the prevailing market rates and to offset any intervention in favor of certain parties in the market.

V. Determination of Debt Conversion Exchange Rate

During the registration period, the best real converted exchange rate is applied.

- ◆ As an example, PT X joins the INDRA scheme at the beginning of August and therefore is subject to the best exchange rate at that time which was US\$1 = Rp.13,000.
- ◆ At the beginning of September, the rupiah exchange rate strengthened to Rp.12,000/USD. The official inflation rate in September was 8%. The debt conversion exchange rate for PT X was no longer Rp. 13,000/USD. Instead, the new real exchange rate of Rp, 11,110/USD is applied. The new real rate is calculated by dividing September's exchange rate (Rp. 12,000/USD) by (1 + 8%)
- ◆ At the beginning of October, the rupiah strengthened again to Rp.11,000/USD, with the inflation rate standing at 6%. The debt conversion value of PT X is readjusted to Rp.10,377/USD at the beginning of September (derived from Rp.11,000/USD/(1 + 6%)) or Rp.9,609/USD during the registration period/beginning of August (derived from Rp.10,377/USD/(1 + 8%)).

- ◆ At the beginning of November, the rupiah strengthened again to Rp.10,000/USD with an inflation rate of 5%. The debt conversion rate of PT X will be re-adjusted to Rp.9,524/USD for October, Rp8,985/USD for September, and Rp.8,319/USD in the registration period/beginning of August.
- ◆ At the beginning of December, the rupiah exchange rate weakened to Rp.12,000/USD with inflation registered at 4%. To derive the most viable exchange rate, the best real exchange rate in the preceding month was compared to this latest rate. Since the prevailing rate had weakened (Rp.10,400/USD is equal to $\text{Rp.10,000/USD} * (1 + 4\%)$), the debt conversion rate to be applied remained the same at Rp.10,400/USD in December, equivalent to Rp.10,000/USD at the beginning of November, Rp.9,525/USD for October, Rp.8,985/USD for September, and Rp.8,319/USD in the registration period.
- ◆ Whenever the latest rate is better than the previous rate, the rupiah debt value will be accordingly revised. Excess payment arising from the difference in the applied exchange rate between the previous conversion rate of exchange and the latest one will be reimbursed to debtors in the form of reduction of the installment payment in the following month (see example of calculation).
- ◆ For a month (July 1999) after the end of the registration period in June 1999, debtors can exercise buy-down options to get a reduction of 10% or 20% from the best real exchange rate that INDRA sets. The options necessitate additional rupiah interest payments by 2.89% p.a., or 6.36% p.a. for an 8-year debt maturity, and by 2.85% p.a. or 6.28% p.a. for a 5-year debt maturity.
- ◆ Reset Window In August 2000, INDRA will determine the most viable exchange rate from a moving average of 20 consecutive working days in May, June, and July 2000. If the chosen rate is better than the previous real rate of exchange adopted by INDRA, the value of outstanding rupiah debts payable to INDRA will be recalculated using the new exchange rate. This last reset will not be retroactive in application.

VI. Conversion Exchange Rate Linked to LIBOR and US Interest Rate

The INDRA scheme is principally designed to cover a flat LIBOR rate. However, INDRA takes into account the possibility of USD interest rates applied by creditors in the restructured debt agreement being higher than LIBOR. Therefore, INDRA is prepared to cover a maximum of 3% interest margin on top of LIBOR. (Should a restructured agreement result in a figure higher than 3%, the excess over 3% will be settled by debtors themselves). However, based on the principle of “no subsidy granted to debtors/creditors,” the rupiah exchange rate to be applied is also adjusted to reflect the magnitude of the differential. For every 1% rate above LIBOR, the conversion rate of exchange will be adjusted by 4.17%.

LIBOR + 1% (premium of 4.17%)

LIBOR + 2% (premium of 8.34%)

LIBOR + 3% (premium of 12.51%)

VII. Rupiah Interest Rate

Is Rupiah Interest Rate fixed?

The rupiah real interest rate is 5.5% p.a. for an 8-year debt maturity, or 5% p.a. for a 5-year debt maturity. However, the interest rate is reviewed on a quarterly basis to take into account changes in the US real interest rate. Any change is incorporated into the equation by calculating the difference between changes in LIBOR and in US inflation figure. This change may increase or reduce the value but historically its magnitude is marginal. For instance:

LIBOR_t is 5.6% and LIBOR_{t+1} is 5.7%, and thus the difference is 0.1%. US inflation rate_t is 3% and US inflation rate_{t+1} 3.15%, and thus the difference is 0.15%. The difference of changes in LIBOR and US inflation rate is 0.1% - 0.15% = -0.05%. Therefore, the rupiah interest rate will be revised by -0.05%.

Is the Rupiah Exchange Rate lower than Market Interest Rates ?

Before the economic crises hit Indonesia, the interest rates applied to a prime debtor in Indonesia's money market were as follow:

Nominal Interest Rate	18 - 20%
On going Inflation Rate	9 - 10%
Real Net Interest Rate	9 - 10%

Evidently, the real rupiah interest rate of 5.5% or 5% that INDRA charges to debtors is far lower than the real net interest rate applicable under 'normal' economic conditions in Indonesia. The difference of 4 -5% p.a. is due to the fact that INDRA places no margin on top of its real interest rate, unlike commercial banks, which have to cover operating expenses and make a profit. In other words, INDRA, is a non-profit institution and charges debtors the interest rate it pays to the creditors.

Repayment Computation Formula:

Annuity = $\frac{1}{(1+i)^n}$, with $i = 5.5\%$ p.a./12

Rupiah Interest Expense =

Rupiah Real Interest Rate x (Rupiah Debt Value x (1 + Monthly Inflation Rate))

Or

Rupiah Interest Expense =

(Rupiah Real Interest Rate x (1 + Monthly Inflation Rate)) x Rupiah Debt Value

For instance, if annual inflation rate is 100%, the nominal interest rate subjected to debtors at a certain time is:

Rupiah Real Interest Rate x (1 + Monthly Inflation Rate) = 5.5% p.a. x (1 + 100% p.a.) = 11% p.a.

VIII. Example of Computation of Rupiah Debt Installment

A debtor registers with INDRA with a debt value of USD100 and chooses to fulfill repayment in rupiah within 8 years or 96 months of repayment period.

At Registration

Given a conversion exchange rate of Rp.13,000/USD, the debt value in rupiah is USD100 x Rp.13,000/USD = Rp.1.3 million. Accordingly, the debtor can estimate the next month's installment as follows:

$$\text{Installment} = \frac{\text{Rp.1.3 million} \times (1 + \text{expected inflation})}{(1 + i)^n} = \frac{\text{Rp.1.3 million} \times (1 + \text{Expected. Inflation})}{77,52345}$$

Comprising:

$$\text{Interest} = 5.5\%/12 \times \text{Rp.1.3 million} \times (1 + \text{expected inflation})$$

Installment :

$$(\text{Rp 1.3 million} \times (1 + \text{expected inflation})) / (1 + i)^n =$$

$$(\text{Rp 1.3 million} \times (1 + \text{expected inflation})) / 77,52345$$

$$\text{Principal} = \text{Total Estimated Installment} - \text{Expected Interest}$$

First Month (First Installment)

Given an 8% inflation rate in the preceding month and the stronger exchange rate of Rp.12,000/USD, the adjusted exchange rate is thus Rp.11,111/USD or Rp.12,000/USD (1 + 8%). The rupiah debt value at registration was Rp.11,111/USD x USD100 = Rp.1,111,111. In line with the agreed principle to capitalize inflation rate in the outstanding debt balance, for the second installment, the debt value is revised to Rp.1,111,111 x (1 + 8%) = Rp.1,200,000

$$\text{Installment} = \frac{\text{Rp.1,200,000}}{1 / (1 + i)^n} = \frac{1,200,000}{77,52345} = \text{Rp.15,479 per month}$$

$$\text{Consisting of: Interest} = 5.5\%/12 \times \text{Rp.1,200,000} = \text{Rp.5,500}$$

$$\text{Principal} = \text{Rp.15,479} - \text{Rp.5,500} = \text{Rp.9,979}$$

The remaining rupiah balance of external debt =

$$\text{Rp.1,200,000} - \text{Rp.9,979} = \text{Rp.1,190,021}$$

Second Month Installment

Given a 6% inflation rate in the previous month and the strengthened exchange rate of Rp.11,000/USD, the adjusted exchange rate is thus updated to Rp.9,609/USD or Rp.11,000/USD / [(1 + 6%)(1 + 8%)].

The rupiah debt value during the registration period is Rp.9,609/USD x USD100 = Rp.960,867. This calls for revision of the first installment:

As inflation is capitalized in the outstanding debt value, in the first installment, the debt value is therefore adjusted to Rp.960.867x (1 + 8%) = Rp.1.037.736

Installment = $\frac{\text{Rp}1,037,736}{1/ (1+ i)^n} = \frac{1,037,736}{77,52345} = \text{Rp.}13,386$ per month

$$1/ (1+ i)^n \quad 77,52345$$

Comprising: Interest = $5.5\%/12 \times \text{Rp.}1,037,736 = \text{Rp.}4,756$

$$\text{Principal} = \text{Rp.}13,386 - \text{Rp.}4,756 = \text{Rp.}8,630$$

The remaining rupiah balance of external debt = $\text{Rp.}1,037,736 - \text{Rp.}8,630 = \text{Rp.}1,029,106$

The difference between the first installment and the revised figure, $\text{Rp.}15,479 - \text{Rp.}13,386 = \text{Rp.}2,093$, will serve as a discount in payment of the second installment. Since inflation rate is capitalized in the outstanding debt balance, in the second installment, the debt value amounts to $\text{Rp.}1,029,106 \times (1 + 6\%) = \text{Rp.}1,090,852$

Installment = $\frac{\text{Rp.}1,090,852}{1/ (1+ i)^n} = \frac{1,090,852}{76,878,769} = \text{Rp.}14,189$ per month

$$1/ (1+ i)^n \quad 76,878,769$$

Consisting of: Interest = $5.5\%/12 \times \text{Rp.}1,090,852 = \text{Rp.}5,000$

$$\text{Principal} = \text{Rp.}14,189 - \text{Rp.}5,000 = \text{Rp.}9,189$$

The net payment of the second installment is $\text{Rp.}14,189 - \text{Rp.}2,093 = \text{Rp.}12,096$, and the outstanding debt balance is $= \text{Rp.}1,090,852 - \text{Rp.}9,189 = \text{Rp.}1,081,663$

Third Month (third Installment)

Given a 5% inflation rate in the preceding month and the strengthened exchange rate of $\text{Rp.}10,000/\text{USD}$, the adjusted rate is $\text{Rp.}8,319/\text{USD}$ or $\text{Rp.}10,000/\text{USD} / [(1 + 5\%)(1 + 6\%)(1 + 8\%)]$

The rupiah debt value at the registration period is $\text{Rp.}8,319/\text{USD} \times \text{USD}100 = \text{Rp.}831,919$.

Consequently, the first and second installments are subject to revision.

As inflation rate is capitalized in the outstanding debt balance, the debt value in the first installment is revised to

$$\text{Rp.}831,919 (1 + 8\%) = \text{Rp.}898,473$$

Installment = $\frac{\text{Rp.}898,473}{1/ (1+ i)^n} = \frac{898,473}{77,52345} = \text{Rp.}11,590$ per month

$$1/ (1+ i)^n \quad 77,52345$$

Comprising: Interest = $5.5\%/12 \times \text{Rp.}898,472 = \text{Rp.}4,118$

$$\text{Principle} = \text{Rp.}11,590 - \text{Rp.}4,118 = \text{Rp.}7,472$$

The remaining debt balance after first installment = $\text{Rp.}898,472 - \text{Rp.}7,472 = \text{Rp.}891,000$

The debt value used to arrive at the second installment is revised to $\text{Rp.}891,000 \times (1 + 6\%) = \text{Rp.}944,460$

Installment = $\frac{\text{Rp.}944,460}{1/ (1+ i)^n} = \frac{944,460}{76,878,769} = \text{Rp.}12,285$ per month

$$1/ (1+ i)^n \quad 76,878,769$$

Consisting of: Interest = $5.5\%/12 \times \text{Rp.}944,460 = \text{Rp.}4,329$

$$\text{Principal} = \text{Rp.}12,285 - \text{Rp.}4,329 = \text{Rp.}7,956$$

The outstanding debt balance after the second installment = $\text{Rp.}944,460 - \text{Rp.}7,956 = \text{Rp.}936,504$.

The adjusted first and second installment payments result in an excess of $\text{Rp.}3,700$, $(\text{Rp.}13,386 - \text{Rp.}11,590 = \text{Rp.}1,796) + (\text{Rp.}14,189 - \text{Rp.}12,285 = \text{Rp.}1,904)$. The excess payment will accordingly

reduce the third installment value by Rp.3,700. By capitalizing the inflation rate in the outstanding debt balance, the debt value for the third installment is adjusted to $Rp.936,504 \times (1 + 5\%) = Rp.983,329$

$$\text{Installment} = \frac{Rp.983,329}{1/(1+i)^n} = \frac{983,329}{76,231130} = Rp.12,899 / \text{month}$$

Comprising: Interest = $5.5\% / 12 \times Rp.983,329 = Rp.4,507$

$$\text{Principal} = Rp.12,899 - Rp.4,507 = Rp.8,392$$

Net payment for the third installment is $Rp.12,899 - Rp.3,700 = Rp.9,199$

The outstanding balance of external debt = $Rp.9,83,329 - Rp.8,392 = Rp.974,937$ etc.

IX. Termination Value

A debtor may withdraw from the INDRA scheme at any time. Funds accumulated at time of exit will be returned according to the following formula:

(The total funds in rupiah received by INDRA)

less

(Rupiah value of USD payment serviced by INDRA to creditor)

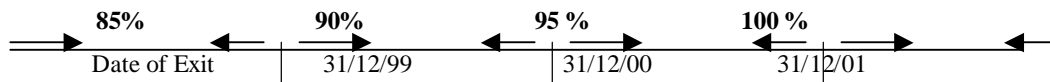
less

(1 % of funds held by INDRA in rupiah)

plus

(Return on Investment from the accumulated fund in Rupiah), provided that the result of this calculation is positive.

However, if a debtor decides to exit from the INDRA scheme in the first 3-year grace period, he will be subject to a penalty, so that the proportion of accumulated funds refunded at various termination times are:



Appendix 8

THE JAKARTA INITIATIVE

Efforts to Settle Private Debts through Negotiations between Debtors and Creditors

It is in the interest of Indonesia to speed up the recovery of the corporate sector in order to increase employment opportunities, promote the recovery of the banking and financial sectors, and to generate tax-revenue for the nation. The successful implementation of these legally non-binding principles will represent an important contribution to Indonesia's economic recovery. The Government anticipates that it will issue supplementary guidelines as part of the implementation of these principles.

GOVERNMENT POLICY

It is essential to the recovery of the Indonesian economy that distressed companies agree with their creditors on corporate and debt restructuring, so that these companies can access new working capital and contribute to the growth of the economy, increase employment, and generate tax-revenue for the nation.

IMPLEMENTATION

Out-of-court commercial negotiations between a company and its creditors can greatly expedite corporate and debt restructuring. The Government will play a limited but crucial role in facilitating and encouraging this process. This out-of-court process, which will apply to both domestic and foreign creditors, will complement the newly amended bankruptcy law, and facilitate the bank restructuring process and access to INDRA.

FOUR-POINT GOVERNMENT PROGRAM

In order to facilitate such out-of-court negotiations, the Government seeks to implement the following program:

1. Adoption of Principles

The government wishes to facilitate negotiations by establishing a number of principles:

a. Organization and Representation

- (1) Companies should normally engage advisors who are experienced in corporate and debt restructuring.
- (2) The restructuring process may be initiated by either the company or its creditors. Creditors should form a single steering committee which is representative of the creditors (the "Committee").
- (3) Unless otherwise agreed, the Committee should elect a chairperson, financial advisor and legal advisor, each of who should be experienced in the process of corporate and debt restructuring. Costs will be borne by the debtor, unless otherwise agreed.

b. Critical Role of Senior Management.

It is critical that the company and the Committee members appoint senior managers to participate in these debt and corporate restructuring. These senior managers should have demonstrable authority.

c. Standstill and Interim Financing

- (1) Subject to reasonable conditions that are consistent with these principles, the creditors should agree to a standstill for a reasonable and finite period of time.
- (2) During the standstill period(s), debtors and creditors should agree on a set of special rules detailing what creditors and debtors can and cannot do during the standstill period.
- (3) To the extent practicable, creditors should subordinate their claims to any new funds advanced after the standstill commences. Creditors should consider providing (or subordinating to others who are willing to provide) critical working capital to finance the company's operations during these negotiations, upon the submission of satisfactory and credible cash budgets demonstrating the company's needs. Access to information should be provided in order to permit an evaluation of request(s) for interim financing.
- (4) Permissible uses of, control over, conditions for disbursement of, and monitoring mechanisms for, such interim financing should be agreed on by both creditor and debtor.

d. Information

- (1) The Committee members and their professional advisors should sign confidentiality agreements. The company should then submit up-to-date, detailed financial information to the Committee and its advisor.
- (2) To the extent permitted by the law, the information should include current, accurate and complete reporting (consistent with internationally accepted accounting standards, unless the Committee agrees otherwise). The following is an indicative list of information likely to be sought; actual information to be provided shall be determined on a case-by-case basis between the debtor and the creditors:
 - a description of the company's group structure and all share holdings, a detailed description of all outstanding loans and financial arrangements (including which group companies are obligors or guarantors, which loans and arrangements are secured, and the repayment schedule for each loan);
 - a balance sheet (including all assets and all liabilities, listed by the obligor) as at the standstill date, each quarter during the three-year period leading up to the standstill date, and a balance sheet forecast for the following three-to-five years;
 - details of (and copies of) all collateral security documents (including identification of encumbered assets), guarantee agreements, and subordination agreements;
 - a detailed listing of all inter-company obligations (including security, guarantee and subordination agreements if applicable);
 - an income statement for the three-year period leading up to the standstill date and an income forecast for the following three-to-five years (all on a quarterly basis);
 - a cash flow statement for the three-year period leading up to the standstill date and a cash flow forecast for the following three-to-five years;
 - details of (and copies of) each of the company's major or critical contracts (including those with creditors, suppliers, customers, management, shareholders, etc.);
 - the company's business plan, including its goals and strategies, its position in the marketplace, and its competition; and
 - such other information as may be necessary for the Committee to evaluate the rescue proposal.

e. Company Restructuring Proposal

- (1) The company should propose a restructuring plan to the Committee not inconsistent with these principles, accompanied by the full information disclosure, as agreed between the parties.
- (2) The proposal should be built on the company's business plan and financial forecasts, the preparation of which should take note of the creditors' contractual priorities, including collateral positions.

f. Committee's Advisory Report

- (1) The company should grant full and ongoing access to the Committee's advisors to review the company's business and financial status. The Committee's advisors will use this information to prepare an advisory report.
- (2) The advisory report should include a review and analysis of the company's business operations, management and future prospects. The report should contain recommendations and conclusions on the viability of the enterprise, group or any business thereunder, its ability to service its debt and its working capital needs.

g. Negotiation of a Restructuring Plan

- (1) Utilizing both the company's restructuring proposal and the Committee's advisory report and such other information as may be available, the debtor and Committee should enter into negotiations to achieve a corporate and debt restructuring plan.
- (2) The agreed plan should respect and preserve the creditors' contractual positions, including collateral rights and positions under subordination agreements.
- (3) No party should be forced to make any concession, but commercial considerations should govern each party's decision-making process.
- (4) An expeditious process is critical so that market uncertainty about the company's viability does not become a self-fulfilling prophecy.

h. Pre-Negotiated Bankruptcy Plans

- (1) Upon reaching a corporate and debt restructure plan, efforts shall be made to present the plan to all creditors, except those creditors whose rights will not be affected.
- (2) Insofar as unanimity among all creditors may be elusive, the newly amended bankruptcy law may permit access to the commercial court for approval of the "pre-negotiated" plan (making it binding on all creditors, even those who do not consent to it), provided that the pre-negotiated plan complies with the requirements of the newly amended bankruptcy law.

i. Non-Discrimination

There shall be no discrimination between domestic and foreign creditors.

2. Jakarta Initiative Task Force

A President-appointed Jakarta Initiative Task Force (the "Task Force") will be established to facilitate the successful restructuring of Indonesian companies in accordance with the Jakarta Initiative.

To ensure that the Task Force is effective, it shall be directed and supported by a dedicated team and will receive adequate funding to support its operations.

The responsibilities of the Task Force will include:

- a. facilitating out-of-court negotiations;
- b. making referrals to the public prosecutor to place the restructuring negotiations to a court-supervised process under the newly amended bankruptcy plan, if the public interest can be better served in doing so.

3. Regulatory changes

The Government will make the necessary regulatory changes to facilitate the implementation of negotiated corporate restructuring. The Task Force may provide recommendations on any further legal, regulatory or administrative changes needed to facilitate corporate restructuring.

4. Corporate Restructuring Advisory Committee and Public Participation

The Task Force shall designate a Corporate Restructuring Advisory Committee, which shall be comprised of a representative group of domestic and foreign banks, Indonesian companies and bondholders. A representative of IBRA and INDRA shall also participate in the Committee to enhance coordination in other aspects of government policy.

The Corporate Restructuring Advisory Committee may propose new approaches and actions, review the effectiveness of actions taken, and make recommendations to facilitate the successful implementation of the Jakarta Initiative.

The Corporate Restructuring Advisory Committee should meet regularly and confidentially report its findings to the Task Force. Furthermore, the Task Force should consult with the Corporate Restructuring Advisory Committee as required.

The Task Force will also draw on the collective experience of professionals from the legal and financial communities, and will also consult with representatives from labor and consumer groups.

RESTRUCTURING MEASURES ALREADY UNDERTAKEN

Recently, in an effort to facilitate the restructuring of Indonesian companies, the government has promulgated several rules. Some of these rules revise prior regulations, while others are new rules.

The rules in question are as follow:

1. Revaluation of Fixed Assets (Revision)

This rule is intended to make it easier for companies to re-evaluate their fixed assets, so that the reserves created from the re-evaluation can be converted into new paid-in shares. Furthermore, this rule covers matters such as:

- a. In addition to land and groups of buildings, the types of assets that can be re-evaluated include categories other than buildings.
- b. The ownership period, which was formerly five years, is now unlimited.
- c. Re-evaluation can be done yearly and companies that made a re-evaluation in fiscal year 1988, based on the old rule, can now re-evaluate based on the new rule.
- d. In calculating income tax, the asset re-evaluation surplus is first charged against losses in the current fiscal year and the balance against tax losses in previous years (vertical and horizontal losses).
- e. In the event that re-evaluated assets are transferred as a result of a merger or consolidation, the transfer is exempt from the final tax of 15%.
- f. In the event of a business consolidation, the final (10%) tax on the excess re-evaluation after charging for any vertical and horizontal losses, can be paid as late as five years after the re-evaluation.

2. **Income tax on forgiven loans (haircuts)**

In accordance with current regulations, a forgiven loan is considered as income that is subject to tax at the general rate (Article 4, paragraph (1), section K of the Law on the Income Tax of 1983).

The current regulations do not stipulate that the benefit received by the company is calculated after first subtracting losses of the current year and the balance of tax losses of prior years (vertical and horizontal losses);

3. **The Use of Foreign Currency in Financial Reports**

On 21 August 1998, the Indonesian Accountants Association (IAI) issued the Accounting Standard (PSAK) Number 52 with respect to Foreign Currency Reporting, making it possible for a company to use foreign currency (functional currency) in its financial reports if certain criteria are met.

The criteria indicated are:

- a. Cash Flow Indicator: When the cash flow related to the principal activity of a company is denominated in a certain currency;
- b. Selling Price Indicator: When the selling prices of products of the company in the short run are heavily influenced by movements in the exchange rate or when the company's products are primarily targeted for export;
- c. Cost indicator: When the costs of a company are heavily influenced by movements in certain currencies;

In the special case of companies that have already sold shares to the public (issuers and public companies), the government, by means of the Capital Market supervisory Agency (Bapepam), has issued the following rules on corporate restructuring:

4. **Mergers**

Based on current rules, mergers with the use of book value and without the incidence of tax are only allowed for banks, insurance companies, pension funds, financial institutions, and companies which have made initial public offerings. With respect to others, the requirements call for mergers to be allowed only if the companies are affiliated.

To encourage companies to undertake restructuring by means of merger, new rules will be issued to allow mergers in various lines of business and to permit book value to be used by unaffiliated companies.

5. **Issuance of Shares in Different Series of Categories**

Based on the provisions of the Company Law, there is a possibility for companies to undergo restructuring with an influx of new investment, with respect to the issuance of new shares in series or categories that are different, and have a lower par value than the outstanding shares.

Considering that some companies have gone public and others not, the rule will be as follows:

- a. For ordinary companies, the value of the shares will first be calculated by an independent appraiser;
- b. For companies whose shares are listed on an Exchange and are quoted below par, there will be a possibility to issue shares in different series or categories, with the stipulation that each class or series will have the same rights with respect to voting, dividends and liquidation (proportional 1:1).

Specifically for issuers and public companies, the government, through the Capital Market Supervisory Agency (BAPEPAM), has also issued rules relating to the corporate restructuring:

6. Capital Increases Without Preemptive Rights

This rule makes it possible for companies to raise capital without issuing preemptive rights to current shareholders, as long as certain conditions are met.

The criteria to be met by the company are as follows:

- a. A bank that has received a loan from Bank Indonesia, or other governmental institutions, amounting to more than 200% of the paid-in capital or other circumstances that would result in a restructuring of the bank by a competent governmental authority;
- b. A non-bank corporation that has negative working capital and liabilities that are greater than 80% of the assets of the company;
- c. A corporation that has failed or that is unable to avoid failing to pay its obligation to a non-affiliated lender, when the lender agrees to receive equity-type securities in an amount up to 5% of paid-in capital in any three year period.

7. Repurchase of Shares by Issuers and Public Companies

This rule makes it possible for issuers and public companies to repurchase shares in circulation, subject to conditions established in Law No 1 of 1995 on Limited Liability Companies, and other conditions such as:

- a. The repurchase is limited to 10% of paid-up capital.
- b. The repurchase must be paid out of net profits.
- c. Approval at the shareholders' meeting is required.
- d. Rules with respect to disclosure, fairness, and liquidity must be observed.
- e. In the event that such shares are resold, the sale can only be done at the same or higher price.
- f. Companies with shares listed on an Exchange may not repurchase shares if this will reduce the amount of shares to a level that could significantly reduce liquidity or result in de-listing.

8. Rights Issue, Form and Content of Registration Statements and Prospectuses for a Rights Issue.

The existing rules have been revised with the intent to speed up and increase the efficiency of document processing, with respect to a Rights Issue of a Public Company or Issuer.

This revision includes, among other things:

- a. a simplified process so that what formerly took 107 days now takes only 42 days;
- b. the requirement for underwriting the unsubscribed portion has been eliminated;
- c. in the interest of protecting investors, the quality of disclosure has been improved.

9. Accounting for foreign currency transactions

This new rule was issued in response to developments in the rupiah foreign exchange market as well as the Financial Accounting Standards Statement (PASK) Number 10 concerning foreign currency transactions, which at this time is being reviewed by the Indonesian Accountants Association (IAI). In principle, the accounting treatment of exchange differences resulting from foreign currency transactions of Issuers and Public Companies are governed by the terms of PSAK 10, with the following additions:

- a. For companies that are not hedging, the accounting treatment of differences that arise from postings to assets and long term monetary liabilities can be postponed and recognized as profit or loss in current or future periods, as long as the posting to assets of monetary liabilities is done systematically.
- b. If the company chooses to carry forward exchange differences that will be charged to the current period.

- c. These provisions are valid for financial reports prepared for the period after January 1, 1998.

10. Improvements in the Exchange Listing Rules

There is concern that the shares of many companies will be de-listed because of difficult financial conditions. This already has had a negative effect on investors, who felt pressured to sell.

In response to this problem, officials at the Jakarta Stock Exchange will immediately revise de-listing rules, which will be effective on 1 December 1998, by reviewing the de-listing criteria now in force and refrain from using this criteria as a “check list”, but instead pay attention to “corporate governance” and compliance with disclosure rules.

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