

TOWARDS EUROPEAN UNION AND ASIA 2000 (What Role for External Actors)

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Never in history has Indonesia experienced such a deep crisis as it is experiencing since 1997. It covers a wide range of fields, such as:

1. *economic crisis* as revealed in a sharp currency depreciation from Rp2,400.- (July 1997) to Rp. 7,800.- to the US dollar (October 1998) due to a mass outflow of capital in very short time which makes it impossible to sustain an already weak banking system; a declining capability of corporations to meet global competition; a reduced world market prices for important export mining and agricultural commodities; and a reduction of domestic food production because of long drought of 1997 and 1998;
2. *social-political crisis* as indicated by a clash between the formal national leadership and its ruling elite against the emergence of a countervailing social political force outside the existing formal official force, and consisting of marginalized social-political groupings under the leadership of Abdurrachman Wahid (Gus Dur), Megawati and Amien Rais respectively; students and university teaching staff at campuses; non-governmental organizations and emerging critical press.

The course of Indonesia's development since 1997 is influenced by the need to cope with the economic and the social-political crisis.

On the *economic field* in cooperation with the International Monetary Fund (IMF), the World Bank (WB), the Asian Development Bank (ADB) and bilateral member countries of the Consortium Group on Indonesia (CGI), measures are taken based on the agreement between the Government and IMF. These measures are: (1) applying prudent macro economic policies, such as raising interest rate, tight money policy, limited budgetary expansion and allowing subsidies on selected basic needs for food, education and health services; (2) flexible exchange rate policy; (3) external debt management, private as well as rescheduling public debt through Paris Club; (4) structural reforms in the banking system, dismantling monopoly, over-protectionism, preferential treatments and managed trading; (5) provision of social-safety-net to curb negative impacts of crisis and structural adjustment's policies on vulnerable groups.

On the *social-political field* the national leadership has been replaced by a transitional leader which is to be assessed in the forthcoming November 10th 1998 People's Consultative Assembly meeting, new laws are currently discussed in the parliament on election and new political parties, political prisoners have been released, the constitutional rights of freedom of association and freedom of the press have been restored, public demonstrations are allowed, although regulated, giving rise to the phrase of "no single day without demonstration somewhere in Indonesia," pro-active actions are taken to preserve human rights, and forces of civil society are increasingly active in corruption and election watch.

Much has been done and achieved, but more is needed to put Indonesia fully at the course towards total reform. It is in this context that the need arises to discuss the

role of external actors, such as multilateral financial institutions and major bilateral players, to face the challenges of the Asian crisis together between the European Union and Indonesia.

I. The Role of External Actors

The Multilateral Institutions

Shortly before the Thai Government decided to float the Thai baht on July 2, 1997, the CGI has successfully concluded its meeting in Tokyo with an optimistic tone that Indonesia may well enter the 21st century as member of the successful "economic tiger family" of Asia.

As late as September 1997 Euromoney's country risk assessment for Indonesia was shown favorably. Major international credit rating agencies showed no indication of potential crisis. Indonesia's stock exchange fluctuated still on high price level till October 1997. No perceptible change has been displayed by interest rate premia for country risk. Most important economic indicators show no sign of possible crisis (see The World Bank, *Indonesia in Crisis*, Washington D.C., July 1998).

It is therefore not surprising if the contagion effect of Thai financial crisis was not taken seriously during July-October 1997. The Monetary Council's program to encounter the financial crisis through bold monetary and fiscal measures combined with dismantling of monopolies and publicly announced by Dr. Saleh Afiff, the Coordinating Minister of Economic, Finance and Industrial Affairs in August 1997, was rejected by the President in the Cabinet session and the Coordinating Minister was put aside. Since then the leadership to cope with the crisis was not firmly established.

Since the crisis become increasingly serious, the Minister of Finance and the Governor of the Central Bank deemed it necessary to invite the IMF in October 1997. In this second stage of coping with the financial crisis, the Government of Indonesia agreed with IMF to launch a structural adjustment program backed by standby credits of US\$ 21 billion, while the World Bank committed US\$ 10 billion, Asian Development Bank US\$ 4 billion and as "second line of defense" an amount of US\$ 20 billion was mobilized from Australia, Canada, France, Germany, Japan, United Kingdom and the United States.

The first step IMF recommended as part of the structural adjustment program was to close 16 banks, including banks of the President's family. Since no adequate provision has been programmed for customers of the closed banks, a panic erupted giving rise to withdrawals of money from private banks to deposit it in foreign and state banks. The confidence on the private banks has been eroded giving way to a deep crisis in the banking system.

Also the confidence of the President on the financial and banking authorities started to erode. And various agreements between IMF and the Government were not taken seriously by the President.

The President could not fully comprehend that the Indonesian economy was in a serious crisis. And the nation suffered from a serious mishandling of the crisis. The

increased seriousness of the crisis, as revealed by the sharp depreciation of the Indonesian currency with 80%, rising prices of basic necessities, closing down of industries, rising unemployment has raised discontent among the people, which is revealed frequently through demonstrations that have forced the President to resign and replaced by his Vice President, whose major task became to implement the "Memorandum of Economic and Financial Policies" as agreed between IMF and the Government of Indonesia.

In a time span of 8 months, during the months of October 1997 till May 1998, the Government has already agreed 4 Memorandums, of which none was seriously implemented. It is therefore understandable if the IMF imposes the conditions of monthly review prior to the disbursement of IMF's fund. And only after agreement has been reached with IMF can other funds of the World Bank, Asian Development Bank and CGI member countries be disbursed. And the structural adjustment program to cope with economic crisis became identified more with the IMF program rather than the Government's. This impression has been strengthened by the fact that the IMF officials are more eager "to sell" the program to the Indonesian opposition leaders and the students rather than the Government's leaders.

Indonesia has enjoyed prior to the crisis a massive inflow of capital. The predictable depreciation of the Indonesian currency and its high interest rate has made foreign borrowing attractive. With a weak domestic Japanese economy, much of Japanese credit was offered to Indonesia. Out of Rp. 88 trillion private debt obtained by private banks, excluding local banks, the Central Research Data on Indonesian Business recently reported that, 68% are dominated by the Global Triad of Japan (28%), USA (23%) and European Union (15%). In the past, most of these credits can be rolled over when due. And short term borrowing is replacing long term capital. When managers of international mutual funds and hedge funds became doubtful on the viability of the East Asian economy than they began to pull out.

A new element enters the world of free commerce in addition to commerce in ordinary goods, namely *free commerce in money*. If free commerce in ordinary goods is broadly efficient because it subjects business to be competitive and allows products to find markets anywhere in the world. George Russell (see *Should we Continue to Invest Globally ?*, Russell Investment Service Conference, September 1998) stated that free commerce in money holds the real economy hostage to the whims of financial speculation, which is vulnerable to herd instincts, manias, and panics. In ordinary commerce, prices adjust and markets equilibrate. In global money markets, erratic and damaging overshooting is the norm.

It is in this connection that ideas are currently floating in Indonesia to explore the possibility of applying taxation on inflow of hot money in order to reduce its negative impact on the economy.

It is significant to note that the IMF seems not to take bold initiative to cope with this particular "hot money" issue. Even in the recent IMF-World Bank annual meeting of October 1998 no final conclusions have been made on this topic.

IMF's role in reform of the banking system, debt settlement and privatization of state's enterprises is crucial. While the World Bank is focusing on "social safety net programs" supported by the United Nations agencies.

If in former times the involvement of Non-Governmental Organizations in channeling official development assistance was not feasible, this time however there is a gradual shift allowing NGO to be actively engaged in social safety net programs. At the initiative of the World Bank, UNDP and 27 NGO's a community recovery program is now implemented by a NGO foundation through network of NGO's which covers whole Indonesia.

Also to cure corruption-collusion-nepotism in the implementation of projects, numerous NGO's are joining forces to watch over the work done by Government. The intensity of corruption watch has raised the unwillingness of Government officials to become projects officers, which previously was a desired position.

Currently NGO's are also organizing themselves in networks of *election-watch*, to engage the public to watch over the honest and free implementation of the coming election.

In a way, the dismantling of monopolies of crony capitalism in collusion with Government agencies has also planted the seeds for the growing forces of civil society. Indonesia is just at the early stage of beginning and it has yet a long way to go.

Major bilateral players

Capital inflow was useful to close the deficit in the current account, which shows the tendency to surpass the 3% of Gross Domestic Products (GDP) due to a faster rate of growth in imports while exports growth rate weakened.

Indonesia's exports, as well as those of other East Asia's countries, has suffered serious competition from mainland **China** after this country has unified its two-tiered foreign exchange market and in the process devalued the renminbi (1994). China has already launched its economic reform which has sharply improved its manufacturing capabilities. Backed up by a massive investment of US\$ 137 billion in foreign direct investment during 1992-1996, China became highly competitive and replaced exports from South East Asia to USA and European Union (see Lawrence B. Krause, *The Economics and Politics of the Asian Financial Crisis of 1997-1998*, Councilor Foreign Relations Corporate Conference, New York, 1998).

Trade documents on **European** External Trade reveal that partial reorientation in the geographical breakdown of EU external trade is already evident in the trade figures for the first five months, January-May 1998, as a result of the Asian financial crisis. *First*, EU global exports to Asian ASEM countries decreased sharply (-19%) compared to 1997, whereas total EU sales to third countries increased by +9%. Losses are concentrated in crisis countries, such as Thailand, Korea and Indonesia. The fall in EU exports to Asia is concentrated in primary products, automotive, office and telecommunication equipment; *second*, EU imports from Asia are growing fast, especially in chemical and transport equipment sectors. But purchases of cars from

Latin America, in particular Brazil, and the CEEC, especially Hungary and Czech Republic are moving faster in January-May 1998, presumably because of relocation policies of European car manufacturers.

In 1997 of Indonesian total export value of US\$ 53.4 billion, Japan occupies the highest amount of US\$ 12.5 billion followed by trade with ASEAN of US\$ 8.6 billion, European Economic Community of US\$ 7.8 billion and USA US\$ 7.1 billion.

The **Japanese** economy is still caught in the policy-induced recession starting May 1997 which is aimed at the correction of massive budget deficit by reducing government's expenditures and raising taxes. Japan is the major economic "locomotive" of Asia. It is therefore not surprising if the Group-7 has put tremendous pressure on Japan to spend and raising its imports. Hence the New Miyazawa Initiative has been launched recently to assist Asia countries to overcome the crisis with a Japanese package of support measuring a total of US\$ 30 billion, of which US\$ 15 billion is made available for medium to long-term financial needs and another US\$ 15 billion for possible short-term capital needs in the implementing economic reform. While this initiative is highly recognized, more important however is the attempt to get the Japanese economy moving again in order that Asian trade can flourish.

The **US** economy is starting to shows indications of passing the top of its economic boom and a downward trend is to be expected after the year 2000.

II. European Union and Asia 2000

With the prevailing economic crisis in Japan, which is predicted will prolong for another three years and a beginning of a downward trend of US economy in early year 2000, while ASEAN economies have not recuperated yet from its crisis, it is clear that the major responsibility of getting East Asia economy moving is shifting on the shoulders of European Union.

But EU is busy to consolidate its regional economy and to launch in January 1999 its Euro currency. Why then should EU be bothered to look into the Asian crisis economy.

The Dutch are found to say that "*regeeren is vooruit zien*" or "*to govern is to look far ahead.*" It is necessary today not to be mentally caught in the Asian crisis of today, but to look beyond the current crisis into Asia 2000.

In a publication of the Organization for Economic Co-operation and Development (OECD), "*The World in 2020 Towards a New Global Age*" it is projected that non-OECD countries will achieve higher growth rate as compared to the OECD countries, which will raise their share of world GDP from 44% (1995) to 67% (2020) and increase their share of world trade from one-third at present to one-half in 2020.

The economic performance of the non-OECD countries is expected to be dominated by the "*Big Five*": *Brazil, China, India, Indonesia and Russia.* These

countries share similarities in large population over the 100 million with a growing income per capita, and having rich natural resources.

Four of these countries are situated in Asia and play a leadership role in regional economies, such as ASEAN, South Asia Association of Regional Cooperation, the Indian Ocean Rim Association for Regional Cooperation and the Asia Pacific Economic Cooperation. It is reasonable to assume that, after the economic crisis, these countries may well become the center of growth of the non-OECD economies.

By establishing firm foundation for cooperation between the European Union and Asia, the synergy of growth in these regions may well become the economic powerhouse that pull the global economy fully ahead in the twenty-first century.

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