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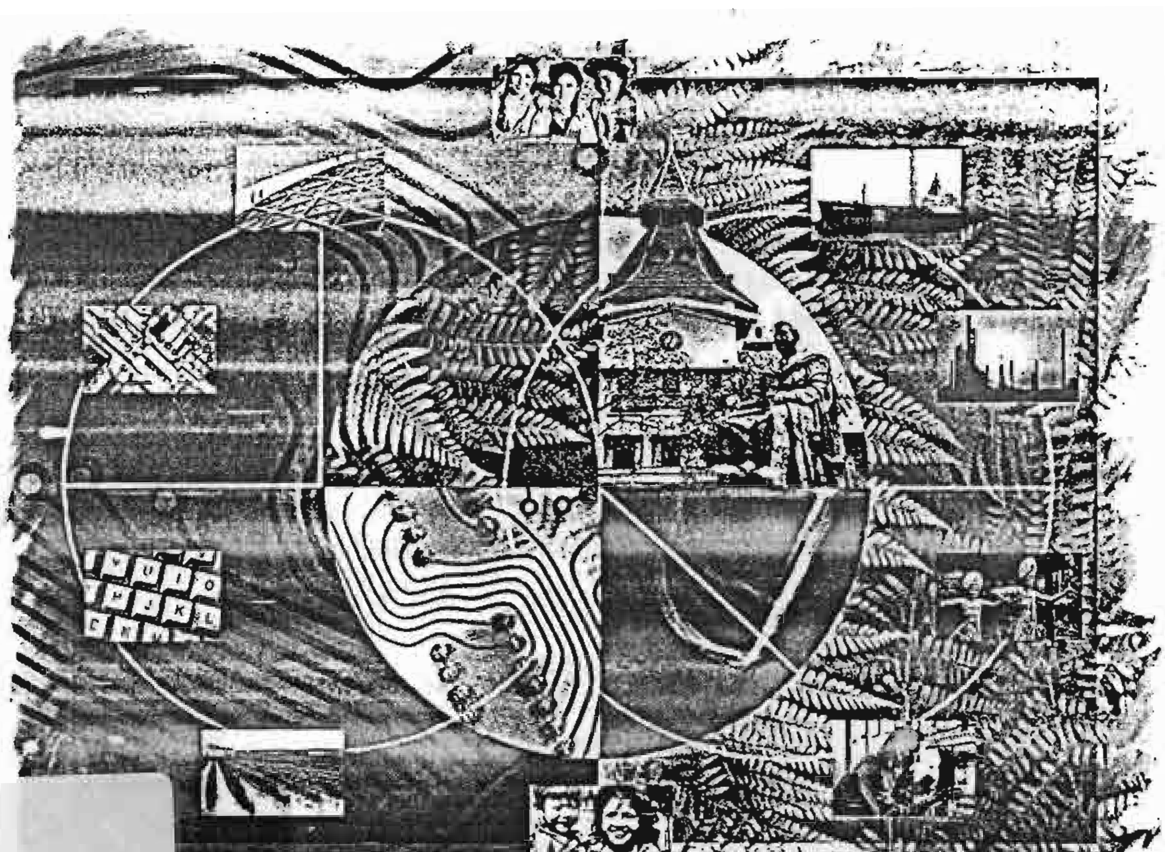

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Economic Recovery and Reform in Indonesia

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ABSTRACT

Amongst the crisis-hit countries in Asia, Indonesia was hit hardest. A great deal has been written about the origin and the unfolding of the crisis in Indonesia. The deterioration of its economic "fundamentals" was not immediately obvious as the economy continued to grow by about 7 percent in the first half of 1997, exports remain strong, the current account deficit was manageable, and the budget exhibited a surplus. Yet, the economy had became very vulnerable to external shocks. Short term debt had accumulated rapidly since the beginning of the 1990s, in part to finance long term projects. The banking system, which expanded rapidly following a major deregulation in 1988, had been under lax supervision. Economic liberalization and deregulation, which began in the mid 1980s, slowed down in the early 1990s. Certain sectors of the economy were re-regulated and a number of activities, in manufacturing and services, were given protection or other favorable treatment because of their close links to the power center. However, the depth of the crisis cannot be explained by these factors alone. In fact, it was the mishandling of the crisis that led to free fall of the economy and the currency (*Rupiah)* in the beginning of 1998. This was followed by the fall of the Soeharto regime that was in power for more than 30 years. The collapse of the regime resulted in an equally deep political crisis. In the four years since Soeharto's fall in May 1998, Indonesia has three presidents.

Given the depth of the economic and financial crisis, coupled, with the political crisis, Indonesia's recovery process had been slow, difficult, and frustrating. With each new government, a new recovery program was introduced, but its implementation was poor due to lack of economic leadership and administrative capacity as well as continuous political interference. The involvement of the IMF has been critical to the setting of the recovery and reform agenda, especially with the changes of government. However, IMF's tendency to "micro-manage" Indonesia's IMF-supported program has added to the difficulties in implementing it.

The Indonesian economy began its recovery in 2000. The economy grew by 4.8 percent, driven to a large extent by domestic consumption and export growth. This recovery, however, was not sustained. Economic growth slowed down to 3.5 percent in 2001. This performance was better than many other Southeast Asian countries. Malaysia, Singapore and Thailand were adversely affected by the slowdown of the US and the global economy, especially since September 11. However, these economies will recover more swiftly with a recovery of the US and the global economy. Indonesia, on the other hand, has to overcome a number of systemic problems internal to its economy and polity. Its slow "recovery without reform" is not sustainable. The banking system remains weak and, in fact, faces the danger of another crisis. The government's budget is experiencing a temporary relief as a result of higher oil prices and the successful rescheduling of public external debt through the Paris Club. The challenge of fiscal sustainability remains great.

Reforms are also necessary to enhance the economy's international competitiveness. The weak currency has been a factor in its international competitiveness, but this cannot be relied upon indefinitely. The competition from China and other economies in the region is real. Increased productivity, moving up to higher value-added production, and a further diversification of the economy requires new investments, especially from abroad. This also requires further reforms and the maintenance of political stability.

Indonesia's recovery and reform agenda has been formulated since the IMF was invited to help support the program. The agenda has not been without criticism, and over the years modifications have been made. Some lessons have been learnt. But the lessons drawn need to take into consideration the overall political environment, which at times had been favorable but at other times had caused severe obstruction.

INTRODUCTION

Amongst the crisis-hit countries in Asia, Indonesia was hit hardest. A great deal has been written about the origin and the unfolding of the crisis in Indonesia. The deterioration of its economic "fundamentals" was not immediately obvious as the economy continued to grow by about 7 percent in the first half of 1997, exports remained strong, the current account deficit was manageable, and the budget exhibited a surplus. Yet, the economy had became very vulnerable to external shocks. Short term debt had accumulated rapidly since the beginning of the 1990s, in part to finance long term projects. The banking system, which expanded rapidly following a major deregulation in 1988, had been under lax supervision. Economic liberalization and deregulation, which began in the mid 1980s, slowed down in the early 1990s. Certain sectors of the economy were re-regulated and a number of activities, in manufacturing and services, were given protection or other favorable treatment because of their close links to the power center. However, the depth of the crisis cannot be explained by these factors alone. In fact, it was the mishandling of the crisis that led to the free fall of the economy and the currency (rupiah) in the beginning of 1998. This was followed by the fall of Soeharto who had been in power for more than 30 years. The collapse of the regime resulted in an equally deep political crisis. In the four years since Soeharto's fall in May 1998, Indonesia has had three presidents.

Given the depth of the economic and financial crisis, coupled, with the political crisis, Indonesia's recovery process has been slow, difficult, and frustrating. With each new government, a new recovery program was introduced, but its implementation was poor due to lack of economic leadership and administrative capacity as well as continuous political interference. The involvement of the IMF has been critical to the setting of the recovery and reform agenda, especially with the changes of government. However, IMF's tendency to "micro-manage" Indonesia's IMF-supported programs has added to the difficulties in implementing them.

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Reforms are also necessary to enhance the economy's international competitiveness. The weak currency has been a factor in its international competitiveness, but this cannot be relied upon indefinitely. The competition from China and other economies in the region is real. Increased productivity, moving up to higher value-added production, and a further diversification of the economy requires new investments, especially from abroad. This also requires further reforms and the maintenance of political stability.

Indonesia's recovery and reform agenda has been strengthened through the IMF-supported program. The agenda has not been without criticism, and over the years modifications have been made. Some lessons have been learnt. But the lessons drawn need to take into consideration the overall political environment, which at times had been favorable but at other times had caused severe obstruction.

This paper begins with a discussion of the overall process of recovery and reform in the context of Indonesia's changing political landscape, affecting the implementation of the recovery and reform programs as well as relations with the IMF. This will be followed by an examination of the evolving programs and policies and the difficulties of implementing them. The final section looks at the overall macroeconomic performance under the recovery program over the last five years.

THE PROCESS

Initial Handling of the Crisis

The Indonesian crisis, which perhaps could be dated to 21 July 1997 when its currency fell by 7%, has been characterized by the extreme depreciation of the rupiah. In the following months the rupiah continued to slide. By 22 January 1998 the currency fell to a record low of about Rp 17,000/$, which amounted to a devaluation of more than 80% since it was floated on 14 August 1997.

The initial debate in the country centered on the link between currency depreciation and "economic fundamentals." One view suggested that Indonesia's economic fundamentals were as sound as they had ever been, and more sound than those of Thailand. Thus the large depreciation must have been caused by other factors. Yet, "contagion" alone cannot account for this. The financial health of the economy, or the lack of it, which was largely overlooked when assessing a country's economic fundamentals, was thought to play a critical role in the crisis. Some argued that "political fundamentals", including good governance, are equally important. The currency crisis as it unfolded came to be seen largely as a symptom of a much deeper crisis of confidence in the government.

The other view argued that the large depreciation must mean that Indonesia's economic fundamentals were much less sound than was generally believed, and that the public was not sufficiently informed about the real state of the economy. In fact, both views appear to converge in identifying the steps necessary to overcome the crisis, namely to increase transparency in both public and corporate governance, and to resume the reform process that seemed to have come to a halt. Indeed, concerns had been raised since about 1992 or so that the country was experiencing "deregulation fatigue". The crisis was thus seen as a blessing in disguise, in that it might produce a new sense of urgency that would revive the drive for economic reforms.

Pressures on the rupiah began to be felt following the decision by the Thai government to float the bath on 2 July 1997. On 11 July Bank Indonesia (BI), Indonesia's central bank, widened its intervention band to avoid having to sell foreign exchange to speculators in defense of the rupiah. On 13 August the upper limit of the intervention band was exceeded despite further interventions by BI. The next day, concerned that it may squander its foreign reserves, BI decided to let the rupiah float freely. The rupiah continued to weaken, and BI responded by tightening liquidity in its efforts to keep inflation under control and to stem the tide of large shifts into dollar holdings by residents. This policy was ineffective because the rupiah continued to slide. This tight money policy was widely criticized, including by President Soeharto himself. The monetary authorities gave in to these pressures but as a precaution BI put a limit on forward transactions in the foreign exchange market.

In mid September the Finance Minister outlined for the first time the government's program to overcome the crisis. It had five main objectives: (a) stabilization of the rupiah; (b) fiscal consolidation; (c) reduction of the current account deficit; (d) strengthening the banking sector; and (e) strengthening the private corporate sector. A number of measures were outlined to achieve these objectives. Among the measures were cancellation of a number of budget-financed (large) projects and the reduction of subsidies on fuel. On the banking sector, the government proposed the mergers of state banks and private banks and the liquidation of insolvent banks. Private companies were advised not to expand their activities, especially if they relied on foreign funding. The government also put an end to the 49% foreign ownership limit on Indonesian stocks.

Following this policy announcement the currency stabilized, but only briefly. By the beginning of October the rupiah had already depreciated by about 35%. Similarly, the Jakarta Stock Exchange index had fallen by 44%. There were reports that private companies were having difficulties to meet their external debt service obligations. This led the Cabinet to decide on 8 October to seek assistance from the International Monetary Fund (IMF). In his initial statement the Finance Minister explained that the government sought technical assistance from the IMF to strengthen the financial system. The possibility of financial support would be explored only as a precaution. It was somewhat obvious that President Soeharto was hesitant to draw in the IMF. However, during the process of exploration with the IMF it was felt that an IMF standby loan, backed by an economic program, was becoming necessary to restore confidence.

In comparative perspective, Indonesia had drawn in the IMF to help overcome the crisis ate an earlier stage than Thailand had done or Korea was to do. It had not drawn down its reserves. An agreement was reached with the IMF on 31 October 1997, in the form of a letter of intent (LOI) signed by the Finance Minister and the Governor of BI. The program to overcome the crisis and towards economic recovery, accommodating IMF's conditionality, were contained in the Memorandum of Economic and Financial Policies (MEFP) that was attached to the LOI. The program was to be implemented over a three-year period.

The program was built around three main pillars. First, a strong macroeconomic framework designed to achieve an orderly adjustment in the external current account, and incorporating substantial fiscal adjustment as well as a tight monetary stance. Second, a comprehensive strategy to restructure the financial sector, including early closure of insolvent institutions (banks). Third, a broad range of structural measures that also improve governance. The program was clearly aimed at restoring macroeconomic stability and confidence. Stimulating or revitalizing the economy was not the essence of the program. Indeed it was only much later that the problem of corporate debt and the revitalization of the economy were taken into consideration.
The first pillar was simply a continuation of the policies that were already introduced by the government since August. However, a much tighter budget appeared to have been demanded by the IMF. A budget surplus of 1% of GDP was aimed for. The justification for this stance was to support the required external adjustment, finance the costs of restructuring the financial sector, and bring down the government debt/GDP ratio.

Within the second pillar, the following day after the announcement of the program the government closed a total of 16 banks. This was a very controversial decision and may have caused an irreparable damage. As there was no deposit guarantee in place, the decision was a big shock to the public. This had led to waves of severe bank runs that forced the government to provide emergency liquidity to save the banks. This rescue operations turn out to be very costly for the government, and for the country. The media had reported that the IMF realized that it had given the wrong advise. However, liquidation of banks was already in the government's own agenda. On 2 September BI had already issued a decree regarding procedures for the liquidation of banks. However, nobody, including banks, appeared to have taken notice of this decree.

The third pillar was the structural reforms. In its design, the recovery program included a strong structural reform component. It was felt that the program, whose main aim was to restore confidence, would not have credibility if it did not have this third pillar. The Indonesian side in the negotiations, supported by the World Bank, could be the party that insisted on including this component in the program. The IMF was said to be reluctant to do so as it had no experience in managing it. Indeed, it is these structural reform measures that become the IMF's Achilles heel in its involvement in Indonesia. It one of the major causes of the mishandling of the crisis, resulting in the very deep and protracted crisis.

1997 - 1999: Difficult Recovery, Difficult Reform

Unlike the Thai and other previous IMF-supported programs, Indonesia's program has a strong structural reform component. Subsequently it became an integral part of IMF's approach, although the current Managing Director, Horst Koehler, has de-emphasized it. However, in the Indonesian case, it cannot be easily taken out from the program as progress in implementing an economic recovery program is constantly threatened by entrenched vested interests, corruption and poor governance, as well as lack of institutions and administrative capacity.

It should be noted that at the time of the Indonesian program any such agreement with the IMF was only announced, as the official document was not made available to the public. It was not long there after, following a lot of criticisms, that the IMF agreed to henceforth make such agreements public. As stated in the MEFP structural reforms were aimed at promoting greater transparency in policy making and competition to support ongoing restructuring of the economy. In regard to this the government intended to speed up its structural reform program through further trade and investment liberalization, and deregulation and privatization. Indeed, the public and the media focused their attention on the structural reform component of the program, and generally found that it did not go far enough. Nevertheless, it helped restore confidence, which proved to be short-lived.

As mentioned before, on 1 November the government announced the closure of 16 banks. Panic broke lose, leading to large withdrawals by depositors even from banks that were generally believed to be healthy. Public confidence in domestic private banks was shattered, literally overnight. Meanwhile, in cooperation with the Bank of Tokyo and the Monetary Authority of Singapore, BI began to intervene in the market to stabilize the rupiah. The government also issued a series of policy measures to implement the deregulation component of the program.

By the third week of November the crisis had hit Korea, resulting in renewed volatility in regional currency markets. The concerted intervention in support of the rupiah was terminated as it was felt that it could no longer be effective under those circumstances. In addition, President Soeharto showed great reluctance to implement the program. The September decision to cancel the implementation of large projects was reversed for 15 projects that were linked to the Palace. One of the 16 liquidated banks that was owned by Soeharto's son was allowed to continue to operate under a different name. In the midst of the crisis Soeharto gave approval for the first private petroleum refinery plant, costing $3.2 billion, to be built by a consortium that included his son.

The various policies introduced by the President who tried to reassert his authority created even greater uncertainties. In early January 1998 the President presented a draft budget to the Parliament that was different from the one that was outlined in the IMF-supported program. The market reacted negatively, causing the rupiah to plummet. The final straw came when the international media reported the alleged unhappiness of the IMF with the way Indonesia implemented the program (*Washington Post*, 8 January 1998). The rupiah hit the "psychological level" of Rp 10,000/$ (compared to Rp 5,000/$ at the end of December 1997), leading to an outbreak of panic buying. Supermarkets were emptied in no time. The IMF team had to come back to Indonesia to "rescue the rescue program".

Within a few days a new agreement was reached. It was a "strengthened" program that was signed by the President himself on 15 January 1998. It came to the surprise of many that Soeharto was willing to sign the agreement covering a program that included the commitment to bring all off-budget resources (controlled largely by Soeharto) into the budget, to again cancel infrastructure projects that were recently reinstated, to discontinue any government support given to the National Car Project (of Soeharto's other son), as well as to discontinue any budgetary or extra-budgetary support to the state-owned aircraft industry, IPTN, which was the pet project of Soeharto's favorite minister, Habibie. The press interview given by Soeharto following the signing of the agreement did little to convince the public that he was serious in implementing the program. If anything, it became all the more clear that Soeharto had his own plans, that was soon to become more apparent.

Soeharto established a Council for Economic and Financial Stabilization, chaired by himself, to undermine his economic team in the Cabinet. On 22 January 1998 the rupiah fell to its historic low of $17,000/$, following the nomination of Habibie as a vice presidential candidate by Soeharto's party, Golkar. The President used the collapse of the rupiah to discredit the IMF-supported program. Then in mid February, almost out of the blue, he indicated an interest in adopting the concept of a currency board system (CBS). In spite of the opposition by the Governor of BI to this idea, on 1 March, in his accountability speech to the People's Consultative Assembly (MPR), President Soeharto proposed a course of action that he called "IMF plus", which included the possible adoption of the CBS. In the second week of March, President Soeharto was re-elected for a seventh term. Subsequently the IMF announced that it was postponing the release of the second trance of its financial assistance because of concerns about Indonesia's commitment to the recovery and reform program, resulting in serious slippage in implementation. The slippage included: monetary policy being too loose; questionable personnel changes within BI, failure to lift the monopoly of Bulog, the state logistics agency; and circumvention of the agreement to abolish the plywood and clove cartels (under the control of a Soeharto crony and son, respectively). During the period of standoff with the IMF the economy continued to deteriorate rapidly. The condition was most serious in regard to the financial position of the domestic banking system.

A new Cabinet was announced on 14 March. Its first big task was to re-establish relations with the IMF. On 17 March an IMF team returned to Indonesia. A supplementary MEFP was submitted on 10 April following successful negotiations under the Coordinating Minister for the Economy, Ginanjar Kartasasmita. This was the first MEFP that addressed to debt problems of private corporations. But Soeharto's days were numbered. Riots began to break out and demonstrations demanding him to step down were on the rise. The announcement on 4 May of a 71% increase in fuel prices and a 20% increase in electricity prices provoked an escalation of social unrest. It culminated in a two-days rioting that left Jakarta devastated. As efforts to shore up his power were unsuccessful, President Soeharto stepped down on 21 May. He handed his power over to his Vice President, Habibie.

On the next day Habibie announced his Cabinet. Ginandjar Kartasasmita was retained as Coordinating Minister for the Economy. On 29 July 1998 under Ginandjar's leadership a new IMF-supported program was drafted. In comparison to the old program, it contained a strategy for corporate restructuring and a more elaborate bank restructuring program.

Table 1 List of Indonesia's IMF Supported Programs
31 October 1997 - 7 June 2002

Date	Agreement	Signatory (ies)	IMF Review
31/10/1997	MEFP	MoF, Gov.BI a)	
15/01/1998	'Strengthened ' MEFP	Pres. Soeharto	
10/04/1998	Supplementary MEFP	Coord. Minister b)	completed
Soeharto's Seventh Term			
24/06/1998	Supplementary MEFP	Coord. Minister b)	completed
Habibie Government			
29/07/1998	New MEFP*)	Coord. Minister b)	
11/09/1998	Supplementary MEFP	Coord. Minister b)	completed
19/10/1998	Supplementary MEFP	Coord. Minister b)	completed
13/11/1998	Supplementary MEFP	Coord. Minister b)	completed
16/03/1999	Supplementary MEFP	Coord. Minister b)	completed
14/05/1999	Supplementary MEFP	Coord. Minister b)	completed
22/07/1999	Supplementary MEFP	Coord. Minister b)	**suspended**
Wahid Government			
20/01/2000	New MEFP+)	MoF, Gov.BI, Coord. Minister c)	
17/05/2000	Supplementary MEFP	MoF, Gov.BI, Coord. Minister c)	completed
31/07/2000	Supplementary MEFP	MoF, Gov.BI, Coord. Minister d)	completed
(New Wahid Cabinet)			
07/11/2000	Supplementary MEFP	Gov.BI, Coord. Min. e)	**suspended**
Megawati Government			
27/08/2001	Extended MEFP")	MoF, Gov.BI, Coord. Minister f)	completed
13/12/2001	Extended MEFP")	MoF, Gov.BI, Coord. Minister f)	completed
09/04/2001	Supplementary MEFP	MoF, Gov.Bi, Coord. Minister f)	completed
07/06/2001	Supplementary MEFP	MoF, Gov. BI, Coord. Minister f)	???

*)Second Arrangement; +)Third Arrangement; ")based on Third Arrangement.
a) Mari'e Muhammad and Soedradjad Djiwandono
b) Ginandjar Kartasasmita
c) Bambang Soedibjo, Sjahril Sabirin, Kwik Kian Gie
d) Bambang Soedibjo, Anwar Nasution, Kwik Kian Gie
e) Rizal Ramli, Anwar Nasution
f) Boediono, Sjahril Sabirin, Dorodjatun Kuntjoro-Jakti

For the next one year, six successful reviews of the program took place (see Table 1). But the Habibie government was entangled in a serious scandal of political financing (the Bank Bali scandal) to help win his election as president. The scandal perhaps involved Habibie himself, a number of his ministers, the GOLKAR party, and allegedly also the Governor of BI. The Governor of BI was taken to court, sentenced, but following an appeal he was later acquitted, while some ministers have been sentenced, but others have not been investigated at all). The government refusal to publicize the audit on Bank Bali by PricewaterhouseCoopers, as demanded by the IMF led to a second standoff with the IMF, resulting in a suspension of the program in September 1999.

At the General Session of the People's Consultative Assembly in October 1999, Habibie's "accountability report" was rejected by 355 votes to 322. He decided to withdraw from the presidential race. Although Megawati came out as the "winner" in general elections in June, because her party, PDI-P, won the largest votes, she lost against Abdurrahman Wahid, who joined the presidential race at the eleventh hour. There was the hope that from then Indonesia will be on its way towards sustained recovery.

Since 2000: Slow Recovery without Reforms

The honeymoon period following the election of Abdurrahman Wahid as President under a more democratic system was only a brief one. It basically ended with the announcement of the National Unity Cabinet. Wahid's cabinet was a great disappointment to many. Firstly, it did not reflect the spirit of "reformasi" (reform) because it was not free from individuals that were associated with the *status quo* forces. Secondly, it was regarded as a "political" cabinet rather than a cabinet that can deliver the reforms because it incorporated all major political parties with diverse interests and agendas. Thirdly, the capability of the economic team was highly questioned as it consisted of politicians from different parties (and some military officers) with no technocratic background.

Abdurrahman Wahid, known as Gus Dur, was fully aware of these shortcomings. He had consciously made a political "trade off" between effective government on the one hand and national unity and reconciliation on the other hand. Gus Dur was of the view, even before assuming the Presidency, that national unity and reconciliation should be given highest priority. He was deeply concerned with the political polarization in the country. This had motivated him to run for the Presidency himself in order to prevent a deepening rift within the nation between the nationalists, represented by Megawati, and the Muslims that are organized into different groups and factions that initially rallied behind Habibie.

The economic situation of the country remained dire. The President, however, was least interested in the economy. There was the hope that he would grow in his job and would begin to attend to the economic problems of the country. When installing the National Economic Council (*Dewan Ekonomi Nasional*) at the beginning of December 1999, President Wahid stated that the Council's main task was to advice him on economic matters, specifically to provide him with a "second opinion". He further stated that this was deemed necessary because his cabinet was the result of "horse trading" with various political parties. Gus Dur did not personally know a number of the candidates but accepted them under that guarantee. It was clear from the outset that those ministers would have difficulties working together unless there was strong leadership from the President himself or from the coordinating ministers.

Soon the media was full of reports about the lack of cooperation and coordination among members of the economic team. The media exposed the struggle between two ministers simply as a struggle between two political camps. However, observers believed that the struggle was one for the control over financial resources by competing political parties. Gus Dur was given 100 days by opinion leaders to prove that his "political" cabinet could deliver. Initially it was widely believed that this kind of pressure would have no constitutional implications. He was legitimately elected by the People's Consultative Assembly (MPR), and constitutionally only the MPR can unseat him. However, as a reaction to the earlier period, the MPR session was to meet every year Instead of every five years, and the MPR could ask for an accountability report by the President every year. The first annual session was scheduled for August 2000. There was, thus, an implicit "threat" of the possibility of a constitutionally legitimate change of government before the end of the term of the president. There was the hope that this could provide an incentive for the Wahid Administration to shape up.

After returning from his trip to Europe, Gus Dur decided to take charge of the economy himself. Despite the assistance given by his two economic councils, the National Economic Council (or *DEN*) and the National Council for Business Development (or *DPUN*), the President failed to exercise economic leadership. With a weak economic team in the cabinet, it was the executing agencies that held the key to the successful implementation of policies to revive the economy. In resolving the crisis the previous government had established new institutions, which included the Indonesian Banking Restructuring Agency (IBRA), the Indonesian Debt Restructuring Agency (INDRA), and the Jakarta Initiative Task Fore (JITF). Together with Bank Indonesia, the Ministry of Finance, the State Minister for Investment and State Enterprises, all those "crisis institutions" were to be involved in the gigantic task of *credit restructuring*, which was one of the main tasks towards the recovery of economic activities. Coordination amongst these institutions and agencies was at best very weak and of an *ad-hoc* nature.

Since the Habibie Administration there was a lot of political interventions towards those "crisis" institutions, IBRA in particular, as these institutions are where possibilities exist for mobilizing financial resources for political funding. The Bank Bali scandal was a clear case in point. There was also intervention towards state banks to conceal huge non-performing loans of politically connected companies. For the very first few days of the Wahid Administration there were also attempts by certain political groups to gain control over IBRA, the institutions that is in control of a lot of "nationalized" assets. To prevent this from happening, the strengthening of IBRA was stipulated in the new three-year IMF-supported program, agreed upon on 21 January 2000.

The new program canceled the 29 July 1998 program and would extent to December 2002. As will be elaborated upon later, this new program incorporated a medium-term agenda with four components, namely a medium-term macroeconomic framework, restructuring policies, rebuilding economic institutions, and improving natural resource management. The medium-term macroeconomic framework was to outline the recovery while maintaining price stability. The targets were set for a 5 to 6 percent growth over the medium term with inflation below 5 percent. Other targets included gross international reserves at about six months of imports, and a gradual reduction of public debt to GDP from more than 100% in 2000 to 65% by the year 2004. The new government was reluctant to adopt even a slightly expansionary fiscal policy. This stance was taken to limit foreign borrowing (including development assistance).

Implementation of the new IMF-supported program was extremely slow. In April Gus Dur reshuffled the Cabinet. The public responded negatively to this decision, suspecting that the new ministers were to become Gus Dur's instruments in his drive to mobilize financial resources for political purposes. In addition, it also became apparent that the Wahid government was not serious in dealing with the KKN (*korupsi, kolusi, nepotisme* or coruption, collusion, and nepotism) issues. In fact, it was itself already entangled in such issues. By June 2000, there were three cases of KKN that had links with the President. One of this was the Bulog scandal (Bulog-gate), which eventually led to his removal from office.

IMF loan disbursements were delayed because of the above as well as the poor implementation of the new program by the economic team, which was basically opposed to an involvement by the IMF. However, public pressures began to mount for the government to be serious about its recovery and reform program. In May and again in July, the government issued a supplementary program, and again in July. The August session of the MPR began with the possibility that some of its members would mount a serious effort to impeach the President. His "progress report" was poorly received. In response to the criticism the President agreed to delegate much of the authority for day-to-day administration to the vice president, Megawati. On 29August he also streamlined his Cabinet and installed a new economic team, headed by Rizal Ramli, who was openly critical of the IMF.

Nevertheless on 7 September the new economic team issued a new Letter of Intent and a supplementary MEFP which was to become the basis for further IMF support. The document stipulated a 10 Point Economic Recovery Program, which was known to be drafted by the new Coordinating Minister himself. This was to give "ownership" to the program, which until then was largely prepared and drafted by the IMF team. This 10 Point Program consisted of the following:

- Maintain macroeconomic stability with the support of IMF/World Bank/ADB.
- Reduce unemployment by creating jobs in all regions.
- Improve agricultural productivity and farmer welfare.
- Increase non-oil export revenues, particularly in manufacturing and agro-industry.

- Promote domestic and foreign equity investment.
- Expedite banking and corporate restructuring.
- Accelerate privatization of state-owned enterprises.
- Initiate comprehensive small and medium scale enterprises (SME) development program.
- Ensure sustainable development of natural resources.
- Implement economic decentralization through an orderly and phased transition.

Many of the points in this new program were never translated into plans of action. In November the government and the IMF met to discuss the (third) review of the program, which was the first review under the new economic team. Implementation of the program was deemed to be too slow. Ramli complained that the IMF was pressing too hard. He argued that it was difficult to implement every reform, while the country was going through a complex transition to democracy. In December the IMF suspended the further disbursement of its funds. In February 2001 Rizal Ramli went to Washington, DC for talks with the IMF. It failed to break the deadlock. Rather surprisingly, on 23 February the World Bank announced that it was sharply reducing its assistance to Indonesia under the new program. Restoration of higher funding levels was made conditional upon economic reforms and improved governance.

The suspension was a major blow to Indonesia's foreign credibility. However, as stated by Dick (2001), it "served the government's political agenda by showing the government as standing up to foreign pressures." Although the IMF had become as much hostage to the government as vice-versa, it did not give in. Yet, in securing its objectives, the IMF was drawn more closely into the political process. In a sense, the IMF was the remaining voice for policy discipline. Dick (2001) argued that it remained an open question whether continuing IMF tutelage is a good or a bad thing. There is a kind of "moral hazard" in the nature of the support program. It "creates perverse incentives for the government to act irresponsibly in public, while making excuses and apparent concessions in private." It is not unusual that the government would evade responsibility by portraying the IMF as imposing harsh or unrealistic discipline.

In April the IMF sent another high-level-mission to Jakarta to get the relationship moving. But this mission slipped quietly out of Jakarta. The IMF insisted that the government revised the state budget because of the danger that the budget deficit would be blown out by the growing economic and political instability to a level of 6% of GDP. Relations between the President and the Parliament had become very tense. The President was not willing to respond to the two Memoranda from the Parliament in relation to his involvement in the so-called Bulog-gate. In his effort to deflect his critics, the President made a plan to hand over "constitutional duties" to the vice president. However, Megawati rejected the plan. On 30 May the Parliament called for a special session of the MPR. That was the beginning of Gus Dur's ending.

A special session of the MPR was initially scheduled for 1 August. President Wahid made it known that he would not attend the session because he regarded it as unconstitutional. On 22 July he wrote a letter to the MPR board stating the above. In response to this, the special session was brought forward to 23 July. In the evening of 22 July the President declared a state of emergency, which allowed him to dissolve the Parliament, and with that the MPR would no longer exist. The decree was ignored by the MPR, and on 23 July a Supreme Court decision stated that the decree had no constitutional basis. There was little support left for President Wahid. He was dismissed by the MPR for refusing to make himself accountable and for issuing the decree. The MPR elected Megawati as Indonesia's fifth President, the third in just 40 months after the fall of Soeharto in May 1998.

It took Megawati about three weeks to form her Cabinet. There was a lot of praise for the economic team in the Cabinet. Indeed, they moved swiftly to mend relations with the IMF. On 27 August the government produced a MEFP, which was built upon the MEFP of 20 January 2000 (the 3rd Program) as the basis for renewed IMF support. This led to the disbursement of a $400 million loan. Another "extended MEFP" was issued on 13 December, with a request to the IMF to extend the program to December 2003. Two supplementary MEFPs were issued in April and June 2002. A review that was to be completed before the end of September 2002 was not concluded. This suggests the limited capacity of the government to implement the program. Is this mainly because of the nature of the program or because of the weak economic and overall leadership of the country? Meanwhile there were increased calls for the government to terminate the program with the IMF when it ends in December 2003. A small group has demanded that the program be ended in December 2002.

The Megawati government has entered its second year. Megawati has passed her first year in office albeit not with flying colors. The media and public opinion have been rather harsh in evaluating the performance of her government in its first year. The general view is that the government has failed to implement the necessary reforms. This is particularly the case with legal reform. Political reform and economic reform have been slow. The economic recovery program was kept on track largely through the IMF-supported program. Yet, the ability of the IMF to act as the "police" in maintaining policy discipline may be waning, perhaps more rapid than generally anticipated.

Although the economy grew by about 3.5 percent in 2001, this is not good enough for Indonesia in view of the need to create job opportunities for the 2.5 million people entering the work force each year. Observers are of the view that a 3 to 3.5 percent growth rate is the "natural" growth rate for the Indonesian economy, this natural rate being the result of population growth. It cannot be regarded as an achievement of the government.

The Indonesian economy can be said to be recovering if it can grow again by 6 percent or more per annum. However, this higher growth rate must be accompanied by its sustainability and improved social justice and greater equity. That is why Indonesia's agenda for economic recovery must include wide-ranging reform measures, covering improved economic governance and the establishment of new economic institutions. This is not an easy task.

In the meantime, efforts to rehabilitate the failed banking and financial system have not been all that successful despite their high cost, particularly to the government. The burden to rescue failed banks and to recapitalize others is carried by the government through its budget that is already very tight. And this burden will be felt for many years to come. It is the government that bears the costs of the financial crisis of 1997/98 which largely originated with the private sector. The domestic debt of the government increased from virtually nothing at the onset of the crisis to about 50 percent of GDP.

In addition, private debt restructuring has been extremely slow. Many private companies have been trying to get out of the problem by being bailed out by the government. A few, politically connected business groups have been rather successful in soliciting the government's helping hand. However, this too resulted in higher contingent liabilities on the part of the government.

Private assets that fell into the hands of the government in exchange for the government's assistance to banks are being handled by the Indonesian Banking Restructuring Agency (IBRA). It is the policy of the government to dispose of these assets as quick as possible. The process has been extremely slow and frustrating. Apart from problems non-cooperation by previous owners, the agency itself suffers from a deficit of competence and transparency, perhaps also honesty, and the inherent difficulties of restructuring. But equally problematic has been the problem of political interference. The sale of these private assets is one source of funding political activities. The Bank Bali scandal during the Habibie presidency exemplifies this problem.

The government's policy to finance up to a significant portion of the budget deficit with domestically mobilized resources is a good way to force IBRA to expedite the process of assets disposal as well as to accelerate the program of privatization. Both asset sales and privatization are expected to finance about 70 percent of the budget deficit, the remaining 30 percent being financed through foreign assistance.

The tight budget has also been helped by the willingness of donor governments to reschedule public external debt service payments. This rescheduling exercise through the Paris Club has been repeated for three times and in all likelihood will have to be repeated again in the years to come to give Indonesia the necessary breathing space to overcome the bunching of debt, both external and domestic, in 2003 to 2006.

Central government development outlays have significantly decreased in the last few years. This is also caused by fiscal decentralization as part of the implementation of regional autonomy. It is as yet unclear as to how local governments will allocate their spending for infrastructure, education and health, expenditures that have impacts on the country's future growth potentials.

In the first few years, there are likely to be problems in the implementation of regional autonomy. Capacity in the regions is still weak, but problems in the implementation are caused to a large extent also by the absence of clear implementation regulations. In addition, local governments are trying to maximize local revenues in the short term by introducing new taxes and other user charges. Many of these new taxes and user charges do not make sense and result in high economic cost. Efforts are being made by the central government to control this but with mixed results. There is also the problem of the sharing of revenues from natural resources between the central and regional governments. Disputes on this matter have caused problems for investors in particular in mining and forestry. The weak government at the center is not helpful to resolving this problem.

Perhaps, the bright side of the picture is that the country has been spared from major political upheavals since Megawati assumed the presidency. There is "quasi" stability. There is political guarantee, reiterated recently by the Chairman of the People's Consultative Assembly (MPR), Amien Rais, that Megawati would stay through 2004.

The government has not been at the forefront in promoting the country's reform agenda. Neither is the parliament. In fact, the parliament has been blocking a number of efforts by the government. Megawati's government appears to suffer from a serious paralysis. She herself is not a champion of the reform. In the political field, she is on the conservative side. In the economic field, she lacks the ability to comprehend the scope and depth of Indonesia's economic problems.

The "muddling through" scenario is still as valid for Indonesia today as it was a few years ago. There are still no political breakthroughs and none is expected to happen in the foreseeable future. Indonesia and the leadership are still in a state of drift. In the short term perhaps even this "quasi" stability is not bad. However, the longer term prospects are worrying if such "quasi" stability continues for an extended period. This stability is characterized by the absence of political upheavals but there is only little movements, especially in pursuing the country's reform agenda.

THE PROGRAMS AND POLICIES

Indonesia's recovery program, as formulated in its first IMF-supported program, is built around three main pillars: First, a strong macroeconomic framework. Second, a comprehensive strategy to restructure the financial sector. Third, a broad range of structural reforms. Subsequently, a fourth element has been included, namely measures to restructure corporate sector debt.

Macroeconomic Policies

Fiscal Policy. The government's fiscal policy was initially very tight, aimed at a surplus of 1% of GDP. To achieve this objective, the government began with a program to adjust administered prices of petroleum products and electricity, with a view to eliminating subsidies for these products. Other measures included the introduction of local-sales tax on gasoline, increased revenues from the luxury sales tax, and increased revenues through land and building tax. However, most importantly was the plan to improve tax administration in general and the structure of the tax system. In addition, it finally took steps to consolidate all off-budget funds into the budget.

The target of a 1% surplus in the 1998/99 budget was abandoned due to the sharp depreciation of the rupiah and the deterioration of the economy. Additional measures to strengthen the budget were introduced. These included the increase in excises on alcohol and tobacco, and the removal of all VAT exemptions. As described earlier, the government canceled 12 major infrastructure projects, many of which were to be undertaken by Soeharto's cronies or children.

Continued sharp deterioration in economic conditions in the first quarter of 1998 greatly endangered the budgetary position. It was estimated that the budget deficit could increased to 6% of GDP. Additional measures were introduced to limit the deficit to about 3% of GDP. This level was determined by the possibility of additional foreign financing. The further deepening of the crisis, following the social turmoil and political changes, put severe pressures on the budget, especially since the government introduced a social safety net (SSN)program to alleviate the impact of the crisis on the poor. The overall cost of the SSN program was initially set at about 7.5% of GDP. There were few options left to reduce the deficit, except for further cuts in infrastructure projects.

By July 1998 the new government under Habibie formulated a new program. In view of the above developments, the IMF allowed Indonesia to run a fiscal deficit of up to 8.5% of GDP to provide room for increased social spending. However, as it turned out, the social impact of the crisis was less severe than initially estimated. This high level of deficit was never reached. In addition, implementation of many development programs was slow, mainly due to administrative delays. During the first five months of the fiscal year, the budget recorded a small surplus. Increased criticisms by the public on the implementation of the SSN programs led the government to develop an internal government oversight mechanism to ensure accountability as well as schemes to cooperate with local governments and civil society. The actual budget deficit in 1998/99 was only 2.1% of GDP. It failed to deliver the planned stimulus.

The 1999/2000 budget was projected to experience a deficit of almost 6% of GDP. This deficit was to be financed not only from external resources but also from bank asset recoveries. A "high quality fiscal stimulus" was to be achieved through better targeting and monitoring of public expenditures. With the assistance of the IMF, the government began to outline structural fiscal reforms, including fiscal decentralization. The latter was to response to the decentralization program that was approved by Parliament and would begin as soon as in 2001. Due to development spending shortfalls, the fiscal deficit for 1999/2000 was much lower than projected.

In 2000, the budget year was moved to coincide with the calendar year. The 2000 budget was drafted by the new Wahid government. This budget was based on five principles, namely: (a) to strike a careful balance between supporting the economic recovery and starting the process of reducing government debt; (b) to continue to avoid domestic bank financing; (c) to initiate a range of structural tax reforms; (d) to start the process of gradually reducing untargeted subsidies; and (e) to begin to restore public sector wages. A budget deficit of 5% of GDP was expected, which was to be financed about equally from foreign sources and domestic sources (asset recovery and privatization). In the end, higher oil prices helped to reduce the pressures on the budget.

Given the high level of debt, especially domestic debt, that had been building up during the crisis, the 2001 budget was designed to restore fiscal sustainability over the medium term. One major component of the policy measures to achieve this goal is the reduction and restructuring of subsidies, a politically sensitive and difficult issue to handle for the government, particularly in the new political environment. The original 2001 budget deficit was set at 3.7% of GDP. The Megawati government that adopts a conservative fiscal policy stance, as its predecessors, was able to contain the budget deficit within that target. As part of its medium-term fiscal consolidation strategy, the 2002 budget targeted a further reduction in the deficit to 2.5% of GDP. Domestic budget financing was targeted at 1.4% of GDP. The draft budget for 2003, recently submitted to the Parliament proposed a budget deficit of 1.5% of GDP. Fiscal sustainability continues to be a serious challenge in the years to come due to the high level of public debt and the pressures of fiscal decentralization..

Monetary Policy. From the outset the government was determined to adopt a tight monetary stance, essentially to support the exchange rate. The wisdom of achieving exchange rate stability as an objective for monetary policy (by using interest rates) has been questioned. The ceiling on base money, which is a main performance criterion in the program, would be adjusted automatically in line with the net international reserves position. Monetary policy remained focused on controlling inflation. The implementation of this policy, however, was hampered by problems in the banking system. As a consequence of the closure of 16 banks discussed earlier, the public had shifted sizable amounts of deposits to state and foreign banks. This led to a bifurcation of the banking system: a large number of banks faced liquidity shortages and were unable to obtain sufficient funds in the interbank market (even at interest rates of up to 75%), while a smaller group of banks became very liquid and were trading amongst themselves at a low rate (of 15%). This had complicated the task of monetary policy. Bank Indonesia (BI) had to provide liquidity support to distressed banks, while withdrawing funds from banks with excess liquidity. The IMF had voiced its concern about monetary loosening. By the end of 1997, as discussed earlier, interest rates were further increased but the rupiah continued to fall.

The liquidity support to banks led to an expansion of central bank credits. In response, monetary policy was further tightened to bring the exchange rate to a more appropriate level and to reduce inflation.

From mid 1998 BI introduced a new system to strengthen monetary management. The system whereby interest rates on SBIs (central bank paper) are set administratively was replaced by an auction system. This will also promote the emergence of a market-determined term structure of interest rates. By late 1998, the Habibie government was becoming more concerned about the impact of high interest rates on the banking system and the corporate sector. The mood was to introduce a more "flexible" monetary policy, to reduce interest rates but at the first sign of inflation or weakening of the exchange rate a tightening of monetary policy would be reintroduced. During the last quarter of 1998, the base money was allowed to grow by 6%. The rise of base money above the target in February 1999, largely due to uncertainty about the bank restructuring program, led to a new round of tightening. For fiscal year 1999/2000 as a whole, the base money increase was set at 9.5%.

BI which had become an independent institution since mid 1999 focused its monetary policy on the control of inflation, more precisely on the so-called "core" inflation. It faced continued pressures to reduce interest rates, and often tried to accommodate those pressures. On the other hand, it did not try to tighten monetary policy further when there were increased inflationary pressures resulting from sources beyond its control, such as adjustment of administered prices or confidence problems. The issue of independence of the central bank remains controversial, and the unresolved revision of the Central Bank Law is another main factor that weakens BI monetary management. It should also be mentioned that for an extended period BI was headed by a Governor that was sentenced by the court but refused to resign, and more then half of its directors had tendered their resignation but remained in place so long as their replacement cannot be decided upon given that revision of the Law remains a pending issue.

At the end of December 2001 the government admitted that it was unable to keep base money growth within the target. This was blamed on prolonged political instability and uncertainty over the direction of economic policies. Furthermore, the impact of upward adjustments in administered prices has added to the higher inflation since mid-2000. The policy of the Megawati government is to restore single digit inflation by the end of 2002. To this end, BI will gradually reduce base money growth to 12-14% by the end of 2002 from about 20% at the end of 2001. By mid-2002, inflation had been brought down, and interest rates began to fall. It remains to be seen whether this would help stimulate the economy that has experienced a weakening, both due to internal conditions and external developments.

Financial Sector Restructuring

The critical importance of financial sector restructuring for the success of the recovery program has been realized from the outset. The main challenge was to be able to overcome the problem of high nonperforming loans (NPLs) of the banking system. There was, in fact, great underestimation of the extent of NPLs in both private national and state banks.

A four-part restructuring program was undertaken. The first measure taken was to close insolvent banks. This led to the closure of 16 banks on 1 November 1997. The second was to require weak, but viable, banks to formulate and implement rehabilitation plans. The third was to resolve the specific problems of state and regional development banks. A plan to merge state banks was also announced on 1 November. The fourth part was to improve institutional, legal, and regulatory framework for banking operations. On the latter, prudential regulation enforcement, a key task in strengthening the financial sector, has been attempted through the establishment of a graduated system of penalties for noncompliance. This could culminate in the withdrawal of banking license. To strengthen the institutional infrastructure for banking, the following measures were taken: (a) revise the legal framework for banking operations; (b) improve transparency and disclosure in banking; (c) level the playing field for foreign investors in banking; and (d) eliminate all restrictions on bank lending.

At the end of January 1998 the government announced its long awaited rehabilitation program for the banking sector. The program has two elements. The first is the government's full (blanket) guarantee to all depositors and creditors of locally incorporated banks. The second is the creation of the Indonesian Banking Restructuring Agency (IBRA) that is to become the key player in the restructuring of the banking sector.

The cost of the guarantee is huge, although it becomes real only in the case of a default. This effectively means that BI assumes the risk of the banking sector. At the announcement, the intention was to have the guarantee in place for at least two years and in due time it will be replaced by a deposit insurance system. Four years after its introduction the system is still in place and no replacement is being seriously prepared. IBRA also has a limited lifespan and will be terminated in 2004. IBRA's two main functions are to supervise banks that are in need of restructuring and to act as the management agency for assets that it acquires in the process of bank restructuring. The cost of IBRA turns out to be high as well.

A total of 54 banks, representing 40% of banking assets, were immediately brought under IBRA's supervision. In April1998 the government announced the suspension of seven relative insignificant banks while a further seven banks that could continue operate were placed under IBRA's management. The latter includes some of the largest national private banks, which comprise 20% of the banking system assets and account for 75% of the total liquidity support provided by BI to the banking system. The liquidity support given exceeded 500% of equity. The transfer of banks to IBRA was crucial for stopping the flow of liquidity support to banks and for BI to regain monetary control. However, the transfer to IBRA is only the first step in restructuring the banking sector. Its real task is to restructure the banks. This is an enormous task for such a new institution.

In the May riots, BCA, the largest national private bank, became the target of looting due to its close connections with Soeharto. This was followed by a huge depositors run, creating enormous problems not only for the bank but for the financial system as well. BI had to provide substantial liquidity support and the bank was placed under IBRA's management.

In June 1998, the 128 private banks were grouped into three categories: 32 banks were placed in category A (having CARs of more than 4%); 62 in category B (with CARs of between -25% and 4%), and 34 in category C (with CARs below -25%). Those in category C faced the prospect of being forced to close or merge with other banks unless they could raise their CAR above -25%. Restructuring of state banks has been conducted in a separate program. This too has been slow. Recapitalization of two large state banks, BRI and BNI, was completed only in July 2000.

The total cost of bank restructuring, which includes the cost of recapitalizing banks to an 8% CAR (capital adequacy ratio) and of repaying Bank Indonesia for the liquidity support provided to banks taken over by IBRA, was estimated in the April1998 IMF-supported program to amount to about 15% of GDP. This is financed by issuing government bonds. It turned out later to be much costlier and reached the order of 50% of GDP.

Throughout 1998 the conditions of banks continued to deteriorate. A comprehensive strategy was drawn to arrest this situation. Weak banks will be addressed through a combination of mergers, recapitalizations and freezings. Deposits of a frozen bank will immediately be transferred to a designated recipient bank. The bad loans of banks will be transferred to an Asset Management Unit (AMU) within IBRA. In all cases, depositors and creditors will be fully guaranteed. All bank are to achieve minimum CARs of 4% by end-1998, 8% by end-1999, and 10% by end-2000.

The bank recapitalization program did not go smoothly. By mid-November 1998, only 27 of the 54 banks under the control of IBRA was audited. There was considerable opposition to the program. Bank's owners, on their part, feared that they would loss control of the banks. There was also concern that the costly recapitalization will transfer wealth from the general public to the wealthy elite who are the principal shareholders of the banks. Essentially, the government lacked a clear and coherent program for bank recapitalization. Details of the bank restructuring program were announced in March 1999. The government closed down a further 38 banks (in category B and C), took over 7 banks (category B), and recapitalize 9 banks (category B). The recapitalization was undertaken jointly, roughly 80% by government and 20% by the original owners. Delays in the restructuring of the banks had greatly increased the cost of the exercise.

It was in January 2000 when BI publicized its estimate that the total amount of government bonds needed to recapitalize the banks would amount to about 51% of GDP. The bonds comprise two parts: (a) those needed to replace the loans made by BI to failed or taken over banks; and (b) additional bonds needed to restore a CAR to 8% by end of 2001.

IBRA was under great stress to sell off assets and restructure debt as quickly as possible. The chairman of IBRA has been replaced several times, in some cases clearly based on political consideration. This has been another cause for IBRA's disappointing performance. As discussed earlier, IBRA was to raise Rp 17 trillion in FY 1999/2000 and Rp 16.3 trillion in FY 2000 from asset sales and the earnings of its performing assets.

IBRA has faced enormous difficulties to work out the debt of some of the largest debtors. Despite its special legal powers given by the Parliament since late 1999, it was unable to deal with recalcitrant debtors and shareholders. In mid-2000 the government announced a plan to establish a Committee for Resolving the Cases of Recalcitrant Debtors. All IBRA's non-cooperative debtors and shareholders will be referred to the Committee for resolution. The Committee was established on 17 July. The Committee will also decide on cases to be brought to court. However, IBRA does not have a good record in this regard. Of the 60 or so cases that it had brought to court it lost in almost all cases. There continued to be heavy political interference towards

IBRA's activities. A new governance framework was proposed in July 2000 to ensure IBRA's independence in carrying out its mandate. A new governing board, composed of independent professionals, will be at the center of this framework. The final governance framework included an Oversight Committee, rather than a governing board.

As part of the asset recovery effort, on 7 March 2002 the government embarked on a strategy to resolve the long-standing problem of shareholder settlement agreements with former bank owners. After delays, by September 2002 a number of these debtors have made an agreement with IBRA to accelerate the settlements of their debt.

With the program of bank recapitalization essentially completed, IBRA's task has become much more demanding. Its new focus, as described in the July 2000 Letter of Intent (LOI) to the IMF, is to drive asset sales and debt restructuring, return assets to the private sector quickly, and achieve budgetary collection targets. The role of IBRA has become crucial to fiscal sustainability. It was able to meet the budgetary targets in FY 1999/2000 and FY 2000 as well as FY 2001. IBRA's target for 2002 is a net cash recovery of up to Rp 35 trillion. However, the challenge appears to become greater as attractive assets have been sold off and the economic prospects remain far from bright.

Nationalist sentiments and interference by various political interests have made the sale of assets a difficult and frustrating one. The sale of BCA was successful but the process took about 2 years to complete. The sale of another private bank, Bank Niaga, is another big headache for IBRA. Allegations that IBRA has attempted to bribe members of Parliament to smoothen the process of the Bank Niaga sale may end up in a failure to sell the bank.

Many issues regarding policies on and the handling of the banking sector during the crisis will continue to preoccupy analysts for many years to come. Was there a better way for BI to rescue banks in the wake of the large bank runs? What needed to have been in place before the closure of the 16 banks in November 1997? Should a new, single institution like IBRA be given the responsibility to manage such a huge task?

Structural Reforms

As discussed earlier, structural reform programs have become an important part of the IMF-supported recovery program. Fundamental structural reforms that were identified included further liberalization of foreign trade and investment, dismantling monopolies and price controls, greater private sector participation in the provision of infrastructure, and expansion of the government's privatization program.

Liberalization of Trade and Investment. This part of the structural reforms is essentially a continuation of the policies that have been put in place since the early 1990s. On tariff reduction, the program extends the tariff reduction schedule issued in May 1995 and June 1996. However, specific attention was given to certain sectors that continued to be protected because of pressures from vested interests, such as petrochemical products and iron and steel. Agricultural trade was also liberalized. The import monopoly of Bulog on wheat and wheat flour, soybeans, and garlic was eliminated. Export taxes and various types of export restrictions on a number of commodities were eliminated as well. The joint plywood marketing body, controlled by a Soeharto crony, was abolished.

All import restrictions on all new and used ships were abolished. They were initially introduced to protect Habibie's ship building project. There was also mentioning about the discriminatory treatment in favor of the National Car Project, owned by a Soeharto son. The domestic trade of agricultural products was fully liberalized. This included clove trade, which was monopolized by a Soeharto son. The administrative retail price for cement was also eliminated.

In March 1988 a number of commitments were made to reduce tariffs to an end date in 2003. Since then liberalization of trade and investment was no longer a major component of the program.

As discussed earlier, the structural programs listed above were one of the causes for Soeharto's silent (and occasionally open) opposition to the IMF-supported program. His reluctance to implement many of those commitments, which characterized the mishandling of the crisis, has led to the deep crisis. Rather than helping to restore confidence, the IMF-supported programs resulted in a further erosion of confidence because of the failure to implement and to deliver.

The circumstances that led to the inclusion of the structural reform programs have been discussed earlier. A policy question which will be raised again and again in the future assessment of the Indonesian case is whether the structural conditionalities should have been introduced only after the initial crisis had been resolved.

Deregulation and Privatization. Some measures to promote domestic competition have been included in the above discussion. Most important is the phasing out of import and marketing monopolies and price controls on agricultural commodities except for rice and sugar.

A comprehensive program was drafted to review public sector expenditures, including of state-owned enterprises and strategic industries. This was to be become the basis for an accelerated program of privatization. In particular, promoting competition will be undertaken by accelerating privatization and expanding the role of the private sector in the provision of infrastructure.

The initial step was to sell shares in some state enterprises that were already listed on the stock exchange and were operating in a competitive environment, including PT

Telkom (domestic telecommunications), PT Indosat (international telecommunications) and PT Semen Gresik (cement production). The next batch of privatization would include enterprises in plantations, infrastructure, mining and manufacturing, including Pelindo II (ports infrastructure and management), PT Perkebunan Nusantara IV (palm oil plantation) and PT Jasa Marga (toll roads).

A masterplan for the restructuring and privatization of all state enterprises over the medium term was released in late 1998. It provides for the review of the regulatory framework in the key privatized sectors. The privatization program on the basis of the masterplan began to implemented in 1999/2000, with a modest target of receipts of $1.5 billion, or 1% of GDP. A special audit was undertaken on the three most important state enterprises, Pertamina (oil), PLN (electricity) and Bulog (logistics agency). Both the restructuring of the oil sector and the power sector was outlined in the March 1999 Supplementary MEFP to the IMF. The audits were completed in June 1999.

The economic team in the Wahid government appeared to be less enthusiastic about the privatization program. They proposed to review the program, but at the same time expected that the privatization revenue would amount to Rp 8.6 trillion during 1999/2000, much higher than the original target set by the earlier government. The new government has updated the masterplan to promote "fast-track privatization" for enterprises in competitive industries. The privatization transaction for FY 2000 was set at Rp 6.5 trillion. The change in mood on the part of the government could have been caused by necessity. As this government was determined to reduce external financing of the budget deficit, it had to resort to domestic resources mobilization. Privatization is one important source for this.

Priority was given by the Wahid government to the rapid restructuring and privatization of the telecommunications sector and the energy sector. With a new