Jan. 30, '98

Statement by [] on Indonesia's Economic Reform Program

Two weeks ago, on January 15, the President announced a reinforced economic reform program, which envisaged that Indonesia would take bold and immediate measures to overcome our serious economic problems. Today, I would like to give you a progress report, to tell you what we have already achieved and what we plan to do next.

Let me begin by bringing you up to date on our accomplishments so far. You will remember that at the time the program was announced we pledged to sweep away virtually all of the restrictions and distortions to economic activity that had accumulated over the years. We also pledged that we would undertake these structural reforms quickly, before February 1, in most cases. At the time, we ourselves realized that this objective was very ambitious, since the breadth, the depth and the speed of these planned reforms had few parallels, either in our past history or in the experience of other countries. In effect, we were pledging to recast the economic framework of our country in the span of just a few short weeks.

This is why I am very pleased to tell you that we have fulfilled these pledges, a week ahead of schedule. All of these measures have already been announced in various places on various occasions, but it still might be useful to bring them all together and summarize the major actions we have taken.

- Earlier, we had stated that, in the current crisis, it was no longer possible to provide special government support to specific enterprises or projects Accordingly on January 21, decrees were issued that revoked all special tax, customs, and credit privileges previously granted to the **National Car Program** On the same day Presidential instructions were issued directing the Minister of Finance to discontinue all budgetary and extrabudgetary funding for **IPTN**, the aircraft manufacturer, effective immediately

- We had also promised that all **restrictive marketing arrangements** will be abolished, leaving firms free to produce and export their products as they wish This commitment has been fulfilled, as decrees and instructions have already been issued, which will ensure that the cement, paper, and plywood cartels will be dissolved, effective February 1

- Another key commitment was to limit **BULOG**'s monopoly solely to rice This, too, has already been done

- Our **bold structural reforms** have encompassed many other areas, as well Domestic trade in agricultural products has been fully liberalized, restrictions on foreign investment in palm oil plantations have been lifted, and tariffs on all food items have been reduced to a maximum of 5 percent Taken together, these actions will transform and strengthen our economy, not only by creating new investment opportunities for firms, but also by lowering prices on basic commodities for all of the people of the country

- At the same time, we are making sure that this process of economic transformation will take place within the context of stable overall economic environment To do this, we have submitted a **revised budget** to Parliament, which respects Indonesia s long-standing balanced budget principles, but is based on the new assumptions of zero growth and 20 percent inflation To keep the budget in balance under these conditions has required serious measures to contain government spending Civil servants will not be given pay increases this year, while domestically financed development expenditures will actually be reduced in nominal rupiah terms, despite inflation and the rupiah's depreciation Energy subsidies will also be curtailed, by gradually bringing both fuel and electricity prices back into line with world market prices, starting with an initial adjustment on April 1

- At the same time, we are making sure that the central bank will be able to implement a sound **monetary policy,** aimed at keeping inflation firmly under control Already, the President has issued a degree granting Bank Indonesia the autonomy to set interest rates in line with its objectives And, already, this autonomy is being utilized Today, Bank Indonesia announced that it has raised interest rates on is SBI certificates across the spectrum of maturities, from a range of [x-y] percent to a new range of [x-y] percent In this way, the central bank has not only brought SBI rates into line with current market conditions, but it has also signaled its determination to maintain a firm policy stance until confidence in the rupiah has been restored

In brief, we have already come a long way, in just the past few weeks But there is still much to do before the current crisis is overcome So now let me turn to the measures that we will be taking in the future You will undoubtedly recall that at the time the President announced the reinforced program, he mentioned that plans would soon be forthcoming to resolve the problems of the banking system, and deal with the difficulties of corporations which are finding it difficult to repay their foreign debts Today, I would like to announce these plans

Let me begin with the plans for strengthening the banking system Over the past several months, the waves of economic difficulties have been taking a heavy toll on the health of the banking system And as this has occurred, confidence in Indonesia's banks has begun to wane The public has been withdrawing their deposits from the banking system, reducing the amounts that banks can lend to corporations Foreign banks have become increasingly reluctant to accept Indonesia letters of credit, making it difficult for the country to obtain vital imports Even domestic banks have become reluctant to lend to each other

This serious situation demands immediate and decisive government action Accordingly, the government has decided that from today it will stand behind the commercial banks of the country and guarantee that obligations to depositors and creditors will be met Should any bank encounter difficultly in making payments, Bank Indonesia, acting on behalf of the government, will immediately step in to make sure that these payments can be made This means that the public can now rest assured their bank deposits are now completely safe and sound

At the same time, we recognize that guarantees, by themselves, are not sufficient to solve the problem Action must be also taken to resolve the underlying financial difficulties of the commercial banks For this reason, we are today establishing a new government institution, the Indonesian Bank Restructuring Agency—IBRA, for short—which is being charged with the task of bringing commercial banks back to financial health Whenever Bank Indonesia discovers that a commercial bank is in financial distress, it will be transferred to the umbrella of the IBRA The IBRA will then ask the bank's shareholders to prepare and implement an immediate rehabilitation plan If they are not in a position to do so, then IBRA will take over the task itself, either by restructuring the bank's operations and finances, or by merging it with other banks In this way, bank by bank, IBRA will build a stronger, healthier, and more competitive banking system

Finally, allow me to explain our plans to address the problem of corporate debt As the exchange rate has depreciated, it has become increasingly difficult for Indonesian corporations to service their external debts Yet it has also proved difficult for these corporations to negotiate new arrangements with their creditors, on a purely bilateral basis It has therefore become increasing important that an overall framework be developed, so that these negotiations can proceed and orderly relations between creditors and debtors be restored Equally, though, it is important that this framework remain informal and voluntary—and not involve any funds from the public sector

This is why I am pleased to note that Indonesia's creditors are now in the process of forming a Steering Committee, which will work out just such a framework, in consultation with a Contact Committee of borrowers With such a framework, it should now be possible to create a "win-win" situation for creditors and debtors alike, while minimizing the risk for both This is possible because, at bottom both creditors and debtors have a common interest, in ensuring that the corporations survive, so that they can eventually repay the creditors and earn profits for the shareholders Equally, it is clear that without action market conditions will only continue to deteriorate, and creditors and debtors will both lose

I realize that I have provided only the barest outline of the corporate debt plans A fuller explanation will be provided shortly by Mr Radius Prawiro and Mr Pen Kent, formerly a Director of the Bank of England, who is advising us on the framework

From David Robinson
To MLH3S PO05(ACHOPRA, ASINGH, BAGHEVLI, CBROWNE CCO
Date 1/30/98 9 06am
Subject currency board option -Reply

I missed last week's debate (and so apologize in advance if I am repeating arguments already made on this issue) However, I share the view of the sceptics, for (inter alia) the following three reasons

1 **Arithmetic** The impact of the interest rate/exchange rate trade off needs to be explored carefully (as Ranjit noted in the SS meeting) In Malaysia the private credit/GDP ratio is 170 percent of GDP If interest rates rose to say 50 percent for 3 months (far from impossible under a currency board) this would imply a transfer of about 17 percent of GDP from borrowers to depositors [(50-10)/4*170/100] in a period of three months, placing a huge strain on corporates/the banking system This could easily call into question the viability of the arrangement ex ante

In contrast, unhedged external debt in Malaysia is only about 18 percent of GDP or so The ringgit would have to depreciate by 75 percent (Fund definition)--and stay at this level for a year--to achieve the same cash flow effect As importantly, it would be concentrated on a far smaller group of corporates (this may be less true in Indonesia, perhaps)

I don't know the arithmetic for the other countries, although I recall that in Thailand it was similar

2 **Regional aspects** I would have thought that the regional aspect would be an issue especially if there is more downside risk on the currencies (and if there is not, we presumably don't need currency boards) At the least, a currency board in a country whose competitor's exchange rates are falling would come under additional strain, adding to the fiscal costs noted above

3 **Permanance** I continue to believe that a fixed exchange rate/ currency board arrangement is not optimal for the SE Asian countries in the longer term If markets agree, the credibility of the arrangement would be in question from the outset

In sum, I am not convinced that a currency board is a viable option, and if it were introduced, it could require huge bailouts of the banking/corporate sector in countries with high credit/GDP ratios I agree with you, though, that alternatives will need to be considered if the present situation continues, I would prefer the option of capital controls/ foreign creditors being forced to restructure their debt, which would at least impose some costs on foreigners

CC MLH3S PO05(nweerasinghe, varora) preynolds kkoch

Office Memorandum

cc: FOSS
[illegible]

To: Mr. Zamani

January 30, 1998

From: Michel Camdessus

Subject: **"Rescue Plan for Indonesia in Jeopardy," Washington Post, January 7, 1998**

Thank you for you memorandum on the above subject. Like you, I have been disturbed at the fall in the rupiah in recent weeks. However, I am sure you will agree that it is difficult to ascribe this development to comments in the Washington Post by an unnamed IMF official rather than to market participants' own assessment of the evolving situation in Indonesia and to the commentary by numerous other individuals and entities.

ASIA/PACIFIC

2 FEB 98 4: 14

Now that the Indonesian government has announced its strategy for dealing with the financial and corporate sectors and made substantial progress in implementing the structural reforms contained in the revised Letter of Intent, I would hope the we will see a turnaround in market confidence.

Let me assure you that Fund management and staff are careful in making comments to the press. The aim always is to support the reform process in member countries and help explain members' policies to markets and to the public.

cc: Executive Directors

DG
MRK
via
e-m.
JJ 4,
Forwarded to BBA.

From: "Richard P. Roulier" <Rroulier@worldbank.org>
To: MLI1S.PO14(CENOCH)
Date: 1/30/98 6:02pm
Subject: Indonesia: IMF/WB Team

Charles:

As you and I have discussed, the sheer enormity of the problems (and the needs for a rapid and coordinated response) in Indonesia suggest that "business as usual" doesn't work and that we all need to fashion a more efficient way of addressing the problems. Bottom line, our different products and deliverables, our different cultures, our different incentives impede our working together efficiently as we both recognize we must.

Reaching this conclusion is fairly easy, proposing a workable solution is far harder. I don't purport to have the answer, but I'd like first to detail some of the more obvious problems and then to suggest an approach that we might take. The "problems" listed, below, aren't the substantive problems of how we design solutions for the Indonesian crisis; rather these are the "problems" you and I and the Fund and the Bank need to address if we're going to be sucessful in then dealing with the actual substantive problems.

> The IMF and the Bank have different products to offer. The IMF looks at the macro and policy environment and provides a very rapid response to a "systemic" crisis -- it agrees with governments on the broad outlines of required policy adjustments. The Bank, on the other hand, focuses not only on the broad policy perspective but then also (a) provides the micro/institutional assistance that is necessary for our counterparts to deal with the details of implementation and (b) designs and finances a much longer-term development strategy and program. The recipe is provided largely by the IMF in its LOIs -- but then responsibility for finding the ingredients, mixing them properly and monitoring the cake while its in the oven are largely the responsibility of the Bank. Bottom line, I think our team in Indonesia has made dramatic progress in the last several missions improving the coordination between the Fund and the Bank. There is, however, still room and need for improvement to make sure that programs designed are implementable -- and are based on the valuable advice that can be offered by both the technical specialists in each institution and the regional representatives in Washington and in the field who know the country conditions, who have excellent professional and personal relationships with the authorities, and who have for many years advised the Indonesians on the matters we're now debating.

> As a result of the different products and processes in the Fund and the Bank, we've grown quite different cultures. The Fund by virtue of the crises it deals with (and of the sensitivity of information it gathers) needs to maintain a high level of confidentiality. The Bank, on the other hand, operates much more on the basis of consensus building -- which is not to suggest that information flows freely from one department to another -- but it does suggest there is a belief that value can be added by sharing information and by being aware of different approaches.

The dynamics of operating in a crisis necessitate that decisions be made rapidly In addition logistics of E-Mails and faxing data often take significant time As a result of confidentialy, need to decide rapidly and logistics of communication, it proves difficult to provide information to those in the field and/or in Washington who have both (a) a legitimate need to know, and (b) knowledge and perspectives which could benefit our team and the Indonesians

I returned from Indonesia last night I know that you've also only returned in the last 48 hours I also know that both of us must now immediately prepare to fly back out next week Still, it would be good if you and I and others from the Fund and the Bank could sit together on Monday to consider a range of possibilities that might increase our probability of

providing improved service to the Indonesians,
keeping people in our respective organizations up to date on the design and implementation of crisis-resolution strategies and programs, and
benefiting from the advise and guidance that the key players in our organizations are prepared to make available to us

The ideas I think we should try jointly to discuss are

How we might back-stop each other in our mission planning, i e , the extent to which we can be one integrated team all of whom don't have to be in Indonesia at all times -- you and I perhaps playing tag for some period so that one or the other is in the field, overlapping as we come and go, but not duplicating each other by always both being present,
How we could create common documents (for management/Board decisions and information) for our respective institutions rather than first addressing the problems and solutions in Indonesia and then needing to format the output in a different fashion -- one set of documents for the Fund and another for the Bank,
How we could communicate more efficiently with our own key players, e g , by having one "reporting cable" from the field each evening that reported back to all the key players in both institutions rather than various people on the Fund team and various people on the Bank team struggling with E-Mails and faxs to multiple parties -- trying vainly to make sure that everyone is informed and that no one is blind-sided, and
How we can assure that an integrated team approach and common reporting and information sharing won't either (a) slow the decision process, (b) impede the IMF in reaching the agreements it must reach with the government, or (c) violate needed confidentiality

I'm sure many of my ideas on the above topics will not be fully subscribed to by many on the distribution list -- I also recognize that sending this to everyone before first discussing it with everyone (sequentially up the chain of command) is not the most politic way of introducing these ideas In my defense, we simply don't have time to properly grease the wheels before getting this cart rolling My apologies if I have misrepresented or overly simplified either the Fund's or the Bank's approach in my characterizations, above Further apologies to those on the distribution list who would have preferred I solicit their ideas personally before sending this to every one

Your thoughts?

Rich

CC Masood Ahmed <Mahmed@worldbank org>, "Dennis N De

Office Memorandum

To: Mr. Zamani

January 30, 1998

From: Manuel Guitián MG

Subject: **Indonesia—MAE Mission**

A mission from the Monetary and Exchange Affairs Department will visit Indonesia for approximately two weeks. The mission will comprise Charles Enoch (Mission Chief), Alain Ize, Luis Cortavarria (all MAE economists), and Funke Orimoloye (Staff Assistant, MAE).

The mission will assist the authorities in the areas of bank restructuring and operation of monetary policy. Questions regarding this mission may be addressed to Mr. Enoch (ext. 35372).

ASIA/PACIFIC

30 JAN 98 5: 14

cc: Mr. Neiss
Mr. Enoch

cc: Foss
DVY

R:\DOC\MR\1998\MISSIONS\ED.MEM January 30, 1998 (3:00pm)

From Owen Evans
To sf
Date 1/29/98 10 36am
Subject IMF/WTO--further talk with Boonekamp

[Keila, can you add this to the collection on this topic that I gave the boss yesterday? Thanks]

Mr Fischer

Boonekamp called again this morning (Thursday 1/29) from Geneva He spoke again with Ruggiero, following my conversation with him yesterday, and he reports that Ruggiero is now calmed down and reassured Ruggiero is not going to make a fuss and will not raise these issues in the public domain at Davos but may seek to chat with you in the corridor

Boonekamp informed Ruggiero of the recent agreement to provide certain restricted Fund documents--Ruggiero had not been aware of this and greatly appreciates this step On being reminded by Boonekamp, Ruggiero recalls his conversation with the MD around the time that the original Indonesia program was being negotiated Informal communication between staff along the lines in earlier Emails is something that WTO staff appreciate and want--you may wish to be soothing on this point

Still some residual concern that the implications of the further steps re national car project in the latest Indonesia LOI remain a bit murky to WTO staff and thought that maybe there could haveperhaps been a bit more communication from Fund staff on this but given speed, pressure and deadlines, the reasons are understood Not going to be made an issue of

Cheers

CC keila,michael,ssekera,rsharer,ogoodger

Office Memorandum

To: Mr. Downes
Mr. Galbis
Mr. Enoch o/r
Mr. Neiss
Mr. Vaez-Zadeh
Mr. Suzuki

January 29, 1998

cc: DG (to handle)
JV4.

From: Nicholas Roberts NHR

Subject: **Indonesia—Draft Terms of Reference**

Attached are draft terms of reference for a staff visit during February 7-23. I would be grateful for any comments you may have by noon, Monday, February 2.

Attachment

cc: PDR

INTERNATIONAL MONETARY FUND

Monetary and Exchange Affairs Department

Indonesia

Draft Terms of Reference MAE Staff Visit

At the request of the Bank Indonesia (BI), Mr Nicholas Roberts 1/ will visit Jakarta during the period February 7-23, 1998, to assist BI staff with payment system reforms The mission will coordinate its activities closely with the Fund's resident representative, Mr Al-Eyd

I BACKGROUND AND INTRODUCTION

The BI National Payment Reform Committee has been working on a strategy for payment system reform for around three years BI has employed a number of consultants, discussed its reform plans with other central banks, and received two MAE technical assistance missions on payment issues as well as an MAE-Sponsored visit by experts from the Bank of Japan

An extensive reform agenda has been delineated but, following difficulties arising from changes to the timing of settlement at the Jakarta Clearing House in April 1996, and subsequently the emergence of critical problems in the banking sector, the pace of implementation has been slow BI's overriding priority at present is to reestablish confidence in the banking system and consistent with this the BI Payment Reform Committee has identified two critical areas for payment reforms These are adoption of new failure to settle principles and changes to the clearing and settlement cycle to allow all payments cleared through the Jakarta Clearing House to be settled before the end of the day

Measures to develop failure to settle rules in the Jakarta Clearing House based on loss sharing rules have been supported by the IMF as useful step toward implementing greater discipline in the relationship between BI and the banks and in promoting greater transparency in BI s relationship with banks These changes should help to rebuild confidence in the banking system in the short term, while ultimately encouraging the smooth introduction of an RTGS system by making banks bear the costs of risks in the existing paper system

Speedier settlement of clearings made through the Jakarta Clearing House also be useful as a confidence building measure as this will reduce credit risks

1/ Headquarters based consultant, Financial Systems and Banking Division

II MAIN TASKS OF THE MISSION

The mission will work with staff BI to refine proposals that they are to put to the Board of BI for changes to the Jakarta Clearing House clearing and settlement cycle and to establish the principles to be applied in the event that participants in the Jakarta Clearing House fail to meet their settlement obligations at prescribed settlement times Some of the main issues on which the mission will provide advice to BI staff are noted in the sections below

A Loss-sharing Arrangements for the Jakarta Clearing House

In looking to develop principles for loss-sharing the mission will emphasize that the major short term objective should be to establish a base for strict and credible settlement policies which do not rely on BI providing ready access to overdraft facilities

Placing responsibility for ensuring daily settlements at the Jakarta Clearing House on commercial banks will provide them with appropriate incentives to reduce the risks to which they are exposed through existing clearing arrangements However, placing an extra burden of risks on banks, while beneficial in the long term, will require careful implementation to avoid any short term damage to public confidence in the banking system The issues which will need to be resolved include

(1) The size of failure that the commercial banks will be asked to cover The benchmark suggested by the Lamfalussy standards is for failure to settle rules to ensure settlement in face of the failure of the participant with the largest net debit obligation However, since the Jakarta Clearing House operates as a deferred net settlement system without any real time information there are no means to limit the largest net debit obligation on any day and this could potentially be very large However, the mission will support interpreting this requirement as requiring banks to cover an amount equal to the largest net debit position recorded over the period for which statistics on the Jakarta Clearing House have been kept In due course, and as alternative interbank payment circuits begin to operate, this requirement could be made more stringent by requiring that banks cover settlement of something closer to a "potentially" largest net debit position

(2) The extent to which the loss-sharing obligations of banks are to be collateralized Lodging collateral is expensive, but if the loss-sharing requirement is to provide participants with assurance of finality the additional settlement obligation this confers on banks must be collateralized BI may want to do some calculations of the likely cost of collateral in light of the size of the "largest net debit position" which participants will be required to cover

(3) The loss sharing calculation The mission will favor a loss-sharing formula based on each bank's share in total Clearing House activity based on its "normal" level of outward debits and

inward credits The rationale for this is that each bank should share in any loss to the extent that it routinely exposes itself to settlement risk in the Jakarta Clearing House

(4) The location of the failure to settle provisions The mission will suggest that the failure to settle principles be reflected in a stand alone agreement to be signed by the banks which settle obligations at the Jakarta Clearing House The agreement could then be cross-referenced in any existing regulations of the Jakarta Clearing House Drafting a self-contained document will minimize the risks of delaying implementation of the agreement

(5) The treatment of agency arrangements Allowing banks to settle on behalf of others raises a number of potential problems If an indirect participant fails to pay a direct participant and this triggers the failure of the direct participant then all the banks which settle through the direct participant could be treated as failing Also, if a direct participant fails these will trigger problems for indirect participants using its services To avoid this type of risk BI should consider limitations on the size of exposures that any direct participant can undertake as an agent and there may need to be provision in the failure to settle rules for indirect participants to make alternative arrangements for clearing and settlement in the event that their agent is deemed to have failed A more sweeping alternative, and one which could be considered in the longer term, is to require all participants to settle directly with BI albeit that they use agents to handle the processing of their payments

(6) The degree of discretion that the Jakarta Clearing House rules should allow in the event that a bank is unable to meet its settlement obligations The mission will put the view that BI, including its Supervision Department, must be involved in any decision to trigger the failure to settle rules and it must have discretion to decide whether a bank is deemed to have failed or whether it wishes to extend a lender of last resort facilities to a bank which is considered to be soundly managed and well run Any attempt to reduce the discretion of BI in this area will likely be counterproductive as inevitably there are occasions where a bank may be subject to unfounded rumor, or errors in the clearing process Of course, the decision making process in the event that a bank cannot meet its settlement obligations must be transparent and the reasons for each decision fully documented

B Clearing and Settlement at the Jakarta Clearing House

The mission will need to establish the precise nature of the changes which BI wish to make to the Jakarta Clearing House clearing and settlement cycle In looking at the proposed changes the mission will emphasize the importance of achieving timely settlement so that the duration of unsettled interbank obligations can be reduced, the importance of documenting the procedures leading to settlement, and the importance of ensuring that all participants are clear about the new procedures and are able to comply with them ahead of their introduction The principle of speedier settlement is important for reducing credit risk, but equally implementation of changes will need to be handled carefully to avoid any adverse impacts on confidence in interbank payments

III MISSION OUTPUT

The mission will prepare a concluding statement of its findings on BI's proposals which will be left with BI as a draft and which will be finalized on return to Head Office

1

→ APD
PDR, file, OK
1.30.98

cc: HN
BBA
AS
MK
DG
D4
WT

Mr Neiss
Does CCFF apply?

SF.

INTERNATIONAL MONETARY FUND

January 29, 1998

To: Mr. Fischer HN

Subject: **Indonesia--Food Situation**

-OFFICE FDMD-

29 JAN 98 3 : 23

Attached is some information on food stocks and import demand . While there has been a significant deterioration, it is not possible to make an assessment, based on this information, how critical the situation is. I was told that World Bank staff would further look into this.

Attachment

cc: Mr. Ouattara
Mr. Sugisaki
Mr. Cross

Hubert Neiss
(4-320, ext. 37604)

ASIA/PACIFIC-

4 FEB 98 8 : 53

Food Logistics in Indonesia
January 28, 1998

Rice	Imports -	December	228,000 mt
		January	426,000 mt
		February	500,000)
		March	600,000) contracted for delivery
		April	600,000)

Stocks - Mid-January 1,200,000 mt
(down from 2 4 mmt in October)

Releases 150,000 mt per month to Budget Groups
500,000 mt to market operations

No domestic procurement until late April or May, and all indications are that BULOG will not be able to procure very much from local markets and still maintain retail rice prices at near current levels Rice prices seem to be Rp 1200-1500 per kg, up about 30 percent from six months ago

Imports can be landed at $300/mt on the basis of current contracts, perhaps 10 percent less than this if corruption is reduced Thus the monthly import bill for rice alone is $150-180 M When sold into the local markets at, say, Rp 1200 per kg, each ton will earn Rp 1 2 M, but a cost $300, for an implicit exchange rate of Rp 4,000 per USD The current (thin) market exchange rate is about Rp 10 000 per USD, so the domestic rice price is being held at about 40 percent of its border equivalent (and this domestic price is already about 30 percent higher than in mid - 1997)

Wheat and Soybeans

Soybeans have been imported commercially for several years, about 600,000 mt last year At about $350/mt CIF, that translates into financing needs of $17 5 M per month Wheat imports are about 200,000 mt per month, which at $200/mt is another $40 M per month in financing Just these three commodities will require about $240 M per month in import financing Demand may slacken for both wheat and soybeans, but we need to keep rice demand at near its current levels, and must stabilize rice prices to do that

PTimmer/rcd l \drafts\fox\timmer doc

Mr Neiss

I mentioned this to the MD. His view was that we should stand ready to step in immediately with whatever instruments we have, and to take advance steps if needed to ensure that we are there before a problem emerges.

MC 29 Jan 98

FOSS
DU4

INTERNATIONAL MONETARY FUND

emailed to SPI yet in Seoul for HN 1/30

January 29, 1998

To: Mr. Fischer HN

Subject: **Indonesia--Food Situation**

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INTERNATIONAL MONETARY FUND

January 29, 1998

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Banks, Investors Haıl Indonesıan Plan

By Paul Blusteın
Washıngton Post Staff Writer
Wednesday, January 28 1998 Page A13

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Jan 28, 98

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- The economic crisis in Indonesia is beginning to cause real pain for citizens there
- Special report Part 1 In hindsight signs of crisis in Asia were clear
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JAKARTA, Indonesia, Jan 27—Foreign investors and bankers cheered today's announcement of new plans to address Indonesia's banking and debt crises, raising hopes that Indonesia has averted a threatened collapse of its financial system

But the plans leave a number of thorny issues unresolved, ranging from relatively narrow worries over how exactly they will work to broader fears about Indonesia's political stability And the moves raised fresh concerns that the international rescue of Asia's troubled economies will bail out wealthy lenders and borrowers, helping them avoid the full consequences of foolish business decisions

Indonesia's currency, the rupiah, rallied after this morning's double-barreled announcements by the government and the International Monetary Fund, which is leading a $43 billion effort to rescue Indonesia

In the first announcement, the government said it is guaranteeing all deposits and other obligations of Indonesian banks and setting up an agency to restructure or merge banks with excessive bad-loan problems In the second announcement, the government said it is proposing that many Indonesian companies "temporarily pause" in paying their foreign debts pending a major, organized rescheduling of Indonesia's overseas obligations

The rupiah strengthened to around 10,500 per U S dollar in late Asian trading, from a morning low of about 14,000 per dollar Although trading in the currency remained light, it reversed last week's pattern in which the rupiah was plumbing record depths almost every day

The rupiah's decline has meant that most major Indonesian companies are technically insolvent because their foreign debts, denominated in dollars, have become too crushing to pay

Also heartening for Indonesia's prospects was the generally positive reaction of foreign bankers, who met this morning at the country's central bank, according to participants at the meeting The crisis has deepened in part because many foreign banks are refusing to extend letters of credit to Indonesian borrowers, raising the specter that Indonesia won't be able to buy the imported goods and food it needs to keep its economy functioning properly

At the meeting, bankers closely questioned the government's representatives on the debt issue, particularly the "temporary pause" representatives on the debt issue, particularly the "temporary pause" in debt service payments That phrase smacked of a debt moratorium to some bankers

But government officials stressed that the pause is a voluntary matter to be negotiated between debtors and creditors And a foreign banker recalled that the government's representatives said, in effect "Right now, [the Indonesians] aren't paying anyway, so what do you want to do? You want to work with the program or not?" Indonesia's notoriously poor bankruptcy courts have made it almost impossible for lenders to press claims against debtors

Although that answer struck a chord with bankers, some expressed unease about other aspects of the package For instance, to cope with the $65 billion that Indonesian companies owe to banks, "steering committees" of lenders and borrowers have been established to decide which of three broad categories Indonesia's biggest companies fit into -- those that are viable and can afford to pay much of their foreign debts, those that don't have viable business opportunities and should go bankrupt, and those that fall in between and need debt payments postponed

Foreign bankers said it was still unclear how the steering committees would make their decisions, and whether big companies could somehow use political clout to influence those decisions

"There are many moral hazards that are being created," said one banker, using the economists' term for the problems that arise when a government bails out wealthy investors, banks or companies instead of allowing the market to punish them He cited worries that, with all their deposits and other obligations guaranteed, Indonesian banks may resist mergers or changing the practices that got them into trouble in the first place

In an interview, Bijan Aghevli, the chief of the IMF mission in Jakarta, dismissed such arguments as unfair "The quid pro quo of the guarantee is banks submit to authority of IBRA to put their house in order," he said IBRA is the Indonesian Bank Restructuring Agency, established along the lines of the U S Resolution Trust Corp to rehabilitate ailing banks by selling off their old bad loans and requiring them to merge if necessary

Still, no matter how carefully drafted the economic parts of the package are, investor sentiment in Indonesia may ultimately be ruled by fears of widespread social unrest, one North American banker said

"You still have the unresolved political dynamic, which sort of overhangs the entire economic reform package," this banker said "And until that's ultimately solved, there's going to be a negative bias put on any potentially positive news "

Office Memorandum

To Mr Aghevli January 28, 1998

From Hubert Neiss

Subject **Indonesia--Banking Package**

Bijan

I am sure we will find a number of loose ends in the days to come and have to take them as they emerge One seems to me the guarantees (if any) by Indonesian banks of loans directly extended by Indonesian corporations by foreign banks

Question 1 As of yesterday, what was the share of the amount guaranteed by Indonesian banks in the total external borrowing of corporations? Presumably, this part must be included in the blanket guarantee

Question 2 Do we want new external borrowing by corporations to be guaranteed by Indonesian banks (they will probably be quite willing to do that)? I assume, no

Question 3 If we want to close this avenue for extending the blanket guarantee to the nonbank private sector, what is the best way to handle this (prohibit banks from extending their own guarantee, exclude banks' own guarantees from the blanket guarantee)?

cc Mr Fischer
Mr Guitian

From Hubert Neiss
To SFischer
Date 1/28/98 11 01am
Subject Korea, Indonesia, Malaysia

1 Korea - Debt Negotiations

Both Chung and Walker called (a) they expect agreement in principle to be announced tomorrow or Friday, (b) they encountered a last minute difficulty when Treasury (Dan Zelico) told them that a high Fund official (presumably you) indicated that the Fund was still dissatisfied with the results on off-balance sheets They asked that this be clarified I suggested that we give them our first reaction to the survey results which should be available on Friday, and, if necessary, the original team should return to explore the issue further Chung said this was agreeable David Burton is also talking to Walker and the Treasury

2 Indonesia - Monitoring of Banking Package

I just found out that Charles Enoch has already left Jakarta following his earlier plans May I (or you) suggest to Manuel that he return early next week for at least three weeks Bijan thinks he is very well suited for this job and I cannot think of another candidate that could fully function immediately, which is necessary, as next week is crucial

3 Indonesia -- Food Situation

The World Bank is very concerned and Dennis is talking to a monitoring group (Australia, US, Japan, and others), but it is not clear whether the Bank has enough data on stocks, import needs, etc to realistically assess the situation However, they will get back to us in the next two days and provide us with whatever they have The US is talking about a $400 million credit (at the market rate), for imports of wheat and rice from their surplus stocks, but there are technical difficulties (e g , who opens LCs and who guarantees) which have yet to be settled

4 Malaysia - Bank-Fund Collaboration

In a meeting with Severino and company yesterday, he complained of lack of information and coordination on Malaysia I told him that (a) he has nothing to complain about, and (b) we fully welcome the Bank's help, not only in financial sector issues, but also in the issues of corporate restructuring and governance, as well as in the assessment of the large investment projects Severino called me last night to apologize He found out that he and his bosses were misinformed internally and that, in fact coordination has been taking place and has been satisfactory I asked him to make sure Sandstrom is aware of this as he had already complained to you

CC Oevans KMoses

INTERNATIONAL MONETARY FUND

January 28, 1998

To Mr Fischer

Subject **Indonesia**

Do you have any comments before I send this?

Attachment

Hubert Neiss HN
(4-320, ext 37604)

Office Memorandum

To Mr Aghevlı January 28, 1998

From Hubert Neıss

Subȷect **Indonesıa- Bankıng Package**

Bıȷan

I am sure we wıll find a number of loose ends ın the days to come and have to take them as they emerge One seems to me the guarantees (ıf any) by Indonesıan banks of loans dırectly extended by Indonesıan corporatıons by foreıgn banks

Questıon 1 As of yesterday, what was the share of the amount guaranteed by Indonesıan banks ın the total external borrowıng of corporatıons? Presumably, thıs part must be ıncluded ın the blanket guarantee

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cc Mr Fıscher
Mr Guıtıan

R \DOC\AI\HN\127BIJAN MEM January 28 1998 (3 28pm)

1.28.98

OK

SF

HN

cc Foss

D4

cc The MD.

Office Memorandum

January 28, 1998

To The Managing Director
The Deputy Managing Directors

From Hubert Neiss and Joaquin Ferran

Subject **Indonesia Board Date for First Review**

-OFFICE FDMD-

28 JAN 98

On the basis of the original program put to the Board on November 5, 1997, the second purchase under the arrangement is to become available on March 15, conditional on observance of end-December PCs and completion of the first review The review would normally be completed around that date End-December data, however, will become available by mid-February, and the structural measures specified in the original letter of intent for implementation by mid-March have already been taken Thus the unusually long lag (ten weeks) initially provided between the test date and the review is no longer necessary, and we would suggest completing the first review around mid-February To avoid a long lag between completion of the review and release of the purchase, we would suggest at the same time modifying the schedule of purchases so that the second purchase can become available as of February 15, and subsequent purchases at three-month intervals (that is, with the more usual six-week lags after the corresponding test dates)

Specifically, we would suggest setting the Board date for February 18 [1]

LEG agrees

29 JAN 98

ASIA/PACIFIC

cc LEG
Mr Cross

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[1]The suggested date for the first full review of the Korea program is February 17, the arrangement states February 15, which is a Sunday, and February 16 is a holiday

INTERNATIONAL MONETARY FUND

1 28 96

Mr. Neiss

Please find attached a note I sent to Mr. Fischer in the Board, and his response

I have spoken to the Treasury as he requested (but did not wake Wanda as I already had the latest story from Tomas Balino)

I will touch base with Chuck later

David Burton DB

January 28, 1998

Mr Fischer

I had a call from Mark Walker, who was very concerned that Dan Zeliko (U S Treasury) had said that the IMF had "disavowed" its earlier study on off balance sheet items He wanted to know whether that was true, and where we stood on our follow-up review

I said that we had not disavowed the earlier preliminary study, and were just following up with a more complete survey This was partly prompted by information about total return swaps that had come to light (which he knew about), but we had no reason to believe that amounts involved were very large (The largest number for the total return swaps I have heard is $1 2 billion) This is consistent with what you said to the bankers on January 21

A short while later Mark Walker called back to say that the Treasury was adamant that the IMF had disavowed the earlier off balance sheet study, citing top officials and Ms Lissakers Would it be useful for you to speak to the Treasury to clarify the situation?

On the timing for the broader review, I said that the earliest the survey returns would be available was now Friday, and that I would find out how long it would take us (and the Fed people) to analyze them I have since learned that we should be able to get an idea of whether there is a significant additional problem quickly (a day or two), and I plan to get back to him and tell him that This would not involve an assessment of the cash flow implications

Separately, Peter Hayward has spoken to Terence Checki, who had been thinking of sending someone to look in detail into the total return swaps involving U S institutions, but appears to have decided against that for the time being There is a question whether it would be worth asking a rocket scientist from the Fed to go out there to look at the cash flow implications of the total return swaps we know about and anything else that comes to light, but I am worried about stirring things up even more An alternative would be to wait until the survey results come in, but that would mean a delay if there does appear to be a problem

David

P.S. The talks with the banks are going well, with pricing the main issue to be settled. Mark Walker hopes for an agreement today or tomorrow

INTERNATIONAL MONETARY FUND

TO Mr Burbon

FROM Shukur

Thanks for your note

1. Pls call Zeliko directly to tell him the situation, but after speaking to Wanda

2 Check with her on what is happening (Perhaps you have already)

3 In terms of the rocket scientist, since he/she wouldn't get there till Friday, we might as well wait to see what the survey results say *

Thanks

* But warn/ask Checchi we may want someone to leave on Friday.

Jan. 28, 96

From Ollie Goodger
To SFischer
Subject Indonesia What Next?

On your earlier question, the following comes to my mind

1 Persuade Teh and Sakakibara to be ready for supportive intervention next week (starting Monday) to prevent any backsliding in the exchange rate

2 Ask Kadhim to monitor on a daily basis the launching of the corporate debt scheme (in particular, after Kent has left there may be an occasional need to intervene in this private and voluntary process)

3 Make sure Enoch stays in Jakarta for the next 2-3 three weeks to assist putting in place the IBRA and monitor the banking scheme

4 Set a Board date for the review, I would suggest around mid-February (possibly February 18, the Korean review is on February 17)

5 With the help of the World Bank, assess the food stock situation, import needs over the next three months, and the state of the distribution system especially in the drought-stricken areas

6 Decide on the temporary second mission chief to Indonesia (I have asked David Goldsbrough to delay departure so as not to pre-empt management's decision, the ground is adequately covered this week)

Did you talk to Mr Sullivan?

On another issue, Mr Guzman may call you He is annoyed/embarrassed that

1 He was not invited to the Mexican presentations
2 He did not know about Mulhas, as his appointment did not go through his office

CC Oevans, KMoses

From Ollie Goodger (for Hneiss) (Ollie Goodger)
To SFischer
Date 1/27/98 11 04am
Subject Indonesia -- What next?

One point I forgot in my earlier note

7 Ask the Legal Department to prepare for technical assistance to put in place legal provisions as well as implementation guidelines to establish, as quickly as possible, well functioning bankruptcy procedures

CC Oevans, KMoses

Office Memorandum

To Mr Aghevlı January 28, 1998

From Hubert Neıss HN

Subȷect **Indonesıa--Bankıng Package**

Bıȷan

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cc Mr Fıscher
Mr Guıtıan

cc' (HN) BBA AS WT MEK DG D4

Office Memorandum

To Mr Fischer January 28, 1998

From Manuel Guitian *MG*

Subject **Indonesia—MAE Presence over the Coming Week**

We are as concerned as you are that there should be a continued MAE presence in Jakarta in the period following yesterday's announcement of the plan for restructuring the Indonesian banking sector

For that reason, Stefan Ingves, Deputy Governor, Bank of Sweden, and Olivier Frécaut, Consultant, Banking Supervision Division, MAE, have remained in the field Both are very experienced in banking sector issues As you are aware, Mr Ingves was in charge of the Swedish bank restructuring agency, Mr Frécaut was for many years an Inspector with the Bank of France We had already arranged for both to stay in Jakarta until the middle of next week I have now been in contact with Mr Frécaut, and although he has already been away for several weeks, he is willing to extend until the end of next week I will also be talking to Mr Ingves to see if he too can stay until that time This extension may require contacting the Governor of the Riksbank, in which case, I would get in touch with him to secure his agreement

Additional support can also be obtained from APD Peter Dattels, the new assistant resident representative was for many years in MAE And Chris Ryan, who is participating on Mr Goldsbrough's mission, only transferred from MAE this month I would expect that both of these could spend a substantial amount of their time working with the MAE team on banking sector issues Lastly, the World Bank has been arranging for Mark Carawan, from Arthur Anderson, who is deeply involved in the bank restructuring in Thailand to fly in to Jakarta this weekend with an associate Our relationship with the World Bank seems to be working out better in Indonesia than in some of the other Asian countries, and Mr Carawan—together with a World Bank team—participated fully in the MAE mission last week

Finally, should Mr Ingves be unable to stay on, I will ask Mr Enoch to return to Jakarta to be there by the time that Mr Ingves leaves And if Mr Ingves is able to stay and the situation still called for further MAE involvement, I will ask Mr Enoch to go out next weekend, possibly accompanied by additional MAE staff

cc Mr Neiss

ASIA/PACIFIC

29 JAN 98 8:09

O:\DRAFTS\MR\CE\ADM\INDON1 WPD January 28 1998 (5 40pm)

cc: HN
BBA
AS
WT
MRK
DG to respond
D4

Office Memorandum

To: Mr. Fischer

January 27, 1998

From: Margaret Kelly MRK

Subject: **Response to Overseas Private Investment Corporation**

Attached is a response to the letter from OPIC, which incorporates comments from LEG (Ms. Siegel), on Indonesian infrastructure projects that have been canceled in the context of the Fund program. Karen Lissakers spoke with me on their request for a meeting and said that Treasury had not cleared this request. She said that she was following up on the issue and that it was not necessary for staff to meet with OPIC at this stage.

OFFICE FDM

7 JAN 98 6 3 03

Mr. Aghevli had also received an invitation to attend a meeting of Chevron Overseas Petroleum, Inc.—also related to the postponement of its projects in Indonesia (attached). We declined the invitation after checking with Ms. Lissakers.

Leaving aside these requests, I think we need to remind the Indonesians of the need to put in place transparent criteria for canceling projects, ~~particularly those that were negotiated~~ transparently and do not involve major public funding. This is important to avoid a further deterioration in the prospects for foreign direct investment.

Attachment

cc: LEG

1.27.98

Ms Kelly:
Agreed - pls go ahead

SF.

From: Michael Deppler
To: sfischer,mmussa,hneiss,dgoldsbrough,dburton,jferra...
Date: 1/27/98 9:03am
Subject: Some unvarnished overnight ruminations on Indonesia

<WP Attachment enclosed>

1 The bank guarantee scheme is helpful from a lt pt of view, and not necessarily harmful from a st one Main deficiency is that it's success is contingent on a stabilization of the xr (otherwise domestic holders of rupiah will try to switch to dollars and provoke a call on the guarantee)

2 The debt scheme is indeterminate in its effect, as described It may provide a window as mkts decide what to make of it, but it does not seem to provide guidance to mkts as of now that would necessarily stabilize the rate Need a scheme to provide that inducement

3 The mexican scheme does seem to fit the ticket in that firms bear the "commercial risk" and the govt the fx risk The cost to the creditor takes the form of a forced reschd, but of a claim on govt One advantage of the scheme is that it would take money off the mkt and help stabilize the situation

4 The flip side of the Mexican scheme's focus on not addressing commercial risks is that it provides a "real" rather than a nominal anchor Basically, the schemes tides enterprises over the period of increased external debt burden during the period it takes to write down (thru inflation) the real burden of domestic debt As far as I can see, there is nothing in the scheme to anchor the exchange rate

5 Ultimately, for the pkg to work, the nominal exchange rate must be stabilized One avenue would consist of merging the Mexican scheme with a nominal anchor To illustrate suppose the auth were to peg rate at 5000 and offer to guarantee pmt (at the 5000 rate, but on rescheduled terms) for all enterprise external debts which were paid up to it at a 4500 rate with the consent of the creditors Creditors would get a guarantee, debtors would get a 10% subsidy as an inducement to channel pmt thru the scheme, and (via the rescheduling process) demand for fx could be kept out of the mkt It is true that the wedge in the xr will lead to bilateral deals between creditors and debtors at the expense of the state, but is that not a cost worth paying to stabilize the situation? Note also that the scheme would not cover commercial risks, so that imprudent borrowers and lenders would be penalized, and there is nothing stopping debtors and creditors from settling outside the scheme In particular, there could be an agreement to roll-over or reschedule voluntarily at 5000 (or some rate between 4500 and 5000) But given sufficiently tight rein on the availability of rupiah, the temptation to do so without the creditor rolling over seems rather limited

6 With such an element in place, it seems to me a cba makes a lot of sense it would assure depositors of the value of their deposits (hence curtailing the demand for fx), it would provide an automatic and transparent mechanism for controlling the supply of rupiah, it provides the prospect of an early reduction in interest rates--not an insignificant consideration given the quite considerable fiscal obligations that the state is acquiring, it seems to cohere with the country's monetary ethos (?), and it provides a strong backdrop to a nominal variant of the Mexican scheme

Mr Neiss

NB Please retype Kent statement with opening para as attached and changes on p3 + p6

Thanks

SF

done.

INTERNATIONAL MONETARY FUND

January 27, 1998

To: Mr. Fischer

Subject: **Indonesia**

-OFFICE FDM.-

27 JAN 98 11:40

Two EDs (you know which ones) have asked repeatedly for the final versions of the documents relating to the banking and corporation packages. I thought we could distribute them to all. If you agree please sign the attached.

HN

Hubert Neiss
(4-320, ext. 37604)

Let me emphasize before we begin that I am here as a consultant to Mr Prawiro, given the task of helping put in place a framework for dealing with the Indonesian corporate debt problem, based on a purely voluntary, private sector approach What I will be suggesting is a set of principles to ensure an effective process The general principles would of course have to be agreed on between the Steering Committee and the Contact Committee And the practical application of these or related principles in each case would have to be agreed on by creditors and debtors as they meet to find a solution for each company's debt problem

First para for Kent

CORPORATE DEBT

STATEMENT BY PEN KENT, ADVISOR TO DR. PRAWIRO 27TH JANUARY, 1998

Objective

To assist in the achievement of the two aims identified in Dr. Prawiro's statement of 27th January, i.e., to maximize the recovery of value by the lenders; and to restore the capital and interest payment streams of viable Indonesian corporations to sustainable levels. And to this end to set up a framework for its realization.

Structure

Mr. David Brougham, Director of Standard Chartered Bank and Mr. Lim Ho Kee, Vice Chairman and CEO of UBS East Asia have agreed to help put the structure of the Steering Committee in place. Mr. Brougham has much experience of corporate restructuring and of the region. Mr. Lim Ho Kee has wide knowledge of banking in the region. The membership will be deliberately kept fairly small, and will consist of senior representatives of the major national groups of banks as measured by exposure.

The Steering Committee will have a counterpart from the borrowing side in the Contact Committee, although detailed negotiations with each borrower will have to be bilateral. The Steering Committee will devise a structure which facilitates these negotiations. It will not be able to handle the whole burden itself.

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies; and will inform Dr. Prawiro of progress from time to time. In particular, they will jointly inform him when they believe their task has been completed.

The Contact Committee representing borrowers is being put together by Mr Anthony Salim, Mr The Ning King and Mr Rachmat Gobel This Committee will act as a point of contact on generic issues and may be able to facilitate the design of general solutions

Openness and Transparency

Trust between all parties would be enhanced by the maximum openness

Confidentiality

Participants will give confidentiality undertakings in relation to individual cases

Rules of the Game

To facilitate its mandate, the Committee will define certain rules of the game which will be grouped into two categories lender/company issues, and intra lender issues These rules will include the following, although others will no doubt emerge in the course of discussions

Lender/Company

Borrowers that can service debts

This group must continue to do so It is intended that the structure of this framework should create incentives to belong to this category out of self interest

Borrowers Unable to Service Debt Principles of Debt Service Pause

Start Line For reasons of equity it is necessary for this category to have a common start line for the pause This is the opening of business today, Jakarta time

Coverage It embraces all foreign currency claims of financial institutions on Indonesian private sector corporations, except genuine trade credits

These claims take the form of loans, overdrafts, bonds, commercial paper and other similar instruments

Restructuring

There could be 3 basic tiers of solution and involvement

Objectives

The purpose is to restore to full creditworthiness as many of the borrowers as possible It is possible that some of these will need to be restructured or change the management

Borrowers

1 Those able to continue debt service which are obliged to do so

2 Those with the prospect of long-term viability, and

3 Those which are likely to be unviable without the injection of major new capital and management

Banks

1 Those willing to play the most active part and where appropriate ready to provide new money for working capital New money will be provided on a last-in, first-out basis--i e , superpriority over other claims

2 Those supporting restructuring but unwilling to provide new money in which case they would become junior lenders

3 ~~Banks not wishing to participate in anyway and ready instead to write off their claims and waive any rights~~ Banks not willing to participate remain free to pursue their interests as they see fit.

Mechanism to define value and its distribution

The two Committees may need to create such a mechanism when dealing with categories 2 and 3 above

Encouragement to Perform

The terms of each group will be structured to encourage graduation towards best performance

Group 1 companies in this category could be encouraged by some recognition of their continued performance Even if this did not maximize earnings in each case, it could improve the aggregate outcome if it encouraged Group 2 companies to graduate to it

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights Safeguards to protect shareholdings from subsequent dilution would be necessary The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions Margins are likely to be widened There may be other reward features for the banks, deferred until the recovery allows

Group 3 companies may have to be closed unless new capital is injected The treatment of this group is likely to be much more varied case-by-case

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers' expense Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups The structure should encourage and demand performance tests to validate such selection

Timetables

Phase 1 of the pause is expected last about 3 months During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources The Contact Committee will be following a parallel course

Phase 2 will last for 9 months During this period all negotiations with the major company groupings in Category 2 will have made substantial progress and possibly target dates for graduation out of Category 2 will have been set A clear body of precedent for each of the 3 groups will have been set

Phase 3 will aim to last for only 12 month It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight The Steering Committee would stand down at the earliest possible date

Liaison

Both committees will have the right to convene a meeting with the other

Legal Principles and Legal Fees will be paid by the borrower The jurisdiction of the eventual restructuring contracts will be a major international center of high standing Lenders commit themselves to pooling legal advice where possible and imposing discipline on fees

Accounting Advice

The lenders may require to hire experts to advise on the financial strength of borrowers In this case, the fees will be paid by the borrowers, although it would be helpful if lenders were to pool the hire of such advise to minimize costs

Intra Lender Issues

Seniority and Security/Collateral

During a pause of this kind seniority and security/collateral will be respected but cannot effectively be exercised—and may have to be modified during restructuring This matter will be considered in more detail by the Steering Committee New money to borrowers in this category will always have "super seniority" (see below)

Voting and Decision Making

For the sake of rapid progress decisions must be driven by commercial judgement rather than the legal fine print of loan documents Of course the eventual agreements will need to be legally drafted and will be subject to a jurisdiction of an acceptable international standard ~~Decisions will be taken by a 75 percent vote by value, notwithstanding unanimity clauses~~

Burden Sharing

The framework will seek equitable burden sharing both between different creditors and between creditors and borrowers

Provisioning

Provisioning requirements and tax treatments vary from country to country It will not, however, be possible to take account of this in the burden sharing process

Local Currency Loans

The relationship between these loans and foreign currency loans needs further examination

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform

* * * * *

cc: FOSS
JV 4

Office Memorandum

To: Mr. Zamani

January 27, 1998

From: Manuel Guitián

Subject: **Indonesia—Staff Visit**

IA/PACIFIC-

JAN 98 5:09

In response to a request from Bank Indonesia (see attachment), Mr. Nicholas Roberts from the Monetary and Exchange Affairs Department will visit Indonesia from February 7 to 23. He will provide assistance to Bank Indonesia in the area of payment system reform.

Mr. Roberts has been asked to assist with preparation of recommendations for improvement in the Indonesian payment system practices and procedures. He will also contribute to the formulation of proposals on the clearing and settlement cycle in the Jakarta Clearing House, including development of loss-sharing arrangements in the event that banks participating in the Clearing House are unable to meet their settlement obligations. The need for improvement in the clearing and settlement cycle is seen as urgent by Bank Indonesia in the context of the worsening financial crisis.

Questions regarding this staff visit may be addressed to Mr. Roberts (ext. 36386).

Attachment

cc: Mr. Neiss (APD)

Mr Downes
Mr Vaez-Zadeh
Mr Galbis
File (Indonesia/General)

BANK INDONESIA

No 30/40/UPPN

December 16, 1997

Mr Hideaki Suzuki
Advisor Monetary and Exchange Affairs Department
International Monetary Fund
Washington, D C 20431
U.S.A.

97 DEC 17 PM 1 01
MONETARY AND EXCHANGE AFFAIRS DEPARTMENT IMMEDIATE OFFICE-2

Dear Mr Suzuki,

We refer to your letter dated on December 2, 1997 regarding the MAE technical assistance program to Bank Indonesia in respect of our National Payment System.

I would like to inform you that Messrs Masanori Ishizuka and Masato Yamasaki, both from the Bank of Japan have met with myself and members of the Bank Indonesia's Payments System Reform Committee We had intensive discussions from Monday December 8 through Friday December 12 1997 concerning the latest operation and the regulatory practices in Indonesia's payment system and our future plans as set out in the Blue Print These discussions covered a wide range of payment system issues, and were especially valuable in allowing us to focus on several topics, including the issue of uncollateralised overdrafts extended to banks by Bank Indonesia

However, the two Bank of Japan officials stated that the main purpose of their visit was merely for fact finding, and that we should not expect much from them either regarding recommendations for improvement, or endorsement of our proposed actions

Although we have not yet received their interim report, we understand that the mission does not intend to specify a work plan regarding future MAE technical assistance What they propose is that Bank Indonesia should prepare draft proposals and then, if necessary, ask the Bank of Japan to comment

We have become increasingly aware of the importance of the role that the Jakarta clearing and settlement cycle plays in the worsening financial crisis, and we are urgently seeking to recommend to our Board some immediate short-term improvements in our payment system practices and procedures However, we do not wish to compromise the quality of our recommendations in our efforts to meet tight deadlines

We

Cont Letter No 30/40/UPPN tgl December 17, 1997

We therefore believe that it would be especially useful if the IMF could provide a payment system specialist in the very near term for perhaps two or three weeks to allow us to quickly finalise our proposals regarding the Jakarta clearing and settlement cycle, including the related "Failure to Settle" arrangements We would appreciate this specialist's advice and support in a manner that would allow us finalise our draft proposals, and to confidently make recommendations to our Board immediately following the mission's visit

I would like to take this opportunity to express my appreciation for the valuable contribution made by the Bank of Japan mission, and trust you will appreciate our desire to now move quickly and positively to resolve the problems and issues we discussed with them

Yours sincerely,

Aulia Pohan
Director of Internal Resources Research
& Development Department

cc IMF resident Representative, Jakarta

CLOSED DOCUMENT
IN ACCORDANCE WITH THE POLICY ON ACCESS TO THE
IMF ARCHIVES

This [X] document or [ ] file has been removed as it belongs to the following category

[X] Legal documents and records that are protected by attorney client privilege,

[ ] Personnel files and medical or other records pertaining to individuals,

[ ] Documents and proceedings of the Grievance Committee,

[ ] Records furnished to the Fund by external parties, including members, with security marking confidential or above (declassification can be requested)

[ ] Other sensitive

Department/Division/ Collection	Asia Pacific Department Records
Series/Subseries	Asian and Pacific Department Director's Office Files - Asian Crisis
Box number	A8-024
File number	2
ADLIB ref number	240
File title & dates	Indonesia - Chronological Files, January 1998
Doc title & dates	Response to Overseas Private Investment Corporation, January 27, 1998

INTERNATIONAL MONETARY FUND

January 27, 1998

To Mr Fischer

Subject **Indonesia**

Two EDs (you know which ones) have asked repeatedly for the final versions of the documents relating to the banking and corporation packages I thought we could distribute them to all If you agree please sign the attached

Hubert Neiss HN
(4-320, ext 37604)

Office Memorandum

To The Secretary January 27, 1998

From Stanley Fischer

Subject **Indonesia**

Attached for distribution to Executive Directors are the final versions of

1 Program for Rehabilitation of the Indonesian Banking Sector,

2 Statement on Corporate Debt by Mr Radius Prawiro,

3 Statement on Corporate Debt by Mr Pen Kent

Attachments

To. APD , 1-202-623-4795   total: 6 pages

cc FUSS
JvY

Program for the Rehabilitation of the Indonesian Banking Sector
January 27, 1998

In order to restore the confidence of depositors and creditors--domestic and foreign--in the Indonesian banking system, and to re-establish the soundness of the system, we are undertaking a comprehensive program to rehabilitate the system This program comprises two main elements First, the provision of a full guarantee by the Government of Indonesia to all depositors and creditors of locally incorporated commercial banks And second, the creation of the Indonesian Bank Restructuring Agency —IBRA—which will be responsible for rehabilitating those banks that are at present not sound and do not have good prospects of restoring themselves to soundness The relevant legislative and regulatory changes will be put in place shortly

Guarantee

Effective immediately, the Government of Indonesia is guaranteeing that the claims of depositors and creditors of all locally incorporated banks will be met Both rupiah and foreign currency claims are covered, in the case of foreign currency claims, payment of the guarantee will be in rupiah at the market exchange rate The principal exceptions to coverage of this guarantee are shareholdings and subordinated debt The guarantee applies equally to private, state-owned and regionally-owned banks Thus Indonesian banks are going to be able to meet their commitments We anticipate that most depositors and creditors will wish to

keep their funds in the Indonesian banks by rolling over maturing claims, they can rest fully assured that they will receive payment if they do choose to withdraw those funds

In exchange for this guarantee, all locally-incorporated banks will be subject to the enhanced supervisory oversight that is necessary in present circumstances Banks will also be required to pay a fee based on the value of their liabilities in order to help defray the possible costs of that guarantee

The guarantee will remain in place for at least two years, and will not be terminated before the soundness of the banking system has been restored We will give at least twelve months' notice of the ending of the guarantee At that point, the guarantee could be replaced by a deposit insurance system, the modalities of which will be studied by Bank Indonesia with the assistance of the Asian Development Bank

Prudential requirements

Bank Indonesia, in consultation with the IMF and World Bank is developing a comprehensive set of prudential requirements for a banking system operating with the guarantee In this connection, Bank Indonesia will be issuing additional prudential requirements in order to prevent irregular practices During the period of the guarantee, there will be limits imposed on rates to ensure that banks do not offer terms substantially in excess of market terms There will also be limits on the rates of growth of credit These limits,

together with prudential norms on uncovered positions of banks' customers will be announced by Bank Indonesia in the next few days

Indonesian Bank Restructuring Agency (IBRA)

As the second major element in the rehabilitation program, the government has established IBRA, the Indonesian Bank Restructuring Agency This is an autonomous agency, operating under the auspices of the Ministry of Finance It will be headed by Mr Bambang Subianto The board will consist of both inside and outside members, IBRA will be reviewed by an independent review board which will publish its periodic assessments The agency will have a limited lifespan, and will be wound up once the bank rehabilitation program is complete The objective is to restore the banking system to soundness at least cost to the government within the constraints under which we are operating thus existing shareholders will be taking on a share of the burden We are also eliminating all restrictions on foreign ownership of Indonesian banks, so that foreign capital can help provide the resources for a fully capitalized banking system

In order to make IBRA fully operational at once, initial staff are being transferred on secondment from Bank Indonesia, the Ministry of Finance, and other government agencies and private institutions, and the agency will be supported by foreign expert advisors

IBRA will have two main functions first, it will supervise the banks in need of restructuring, and it will manage the restructuring process, and second, it will be the management agency for assets that it acquires in the course of the bank restructuring In this connection, IBRA will also take over the claims relating to the emergency and other liquidity and solvency support that Bank Indonesia has provided to the banks in the past, this transfer will serve to increase the transparency of such operations and to improve Bank Indonesia's balance sheet

Bank Indonesia is assessing the condition of the banks Those that fail to meet certain standards are to be reviewed by IBRA Where relevant, shareholders of those banks are to be given the opportunity to recapitalize their banks In the event that recapitalization does not take place and a bank fails an IBRA-commissioned review, IBRA will assume full supervisory authority over it

IBRA will consider how to restore such banks to full soundness, whether through recapitalization or through merger or takeover, at least cost to the public, in any case where public money is involved, existing shareholders will have their equity written down or eliminated IBRA will take over responsibility for implementing the government's plans for merging state banks to improve their financial condition and/or operational efficiency This will include the merger of four state banks, by end-June 1998, and the introduction of new management by the end of February 1998 IBRA will, where appropriate, also assume control of problem assets in cases in which it concludes that such action would enable higher realizations from the sale of the bank or of the asset IBRA will develop a specialized asset

management capability to maximize its recoveries After restructuring them, IBRA will aim to sell the banks and portfolios it has acquired This process will thus include the privatization of the state banks over which it exercises control, as well as those for which it assumes control as part of the restructuring process

The government will shortly issue bonds in order to provide the initial funding for IBRA Further issuances can be expected as IBRA s operations develop Over time, as recoveries increase, IBRA will be able to become more self-financing

Bankruptcy Procedures

The government intends to give high priority to the early establishment of more effective bankruptcy procedures within the framework of modern bankruptcy law

Other measures

The government is committed to revising the legal framework for banking operations, after a thorough review of the central bank and banking laws and banking regulations, areas of focus will include contract enforcement, banking disclosure, taking and realizing collateral, and regulations on financial instruments There will be improvements in the data that banks will be required to publish Prudential regulations will be reviewed, various sanctions will be

enforced, including withdrawals of bank licenses and the imposition of appropriate penalties on management and directors for negligence, wilful misconduct or acting contract to the law

Conclusion

This comprehensive program reflects our determination to restore the soundness of Indonesia's banking system We are protecting fully the banks' customers while dealing forcefully with the banks themselves Once this process has been implemented, Indonesia will have a banking system that will be able to meet fully the challenges of restoring rapid growth to the Indonesian economy

*****

Statement on Corporate Debt
by Mr Radius Prawiro
January 27, 1998

Over the past few months, the sharp decline of the rupiah exchange rate has made it increasingly difficult for Indonesian corporations to service their external debts As this occurred, it has become increasingly important that a strategy be developed for restoring orderly relations between these corporations and their creditors I am accordingly announcing today a voluntary framework to manage the external debts of Indonesian corporations As I said in my earlier statement on 28th December, there is no question of public sector finance, subsidies, or guarantees

Mr Kent, who was until recently an Executive Director of the Bank of England, has been advising me on this framework Mr David Brougham, a Director of Standard Chartered Bank and Mr Lim Ho Kee, Executive Vice President and CEO UBS East Asia, have agreed to help put a steering committee of lenders in place The steering committee will consist of senior international bankers from the main creditor countries There will also be a Contact Committee of borrowers I have asked Mr Antony Salim, Mr The Ning King and Mr Rachmat Gobel to assist in its formation

This framework is being set up and managed by the private sector, and will be based on voluntary agreements between borrowers and lenders It is important for both sides of the relationship that these agreements lead to the restoration of debt service in a sustainable way The framework has two principal aims The first is to maximize the recovery of value by the lenders The second is to restore the capital and interest payment streams of viable corporations to sustainable levels, thereby enabling them to survive In this way, the framework should create a "win-win" situation for debtors and creditors alike, while minimizing the risk for both Without action of this kind, market conditions could continue to deteriorate to the lasting detriment of both sides

The framework does not guarantee the viability of every Indonesian corporation Those with no prospect of viability may have to close unless new capital is injected At the

same time, corporations able to service their debts must continue to do so However, we need to recognize that in the current disorderly situation, there are some companies, which are already unable to fulfil their commitments This is unsustainable and needs to be regularized Consequently, a temporary pause in foreign currency debt service, both of interest and capital would be needed for these companies to allow time for new arrangements to be worked out between lenders and borrowers It would be most effective if this pause were to start immediately with the expectation that arrangements will be worked out for the resumption of debt service as soon as possible To this end, a structure is being developed to encourage the borrowers to restore full debt service at the earliest possible date

The details of the framework will be worked out by the Steering Committee in consultation with the other creditors, the Contact Committee, and the borrowers The chairmen of these two Committees will keep me informed of progress

The design of the plan will reflect the circumstances of each debtor and be on terms acceptable to creditors and debtors

The arrangements regarding debt service will only affect financial loans (bank loans, bonds, commercial paper and similar instruments) Genuine trade debts will be excluded from this framework, and where possible will continue to be serviced It is also desirable that banks restore trade lines to allow the economy to continue to operate as near to normal as possible

The architecture and implementation is for private sector parties to carry out It is in this sense that the arrangement is voluntary However, for reasons of equity and effectiveness it is important to have a decisive start That is why I am asking for your understanding that we were not able to consult you in advance

Mr Kent is giving more details to the foreign banking community at separate meetings

CORPORATE DEBT

STATEMENT BY PEN KENT, ADVISOR TO DR PRAWIRO 27TH JANUARY, 1998

Objective

To assist in the achievement of the two aims identified in Dr Prawiro's statement of 27th January, i e , to maximize the recovery of value by the lenders, and to restore the capital and interest payment streams of viable Indonesian corporations to sustainable levels And to this end to set up a framework for its realization

Structure

Mr David Brougham, Director of Standard Chartered Bank and Mr Lim Ho Kee, Vice Chairman and CEO of UBS East Asia have agreed to help put the structure of the Steering Committee in place Mr Brougham has much experience of corporate restructuring and of the region Mr Lim Ho Kee has wide knowledge of banking in the region The membership will be deliberately kept fairly small, and will consist of senior representatives of the major national groups of banks as measured by exposure

The Steering Committee will have a counterpart from the borrowing side in the Contact Committee, although detailed negotiations with each borrower will have to be bilateral The Steering Committee will devise a structure which facilitates these negotiations It will not be able to handle the whole burden itself

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies, and will inform Dr Prawiro of progress from time to time In particular, they will jointly inform him when they believe their task has been completed

The Contact Committee representing borrowers is being put together by Mr Anthony Salim, Mr The Ning King and Mr Rachmat Gobel This Committee will act as a point of contact on generic issues and may be able to facilitate the design of general solutions

Openness and Transparency

Trust between all parties would be enhanced by the maximum openness

Confidentiality

Participants will give confidentiality undertakings in relation to individual cases

Rules of the Game

To facilitate its mandate, the Committee will define certain rules of the game which will be grouped into two categories lender/company issues, and intra lender issues These rules will include the following, although others will no doubt emerge in the course of discussions

Lender/Company

Borrowers that can service debts

This group must continue to do so It is intended that the structure of this framework should create incentives to belong to this category out of self interest

Borrowers Unable to Service Debt Principles of Debt Service Pause

Start Line For reasons of equity it is necessary for this category to have a common start line for the pause This is the opening of business today, Jakarta time

Coverage It embraces all foreign currency claims of financial institutions on Indonesian private sector corporations, except genuine trade credits

These claims take the form of loans, overdrafts, bonds, commercial paper and other similar instruments

Restructuring

There could be 3 basic tiers of solution and involvement

Objectives

The purpose is to restore to full creditworthiness as many of the borrowers as possible It is possible that some of these will need to be restructured or change the management

Borrowers

1 Those able to continue debt service which are obliged to do so

2 Those with the prospect of long-term viability, and

3 Those which are likely to be unviable without the injection of major new capital and management

Banks

1 Those willing to play the most active part and where appropriate ready to provide new money for working capital New money will be provided on a last-in, first-out basis--i e , superpriority over other claims

2 Those supporting restructuring but unwilling to provide new money in which case they would become junior lenders

3 Banks not wishing to participate in anyway and ready instead to write off their claims and waive any rights

Mechanism to define value and its distribution

The two Committees may need to create such a mechanism when dealing with categories 2 and 3 above

Encouragement to Perform

The terms of each group will be structured to encourage graduation towards best performance

Group 1 companies in this category could be encouraged by some recognition of their continued performance Even if this did not maximize earnings in each case, it could improve the aggregate outcome if it encouraged Group 2 companies to graduate to it

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights Safeguards to protect shareholdings from subsequent dilution would be necessary The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions Margins are likely to be widened There may be other reward features for the banks, deferred until the recovery allows

Group 3 companies may have to be closed unless new capital is injected The treatment of this group is likely to be much more varied case-by-case

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers' expense Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups The structure should encourage and demand performance tests to validate such selection

Timetables

Phase 1 of the pause is expected last about 3 months During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources The Contact Committee will be following a parallel course

Phase 2 will last for 9 months During this period all negotiations with the major company groupings in Category 2 will have made substantial progress and possibly target dates for graduation out of Category 2 will have been set A clear body of precedent for each of the 3 groups will have been set

Phase 3 will aim to last for only 12 month It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight The Steering Committee would stand down at the earliest possible date

Liaison

Both committees will have the right to convene a meeting with the other

Legal Principles and Legal Fees will be paid by the borrower The jurisdiction of the eventual restructuring contracts will be a major international center of high standing Lenders commit themselves to pooling legal advice where possible and imposing discipline on fees

Accounting Advice

The lenders may require to hire experts to advise on the financial strength of borrowers In this case, the fees will be paid by the borrowers, although it would be helpful if lenders were to pool the hire of such advise to minimize costs

Intra Lender Issues

Seniority and Security/Collateral

During a pause of this kind, seniority and security/collateral will be respected but cannot effectively be exercised—and may have to be modified during restructuring This matter will be considered in more detail by the Steering Committee New money to borrowers in this category will always have "super seniority" (see below)

Voting and Decision Making

For the sake of rapid progress decisions must be driven by commercial judgement rather than the legal fine print of loan documents Of course the eventual agreements will need to be legally drafted and will be subject to a jurisdiction of an acceptable international standard Decisions will be taken by a 75 percent vote by value, notwithstanding unanimity clauses

Burden Sharing

The framework will seek equitable burden sharing both between different creditors and between creditors and borrowers

Provisioning

Provisioning requirements and tax treatments vary from country to country It will not, however, be possible to take account of this in the burden sharing process

Local Currency Loans

The relationship between these loans and foreign currency loans needs further examination

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform

* * * * *

same time, corporations able to service their debts must continue to do so However, we need to recognize that in the current disorderly situation, there are some companies, which are already unable to fulfil their commitments This is unsustainable and needs to be regularized Consequently, a temporary pause in foreign currency debt service, both of interest and capital would be needed for these companies to allow time for new arrangements to be worked out between lenders and borrowers It would be most effective if this pause were to start immediately with the expectation that arrangements will be worked out for the resumption of debt service as soon as possible To this end, a structure is being developed to encourage the borrowers to restore full debt service at the earliest possible date

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28 JAN 98 4:

ASIA/PACIFIC-

cc: FOSS
DV4

Office Memorandum

To: Mr. Holder January 27, 1998

From: Stanley Fischer SF

Subject: **Indonesian Bankruptcy Law**

As you heard yesterday, both APD staff and the Board believe that a strong bankruptcy law could play an important role in speeding the recovery of the Indonesian economy.

Could you please review the current law, and analyze what should be done to improve it. It would also be useful for you to say what would need to be done to make an improved law effective. You should consider not only the legal aspects of effectiveness, but also what could be done to impact business behavior. In addition please recommend any technical assistance that might be helpful, whether from the Fund or other agencies.

It would be most useful if we could have a preliminary report by February 6; please let me know if that would pose any difficulties.

Thank you.

cc: The Managing Director
Mr. Boorman
Mr. Gianviti (o/r)
Mr. Neiss

30 JAN 98

ASIA/PACIFIC-

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

FIRST DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

January 27 1998

cc: BA
DV4

Mr. George Munoz
President and Chief Executive Officer
Overseas Private Investment Corporation
Washington, DC 20527-0001

Dear Mr. Munoz:

Thank you for your letter of January 16, 1998 and for your support of the economic recovery program that the IMF is helping Indonesia to put together.

With regard to the issue of CalEnergy projects raised in your letter, Karen Lissakers has kept us informed of your concerns and we have provided her with any information that we have concerning these projects. We also received copies of relevant correspondence addressed to Government of Indonesians officials. I would suggest that, for the time being, we continue to liaise through Karen Lissakers' office. At a later date, and after the IMF staff mission returns from Indonesia, we could arrange a meeting if questions remain on the affected projects.

Yours sincerely

Stanley Fischer

Stanley Fischer

CC: MD
MR. FISCHER
MR. OUATTARA
MR. SUGISAKI
MS. LISSAKERS
APD
EXR
MR. CROSS

cc: Ms Lissakers

indonesia

OVERSEAS PRIVATE INVESTMENT CORPORATION

WASHINGTON D C 20527-0001 U S A

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98 JAN 30 AM 10 05
COMMUNICATIONS DIV

As For Background

January 16, 1998

Mr Stanley Fischer
First Deputy Managing Director
International Monetary Fund
Washington, D C 20431

Dear Mr Fischer

-OFFICE/FDMD-

16 JAN 98 10:21

I would like to congratulate you and your staff for the tremendous effort that you have made to put together an economic recovery program for Indonesia

I am writing to alert you to a letter (copy enclosed) that I recently sent to the Indonesian government regarding two CalEnergy power projects that OPIC has insured in Indonesia and to request a meeting between our two staffs The letter was delivered Wednesday by the US Embassy in Jakarta, in one case by Ambassador Roy personally In drafting the letter my staff and I consulted closely with the U S Treasury Department and discussed the matter with Karen Lissakers as well

OPIC has insurance and finance exposure to several US Investors in Indonesia including the two CalEnergy projects Given the importance of the IMF support program to Indonesia and its potential impact on OPIC-supported projects, as well as the potential impact on Indonesia's ability to attract foreign investment in the future if OPIC pays expropriation claims there, it is very important that OPIC and the IMF fully understand each other's views and positions Therefore, I think it would be useful for our staffs to meet to ensure that there is full communication between our institutions on these important issues I hope that such a meeting or meetings can be arranged in short order

025502

Although OPIC has fiduciary responsibilities that we must fulfill, I want to ensure that OPIC proceeds in this matter in a fashion that is consistent with the critical reform measures that IMF is implementing We look forward to working with you

Sincerely,

George Muñoz

George Muñoz
President and
Chief Executive Officer

Enclosure

OVERSEAS PRIVATE INVESTMENT CORPORATION
WASHINGTON D C 20527 USA

OFFICE OF THE
PRESIDENT

January 14 1998

His Excellency I B Sudjana
Minister of Mines and Energy
Republic of Indonesia
Jl Medan Merdeka Selatan 18
Jakarta 10110

His Excellency Mar'ie Muhammad
Minister of Finance
Republic of Indonesia
Jl Lapangan Banteng Timur 2-4
Jakarta Pusat

His Excellency Ir Ginandjar Kartasmita
Chairman of BAPPENAS
Jl Taman Surapati No 2
Jakarta Pusat

His Excellency Ir Djiteng Marsudi
President Director
P T PLN (Persero)
Jl Trunojoyo Blok M I/135
Kebayoran Baru, Jakarta Selatan

His Excellency Soegianto
President Director
PERTAMINA
Jl Medan Merdeka Timur No 1A
Jakarta Pusat

Dear Sirs

I am writing you in my capacity as President and Chief Executive Officer of the Overseas Private Investment Corporation (OPIC) regarding a matter of serious concern OPIC has issued political risk insurance to CalEnergy Company in respect of its geothermal projects at Patuha and Dieng

Fax 408 5133

1100 NEW YORK AVE N W WASHINGTON D C 20527 FAX (202) 408 9859 (202) 336 8400

CalEnergy has brought to OPIC's attention the potential adverse effect of certain Indonesian government actions on those two projects Representatives of CalEnergy have notified us that certain units with respect to each individual project have been affected by Presidential Decrees Nos 5 and 39 (P D Nos 5 and 39) CalEnergy has informed us that in its view adverse treatment of discrete individual units constituting part of the whole project is not consistent with P D No 39 In addition, continued delay arising from review or postponement of either of these projects may detrimentally affect the economics of the projects

Specifically, CalEnergy has advised OPIC that both the Patuha and Dieng projects currently are under construction, justifying inclusion on the "Continue" list, rather than postponement or review pursuant to P D No 39 CalEnergy and its lenders have invested well over $300 million in Dieng and Patuha For its part, OPIC has insured each of Dieng and Patuha as individual projects, not on a unit by unit basis

To the extent that project contracts related to either the Dieng project or the Patuha project are abrogated, and in the event any such abrogation were determined to be a compensable event of expropriation under OPIC's contracts of insurance with CalEnergy, OPIC would pay such claims In that instance, the U S Government, on behalf of OPIC, would seek recovery from the Government of Indonesia pursuant to the provisions of the Agreement Between the United States of America and Indonesia on Investment Guaranties signed on January 7, 1967, establishing the framework for OPIC programs in Indonesia

Our hope is that the Government of Indonesia will establish criteria for determining which projects to postpone, review, or continue that are fair, transparent, and objective Any project placed on the list for review or postponement should clearly meet the relevant criteria OPIC urges the Government of Indonesia to apply the standards of P D No 39 on a transparent and expeditious basis and in a non-discriminatory manner

Sincerely,

George Muñoz
President and
Chief Executive Officer

Office Memorandum

To The Secretary

January 27, 1998

From Stanley Fischer Sf

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IBRA will consider how to restore such banks to full soundness, whether through recapitalization or through merger or takeover, at least cost to the public, in any case where public money is involved, existing shareholders will have their equity written down or eliminated IBRA will take over responsibility for implementing the government's plans for merging state banks to improve their financial condition and/or operational efficiency This will include the merger of four state banks, by end-June 1998, and the introduction of new management by the end of February 1998 IBRA will, where appropriate, also assume control of problem assets in cases in which it concludes that such action would enable higher realizations from the sale of the bank or of the asset IBRA will develop a specialized asset

management capability to maximize its recoveries After restructuring them, IBRA will aim to sell the banks and portfolios it has acquired This process will thus include the privatization of the state banks over which it exercises control, as well as those for which it assumes control as part of the restructuring process

The government will shortly issue bonds in order to provide the initial funding for IBRA Further issuances can be expected as IBRA s operations develop Over time, as recoveries increase, IBRA will be able to become more self-financing

Bankruptcy Procedures

The government intends to give high priority to the early establishment of more effective bankruptcy procedures within the framework of modern bankruptcy law

Other measures

The government is committed to revising the legal framework for banking operations, after a thorough review of the central bank and banking laws and banking regulations, areas of focus will include contract enforcement, banking disclosure, taking and realizing collateral, and regulations on financial instruments There will be improvements in the data that banks will be required to publish Prudential regulations will be reviewed, various sanctions will be

enforced, including withdrawals of bank licenses and the imposition of appropriate penalties on management and directors for negligence, wilful misconduct or acting contract to the law

Conclusion

This comprehensive program reflects our determination to restore the soundness of Indonesia's banking system We are protecting fully the banks' customers while dealing forcefully with the banks themselves Once this process has been implemented, Indonesia will have a banking system that will be able to meet fully the challenges of restoring rapid growth to the Indonesian economy

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Statement on Corporate Debt
by Mr Radius Prawiro
January 27, 1998

Over the past few months, the sharp decline of the rupiah exchange rate has made it increasingly difficult for Indonesian corporations to service their external debts As this occurred, it has become increasingly important that a strategy be developed for restoring orderly relations between these corporations and their creditors I am accordingly announcing today a voluntary framework to manage the external debts of Indonesian corporations As I said in my earlier statement on 28th December, there is no question of public sector finance, subsidies, or guarantees

Mr Kent, who was until recently an Executive Director of the Bank of England, has been advising me on this framework Mr David Brougham a Director of Standard Chartered Bank and Mr Lim Ho Kee, Executive Vice President and CEO UBS East Asia, have agreed to help put a steering committee of lenders in place The steering committee will consist of senior international bankers from the main creditor countries There will also be a Contact Committee of borrowers I have asked Mr Antony Salim, Mr The Ning King and Mr Rachmat Gobel to assist in its formation

This framework is being set up and managed by the private sector, and will be based on voluntary agreements between borrowers and lenders It is important for both sides of the relationship that these agreements lead to the restoration of debt service in a sustainable way The framework has two principal aims The first is to maximize the recovery of value by the lenders The second is to restore the capital and interest payment streams of viable corporations to sustainable levels, thereby enabling them to survive In this way, the framework should create a "win-win" situation for debtors and creditors alike, while minimizing the risk for both Without action of this kind, market conditions could continue to deteriorate to the lasting detriment of both sides

The framework does not guarantee the viability of every Indonesian corporation Those with no prospect of viability may have to close unless new capital is injected At the

same time, corporations able to service their debts must continue to do so However, we need to recognize that in the current disorderly situation, there are some companies, which are already unable to fulfil their commitments This is unsustainable and needs to be regularized Consequently, a temporary pause in foreign currency debt service, both of interest and capital would be needed for these companies to allow time for new arrangements to be worked out between lenders and borrowers It would be most effective if this pause were to start immediately with the expectation that arrangements will be worked out for the resumption of debt service as soon as possible To this end a structure is being developed to encourage the borrowers to restore full debt service at the earliest possible date

The details of the framework will be worked out by the Steering Committee in consultation with the other creditors, the Contact Committee, and the borrowers The chairmen of these two Committees will keep me informed of progress

The design of the plan will reflect the circumstances of each debtor and be on terms acceptable to creditors and debtors

The arrangements regarding debt service will only affect financial loans (bank loans, bonds, commercial paper and similar instruments) Genuine trade debts will be excluded from this framework, and where possible will continue to be serviced It is also desirable that banks restore trade lines to allow the economy to continue to operate as near to normal as possible

The architecture and implementation is for private sector parties to carry out It is in this sense that the arrangement is voluntary However, for reasons of equity and effectiveness it is important to have a decisive start That is why I am asking for your understanding that we were not able to consult you in advance

Mr Kent is giving more details to the foreign banking community at separate meetings

Corporate Debt

Statement by Pen Kent,
Advisor to Dr Prawiro
January 27, 1998

Let me emphasize before we begin that I am here as a consultant to Mr Prawiro, given the task of helping put in place a framework for dealing with the Indonesian corporate debt problem, based on a purely voluntary, private sector approach What I will be suggesting is a set of principles to ensure an effective process The general principles would of course have to be agreed on between the Steering Committee and the Contact Committee And the practical application of these or related principles in each case would have to be agreed on by creditors and debtors as they meet to find a solution for each company's debt problem

Objective

To assist in the achievement of the two aims identified in Dr Prawiro's statement of 27th January, i e to maximize the recovery of value by the lenders, and to restore the capital and interest payment streams of viable Indonesian corporations to sustainable levels And to this end to set up a framework for its realization

Structure

Mr David Brougham, Director of Standard Charter Bank and Mr Lim Ho Kee, Vice Chairman and CEO of UBS East Asia have agreed to help put the structure of the Steering Committee in place Mr Brougham has much experience of corporate restructuring and of the region Mr Lim Ho Kee has wide knowledge of banking in the region The membership will be deliberately kept fairly small, and will consist of senior representatives of the major national groups of banks as measured by exposure

The Steering Committee will have a counterpart from the borrowing side in the Contact Committee, although detailed negotiations with each borrower will have to be bilateral The Steering Committee will devise a structure which facilitates these negotiations It will not be able to handle the whole burden itself

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies, and will inform Dr Prawiro of progress from time to time In particular, they will jointly inform him when they believe their task has been completed

The Contact Committee representing borrowers is being put together by Mr Anthony Salim, Mr The Ning King and Mr Rachmat Gobel This Committee will act as a point of contact on generic issues and may be able to facilitate the design of general solutions

Openness and Transparency

Trust among all parties would be enhanced by the maximum openness

Confidentiality

Participants will give confidentiality undertakings in relation to individual cases

Rules of the Game

To facilitate its mandate, the Committee will define certain rules of the game which will be grouped into two categories lender/company issues, and intra lender issues These rules will include the following, although others will no doubt emerge in the course of discussions

Lender/Company

Borrowers that can service debts

This group must continue to do so It is intended that the structure of this framework should create incentives to belong to this category out of self interest

Borrowers Unable to Service Debt Principles of Debt Service Pause

Start Line For reasons of equity it is necessary for this category to have a common start line for the pause This is the opening of business today, Jakarta time

Coverage It embraces all foreign currency claims of financial institutions on Indonesian private sector corporations, except genuine trade credits These claims take the form of loans, overdrafts, bonds, commercial paper and other similar instruments

Restructuring

There could be 3 basic tiers of solution and involvement

Objectives

The purpose is to restore to full creditworthiness as many of the borrowers as possible It is possible that some of these will need to be restructured or change the management

Borrowers

1 Those able to continue debt service which are obliged to do so

2 Those with the prospect of long-term viability, and

3 Those which are likely to be unviable without the injection of major new capital and management

Banks

1 Those willing to play the most active part and where appropriate ready to provide new money for working capital New money will be provided on a last-in, first-out basis--i e , superpriority over other claims

2 Those supporting restructuring but unwilling to provide new money in which case they would become junior lenders

3 Banks not wishing to participate remain free to pursue their interests as they see fit

Mechanism to define value and its distribution

The two Committees may need to create such a mechanism when dealing with categories 2 and 3 above

Encouragement to Perform

The terms of each group will be structured to encourage graduation towards best performance

Group 1 companies in this category could be encouraged by some recognition of their continued performance Even if this did not maximize earnings in each case, it could improve the aggregate outcome if it encouraged Group 2 companies to graduate to it

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights Safeguards to protect shareholdings from subsequent dilution would be necessary The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions Margins are likely to be widened There may be other reward features for the banks, deferred until the recovery allows

Group 3 companies may have to be closed unless new capital is injected The treatment of this group is likely to be much more varied case-by-case

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers' expense Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups The structure should encourage and demand performance tests to validate such selection

Timetables

Phase 1 of the pause is expected to last about 3 months During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources The Contact Committee will be following a parallel course

Phase 2 will last for 9 months During this period all negotiations with the major company groupings in Category 2 will have made substantial progress and possibly target dates for graduation out of Category 2 will have been set A clear body of precedent for each of the 3 groups will have been set

Phase 3 will aim to last for only 12 months It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight The Steering Committee would stand down at the earliest possible date

Liaison

Both committees will have the right to convene a meeting with the other

Legal Principles and Legal Fees will be paid by the borrower The jurisdiction of the eventual restructuring contracts will be a major international center of high standing Lenders commit themselves to pooling legal advice were possible and imposing discipline on fees

Accounting Advice

The lenders may require to hire experts to advise on the financing strength of borrowers In this case, the fees will be paid by the borrowers, although it would be helpful if lenders were to pool the hire of such advise to minimize costs

Intra Lender Issues

Seniority and Security/Collateral

During a pause of th s kind, seniority and security/collateral will be respected but cannot effectively be exercised—and may have to be modified during restructuring This matter will be considered in more detail by the Steering Committee New money to borrowers in this category will always have "super seniority" (see below)

Voting and Decision Making

For the sake of rapid progress decisions must be driven by commercial judgement rather than the legal fine print of loan documents Of course the eventual agreements will need to be legally drafted and will be subject to a jurisdiction of an acceptable international standard

Burden Sharing

The framework will seek equitable burden sharing both between different creditors and between creditors and borrowers

Provisioning

Provisioning requirements and tax treatments vary from country to country It will not, however, be possible to take account of this in the burden sharing process

Local Currency Loans

The relationship between these loans and foreign currency loans needs further examination

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform

CORPORATE DEBT

STATEMENT BY PEN KENT,
ADVISOR TO DR PRAWIRO
27TH JANUARY, 1998

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For the sake of rapid progress decisions must be driven by commercial judgement rather than the legal fine print of loan documents Of course the eventual agreements will need to be legally drafted and will be subject to a jurisdiction of an acceptable international standard Decisions will be taken by a 75 percent vote by value, notwithstanding unanimity clauses

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INTERNATIONAL MONETARY FUND

January 27, 1998

To Mr Fischer

Subject **Indonesia**

Two EDs (you know which ones) have asked repeatedly for the final versions of the documents relating to the banking and corporation packages I thought we could distribute them to all If you agree please sign the attached

HN

Hubert Neiss
(4-320, ext 37604)

Office Memorandum

To	The Secretary	January 27, 1998
From	Stanley Fischer	
Subject	**Indonesia**	

Attached for distribution to Executive Directors are the final versions of

1 Program for Rehabilitation of the Indonesian Banking Sector,

2 Statement on Corporate Debt by Mr Radius Prawiro,

3 Statement on Corporate Debt by Mr Pen Kent

Attachments

To: APD , 1-202-623-4795 total: 6 pages

cc: FOSS

Program for the Rehabilitation of the Indonesian Banking Sector
January 27, 1998

In order to restore the confidence of depositors and creditors--domestic and foreign--in the Indonesian banking system, and to re-establish the soundness of the system, we are undertaking a comprehensive program to rehabilitate the system. This program comprises two main elements. First, the provision of a full guarantee by the Government of Indonesia to all depositors and creditors of locally incorporated commercial banks. And second, the creation of the Indonesian Bank Restructuring Agency —IBRA—which will be responsible for rehabilitating those banks that are at present not sound and do not have good prospects of restoring themselves to soundness. The relevant legislative and regulatory changes will be put in place shortly.

Guarantee

Effective immediately, the Government of Indonesia is guaranteeing that the claims of depositors and creditors of all locally incorporated banks will be met. Both rupiah and foreign currency claims are covered; in the case of foreign currency claims, payment of the guarantee will be in rupiah at the market exchange rate. The principal exceptions to coverage of this guarantee are shareholdings and subordinated debt. The guarantee applies equally to private, state-owned and regionally-owned banks. Thus Indonesian banks are going to be able to meet their commitments. We anticipate that most depositors and creditors will wish to

keep their funds in the Indonesian banks by rolling over maturing claims, they can rest fully assured that they will receive payment if they do choose to withdraw those funds

In exchange for this guarantee, all locally-incorporated banks will be subject to the enhanced supervisory oversight that is necessary in present circumstances Banks will also be required to pay a fee based on the value of their liabilities in order to help defray the possible costs of that guarantee

The guarantee will remain in place for at least two years, and will not be terminated before the soundness of the banking system has been restored We will give at least twelve months' notice of the ending of the guarantee At that point, the guarantee could be replaced by a deposit insurance system, the modalities of which will be studied by Bank Indonesia with the assistance of the Asian Development Bank

Prudential requirements

Bank Indonesia, in consultation with the IMF and World Bank is developing a comprehensive set of prudential requirements for a banking system operating with the guarantee In this connection, Bank Indonesia will be issuing additional prudential requirements in order to prevent irregular practices During the period of the guarantee, there will be limits imposed on rates to ensure that banks do not offer terms substantially in excess of market terms There will also be limits on the rates of growth of credit These limits,

together with prudential norms on uncovered positions of banks' customers will be announced by Bank Indonesia in the next few days

Indonesian Bank Restructuring Agency (IBRA)

As the second major element in the rehabilitation program, the government has established IBRA, the Indonesian Bank Restructuring Agency This is an autonomous agency, operating under the auspices of the Ministry of Finance It will be headed by Mr Bambang Subianto The board will consist of both inside and outside members, IBRA will be reviewed by an independent review board which will publish its periodic assessments The agency will have a limited lifespan, and will be wound up once the bank rehabilitation program is complete The objective is to restore the banking system to soundness at least cost to the government within the constraints under which we are operating thus existing shareholders will be taking on a share of the burden We are also eliminating all restrictions on foreign ownership of Indonesian banks, so that foreign capital can help provide the resources for a fully capitalized banking system

In order to make IBRA fully operational at once, initial staff are being transferred on secondment from Bank Indonesia, the Ministry of Finance, and other government agencies and private institutions, and the agency will be supported by foreign expert advisors

IBRA will have two main functions first, it will supervise the banks in need of restructuring, and it will manage the restructuring process, and second, it will be the management agency for assets that it acquires in the course of the bank restructuring In this connection, IBRA will also take over the claims relating to the emergency and other liquidity and solvency support that Bank Indonesia has provided to the banks in the past, this transfer will serve to increase the transparency of such operations and to improve Bank Indonesia's balance sheet

Bank Indonesia is assessing the condition of the banks Those that fail to meet certain standards are to be reviewed by IBRA Where relevant, shareholders of those banks are to be given the opportunity to recapitalize their banks In the event that recapitalization does not take place and a bank fails an IBRA-commissioned review, IBRA will assume full supervisory authority over it

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The government will shortly issue bonds in order to provide the initial funding for IBRA Further issuances can be expected as IBRA's operations develop Over time, as recoveries increase, IBRA will be able to become more self-financing

Bankruptcy Procedures

The government intends to give high priority to the early establishment of more effective bankruptcy procedures within the framework of modern bankruptcy law

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The government is committed to revising the legal framework for banking operations, after a thorough review of the central bank and banking laws and banking regulations, areas of focus will include contract enforcement, banking disclosure, taking and realizing collateral, and regulations on financial instruments There will be improvements in the data that banks will be required to publish Prudential regulations will be reviewed, various sanctions will be

enforced, including withdrawals of bank licenses and the imposition of appropriate penalties on management and directors for negligence, wilful misconduct or acting contract to the law

Conclusion

This comprehensive program reflects our determination to restore the soundness of Indonesia's banking system We are protecting fully the banks' customers while dealing forcefully with the banks themselves Once this process has been implemented, Indonesia will have a banking system that will be able to meet fully the challenges of restoring rapid growth to the Indonesian economy

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Statement on Corporate Debt
by Mr. Radius Prawiro
January 27, 1998

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Mr. Kent, who was until recently an Executive Director of the Bank of England, has been advising me on this framework. Mr. David Brougham, a Director of Standard Chartered Bank and Mr. Lim Ho Kee, Executive Vice President and CEO UBS East Asia, have agreed to help put a steering committee of lenders in place. The steering committee will consist of senior international bankers from the main creditor countries. There will also be a Contact Committee of borrowers. I have asked Mr. Antony Salim, Mr. The Ning King and Mr. Rachmat Gobel to assist in its formation.

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CORPORATE DEBT

STATEMENT BY PEN KENT, ADVISOR TO DR PRAWIRO 27TH JANUARY, 1998

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To assist in the achievement of the two aims identified in Dr Prawiro's statement of 27th January, i e , to maximize the recovery of value by the lenders, and to restore the capital and interest payment streams of viable Indonesian corporations to sustainable levels And to this end to set up a framework for its realization

Structure

Mr David Brougham, Director of Standard Chartered Bank and Mr Lim Ho Kee, Vice Chairman and CEO of UBS East Asia have agreed to help put the structure of the Steering Committee in place Mr Brougham has much experience of corporate restructuring and of the region Mr Lim Ho Kee has wide knowledge of banking in the region The membership will be deliberately kept fairly small, and will consist of senior representatives of the major national groups of banks as measured by exposure

The Steering Committee will have a counterpart from the borrowing side in the Contact Committee, although detailed negotiations with each borrower will have to be bilateral The Steering Committee will devise a structure which facilitates these negotiations It will not be able to handle the whole burden itself

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies, and will inform Dr Prawiro of progress from time to time In particular, they will jointly inform him when they believe their task has been completed

The Contact Committee representing borrowers is being put together by Mr Anthony Salim, Mr The Ning King and Mr Rachmat Gobel This Committee will act as a point of contact on generic issues and may be able to facilitate the design of general solutions

Openness and Transparency

Trust between all parties would be enhanced by the maximum openness

Confidentiality

Participants will give confidentiality undertakings in relation to individual cases

Rules of the Game

To facilitate its mandate, the Committee will define certain rules of the game which will be grouped into two categories lender/company issues, and intra lender issues These rules will include the following, although others will no doubt emerge in the course of discussions

Lender/Company

Borrowers that can service debts

This group must continue to do so It is intended that the structure of this framework should create incentives to belong to this category out of self interest

Borrowers Unable to Service Debt Principles of Debt Service Pause

Start Line For reasons of equity it is necessary for this category to have a common start line for the pause This is the opening of business today, Jakarta time

Coverage It embraces all foreign currency claims of financial institutions on Indonesian private sector corporations, except genuine trade credits

These claims take the form of loans, overdrafts, bonds, commercial paper and other similar instruments

Restructuring

There could be 3 basic tiers of solution and involvement

Objectives

The purpose is to restore to full creditworthiness as many of the borrowers as possible It is possible that some of these will need to be restructured or change the management

Borrowers

1 Those able to continue debt service which are obliged to do so

2 Those with the prospect of long-term viability, and

3 Those which are likely to be unviable without the injection of major new capital and management

Banks

1 Those willing to play the most active part and where appropriate ready to provide new money for working capital New money will be provided on a last-in, first-out basis--i e , superpriority over other claims

2 Those supporting restructuring but unwilling to provide new money in which case they would become junior lenders

3 Banks not wishing to participate in anyway and ready instead to write off their claims and waive any rights

Mechanism to define value and its distribution

The two Committees may need to create such a mechanism when dealing with categories 2 and 3 above

Encouragement to Perform

The terms of each group will be structured to encourage graduation towards best performance

Group 1 companies in this category could be encouraged by some recognition of their continued performance Even if this did not maximize earnings in each case, it could improve the aggregate outcome if it encouraged Group 2 companies to graduate to it

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights Safeguards to protect shareholdings from subsequent dilution would be necessary The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions Margins are likely to be widened There may be other reward features for the banks, deferred until the recovery allows

Group 3 companies may have to be closed unless new capital is injected The treatment of this group is likely to be much more varied case-by-case

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers' expense Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups The structure should encourage and demand performance tests to validate such selection

Timetables

Phase 1 of the pause is expected last about 3 months During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources The Contact Committee will be following a parallel course

Phase 2 will last for 9 months During this period all negotiations with the major company groupings in Category 2 will have made substantial progress and possibly target dates for graduation out of Category 2 will have been set A clear body of precedent for each of the 3 groups will have been set

Phase 3 will aim to last for only 12 month It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight The Steering Committee would stand down at the earliest possible date

Liaison

Both committees will have the right to convene a meeting with the other

Legal Principles and Legal Fees will be paid by the borrower The jurisdiction of the eventual restructuring contracts will be a major international center of high standing Lenders commit themselves to pooling legal advice where possible and imposing discipline on fees

Accounting Advice

The lenders may require to hire experts to advise on the financial strength of borrowers In this case, the fees will be paid by the borrowers, although it would be helpful if lenders were to pool the hire of such advise to minimize costs

Intra Lender Issues

Seniority and Security/Collateral

During a pause of this kind, seniority and security/collateral will be respected but cannot effectively be exercised—and may have to be modified during restructuring This matter will be considered in more detail by the Steering Committee New money to borrowers in this category will always have "super seniority" (see below)

Voting and Decision Making

For the sake of rapid progress decisions must be driven by commercial judgement rather than the legal fine print of loan documents Of course the eventual agreements will need to be legally drafted and will be subject to a jurisdiction of an acceptable international standard Decisions will be taken by a 75 percent vote by value, notwithstanding unanimity clauses

Burden Sharing

The framework will seek equitable burden sharing both between different creditors and between creditors and borrowers

Provisioning

Provisioning requirements and tax treatments vary from country to country It will not, however, be possible to take account of this in the burden sharing process

Local Currency Loans

The relationship between these loans and foreign currency loans needs further examination

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform

* * * * *

cc/ Ross
DVY

CORPORATE DEBT

STATEMENT BY PETER KENT,
ADVISOR TO DR PRAWIRO
27TH JANUARY, 1998

Principles of Debt Service Pause

Start Line For reasons of equity it is necessary to have a common start line for the pause This is the opening of business today, Jakarta time

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Objectives

The purpose is to restore to full creditworthiness as many of the borrowers as possible It is possible that some of these will need to be restructured or change the management

Restructuring

There will be 3 basic tiers of solution and involvement

Borrowers

1 Healthy and with the prospect of a rapid recovery to full creditworthiness

2 Those with the prospect of long-term viability, and

3 Those which are likely to be unviable without the injection of major new capital and management

Banks

1 Those willing to play the most active part and where appropriate ready to provide new money for working capital New money will be provided on a last-in, first-out basis--i e , superpriority over other claims

2 Those supporting restructuring but unwilling to provide new money in which case they would become junior lenders

3 Banks not wishing to participate in anyway and ready instead to write off their claims and waive any rights

Encouragement to Perform

The terms of each group will be structured to encourage graduation towards best performance

Group 1 companies may have to offer some deferred fees, warrants, success rewards in exchange for new money from the banks In return, the banks may have to use restraint in increasing margins to reflect risk

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights Safeguards to protect shareholdings from subsequent dilution would be necessary The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions Margins are likely to be widened There may be other reward features for the banks, deferred until the recovery allows

Group 3 companies may have to be closed unless new capital is injected The treatment of this group is likely to be much more varied case-by-case

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers expense Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups The structure should encourage and demand performance tests to validate such selection

Timetables

Phase I is expected last about 3 months The best performers may graduate out of the framework very quickly During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources The Contact Committee will be following a parallel course

Liaison

Both committees will have the right to convene a meeting with the other

Phase 2 will last for 9 months During this period all negotiations with the major company groupings will have made substantial progress Target dates for graduation out of the framework by Group 1 companies will have been set A clear body of precedent for each of the 3 groups will have been set

Phase 3 will aim to last for only 12 month It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight The Steering Committee would stand down at the earliest possible date

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies, and will inform Dr Prawiro of progress from time to time In particular, they will jointly inform him when they believe their task has been completed

Legal Fees will be paid by the borrower Lenders commit themselves to pooling legal advice where possible and imposing discipline on fees

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform

* * * * *

To APD , 1-202-623-4795 total' 6 pages

cc [illegible]

Program for the Rehabilitation of the Indonesian Banking Sector
January 27, 1998

In order to restore the confidence of depositors and creditors--domestic and foreign--in the Indonesian banking system, and to re-establish the soundness of the system, we are undertaking a comprehensive program to rehabilitate the system This program comprises two main elements First, the provision of a full guarantee by the Government of Indonesia to all depositors and creditors of locally incorporated commercial banks And second, the creation of the Indonesian Bank Restructuring Agency —IBRA—which will be responsible for rehabilitating those banks that are at present not sound and do not have good prospects of restoring themselves to soundness The relevant legislative and regulatory changes will be put in place shortly

Guarantee

Effective immediately, the Government of Indonesia is guaranteeing that the claims of depositors and creditors of all locally incorporated banks will be met Both rupiah and foreign currency claims are covered, in the case of foreign currency claims, payment of the guarantee will be in rupiah at the market exchange rate The principal exceptions to coverage of this guarantee are shareholdings and subordinated debt The guarantee applies equally to private, state-owned and regionally-owned banks Thus Indonesian banks are going to be able to meet their commitments We anticipate that most depositors and creditors will wish to

keep their funds in the Indonesian banks by rolling over maturing claims, they can rest fully assured that they will receive payment if they do choose to withdraw those funds

In exchange for this guarantee, all locally-incorporated banks will be subject to the enhanced supervisory oversight that is necessary in present circumstances Banks will also be required to pay a fee based on the value of their liabilities in order to help defray the possible costs of that guarantee

The guarantee will remain in place for at least two years, and will not be terminated before the soundness of the banking system has been restored We will give at least twelve months' notice of the ending of the guarantee At that point, the guarantee could be replaced by a deposit insurance system, the modalities of which will be studied by Bank Indonesia with the assistance of the Asian Development Bank

Prudential requirements

Bank Indonesia, in consultation with the IMF and World Bank is developing a comprehensive set of prudential requirements for a banking system operating with the guarantee In this connection, Bank Indonesia will be issuing additional prudential requirements in order to prevent irregular practices During the period of the guarantee, there will be limits imposed on rates to ensure that banks do not offer terms substantially in excess of market terms There will also be limits on the rates of growth of credit These limits,

together with prudential norms on uncovered positions of banks' customers will be announced by Bank Indonesia in the next few days

Indonesian Bank Restructuring Agency (IBRA)

As the second major element in the rehabilitation program, the government has established IBRA, the Indonesian Bank Restructuring Agency This is an autonomous agency, operating under the auspices of the Ministry of Finance It will be headed by Mr Bambang Subianto The board will consist of both inside and outside members, IBRA will be reviewed by an independent review board which will publish its periodic assessments The agency will have a limited lifespan, and will be wound up once the bank rehabilitation program is complete The objective is to restore the banking system to soundness at least cost to the government within the constraints under which we are operating thus existing shareholders will be taking on a share of the burden We are also eliminating all restrictions on foreign ownership of Indonesian banks, so that foreign capital can help provide the resources for a fully capitalized banking system

In order to make IBRA fully operational at once, initial staff are being transferred on secondment from Bank Indonesia, the Ministry of Finance, and other government agencies and private institutions, and the agency will be supported by foreign expert advisors

IBRA will have two main functions first, it will supervise the banks in need of restructuring, and it will manage the restructuring process, and second, it will be the management agency for assets that it acquires in the course of the bank restructuring In this connection, IBRA will also take over the claims relating to the emergency and other liquidity and solvency support that Bank Indonesia has provided to the banks in the past, this transfer will serve to increase the transparency of such operations and to improve Bank Indonesia's balance sheet

Bank Indonesia is assessing the condition of the banks Those that fail to meet certain standards are to be reviewed by IBRA Where relevant, shareholders of those banks are to be given the opportunity to recapitalize their banks In the event that recapitalization does not take place and a bank fails an IBRA-commissioned review, IBRA will assume full supervisory authority over it

IBRA will consider how to restore such banks to full soundness, whether through recapitalization or through merger or takeover, at least cost to the public, in any case where public money is involved, existing shareholders will have their equity written down or eliminated IBRA will take over responsibility for implementing the government's plans for merging state banks to improve their financial condition and/or operational efficiency This will include the merger of four state banks, by end-June 1998, and the introduction of new management by the end of February 1998 IBRA will, where appropriate, also assume control of problem assets in cases in which it concludes that such action would enable higher realizations from the sale of the bank or of the asset IBRA will develop a specialized asset

management capability to maximize its recoveries After restructuring them, IBRA will aim to sell the banks and portfolios it has acquired This process will thus include the privatization of the state banks over which it exercises control, as well as those for which it assumes control as part of the restructuring process

The government will shortly issue bonds in order to provide the initial funding for IBRA Further issuances can be expected as IBRA s operations develop Over time, as recoveries increase, IBRA will be able to become more self-financing

Bankruptcy Procedures

The government intends to give high priority to the early establishment of more effective bankruptcy procedures within the framework of modern bankruptcy law

Other measures

The government is committed to revising the legal framework for banking operations, after a thorough review of the central bank and banking laws and banking regulations, areas of focus will include contract enforcement, banking disclosure, taking and realizing collateral, and regulations on financial instruments There will be improvements in the data that banks will be required to publish Prudential regulations will be reviewed, various sanctions will be

enforced, including withdrawals of bank licenses and the imposition of appropriate penalties on management and directors for negligence, wilful misconduct or acting contract to the law

Conclusion

This comprehensive program reflects our determination to restore the soundness of Indonesia's banking system We are protecting fully the banks' customers while dealing forcefully with the banks themselves Once this process has been implemented, Indonesia will have a banking system that will be able to meet fully the challenges of restoring rapid growth to the Indonesian economy

*****

cc: Ross
SV 4

Office Memorandum

January 26, 1998

To: Pen Kent

From: Stanley Fischer SF

Subject: **Your statement to the banks**

I apologize for having had to wake you a few mintues ago, but we need to keep the Board on board.

1. Attached is a suggested opening paragraph that would help ease the anxieties of the U.S. ED. The intent is to make it clear that (a) this is a voluntary process; (b) the Kent principles are not legally binding but rather a basis for discussion as to how to proceed; and (c) that the final decisions on the principles to be followed will be made by creditors and debtors.

2. She also raised the question of what would happen if some creditors refused to join the process, i.e. the free-rider problem. Can this be addressed in your statement? Should it be addressed?

Good luck: we're rooting for you.

ASIA/PACIFIC-
27 JAN 98 8:14

cc: The Managing Director
Mr. Boorman
Mr. Neiss

Let me emphasize before we begin that I am here as a consultant to Mr Prawiro, given the task of helping put in place a framework for dealing with the Indonesian corporate debt problem, based on a purely voluntary, private sector approach What I will be suggesting is a set of principles to ensure an effective process The general principles would of course have to be agreed on between the Steering Committee and the Contact Committee And the practical application of these or related principles in each case would have to be agreed on by creditors and debtors as they meet to find a solution for each company's debt problem

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

NEISS, Hubert
ROOM HQ 4-320 0493

News Brief No. 98/4
FOR IMMEDIATE RELEASE
January 26, 1998

International Monetary Fund
Washington, D. C. 20431 USA
www.imf.org

Camdessus Welcomes Indonesia's Measures

Michel Camdessus, the Managing Director of the International Monetary Fund, welcomed the announcement today by the Indonesian government of a comprehensive program for the rehabilitation of the Indonesian banking sector, and a process to put in place a framework for creditors and debtors to deal, on a voluntary and case-by-case basis, with the external debt problems of Indonesian corporations.

Camdessus said: "These programs continue and extend the implementation of the reinforced set of economic reforms that were announced by President Suharto on January 15. A wide range of measures to eliminate structural distortions and restrictions has already been put in place before their committed date of February 1. In particular, all special privileges granted to the National Car Program have been eliminated; special funding for IPTN, the aircraft manufacturer has been rescinded; restrictive marketing arrangements have been abolished; domestic trade in agricultural products liberalized; and the BULOG monopoly restricted solely to rice. Also, a revised budget was submitted to Parliament.

"To prevent the further erosion of confidence in the banking system, which has been under severe pressure in light of the extraordinary depreciation of the rupiah, the government has decided that from today it will guarantee the obligations of depositors and creditors. At the same time, the government is moving decisively to resolve the underlying financial difficulties of the banking system by establishing the Indonesian Bank Restructuring Agency (IBRA) that will be given broad powers to restructure all financially weak banks.

"As the exchange rate has depreciated excessively, many corporations have found it increasingly difficult to service their external debt. To restore orderly debtor-creditor relations, a private initiative is underway to put in place a framework for negotiations between individual creditors and debtors to work out viable debt restructuring arrangements on a voluntary and case-by-case basis. Agreements under this framework would not involve funds from the public sector. In addition, action to strengthen bankruptcy procedures would support effective solutions.

"It is my conviction that the new measures will be implemented effectively and will contribute to a resolution of Indonesia's present crisis," Camdessus said.

MR. NEISS

20 pages

Jan. 26, 98

Draft Statement on Corporate Debt

by Radius Prawiro

Over the past few months, the sharp decline of the rupiah exchange rate has made it increasingly difficult for Indonesian corporations to service their external debts. As this occurred, it has become increasingly important that a strategy be developed for restoring orderly relations between these corporations and their creditors. The President has accepted my recommendation for an informal, voluntary framework to manage the external debts of Indonesian corporations. As I said in my earlier statement on 28th December, there is no question of public sector finance, subsidies, or guarantees.

end Dec

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could be 5 Gn less

To develop this framework, a steering committee of lenders is needed. Mr. David Brougham, a Director of Standard Chartered Bank HK has agreed to help put the structure in place. The steering committee consists of senior international bankers from the main creditor countries [A list of its members is attached.] There will also be a Contact Committee of borrowers.

The international community including the Governments of the Group of Seven, the IMF and the World Bank are supporting this initiative.

This framework is being set up and managed by the private sector, and will be based on voluntary agreements between borrowers and lenders. It is important for both sides of the relationship that these agreements lead to the restoration of debt service in a sustainable way. The framework has two principle aims. The first is to maximize the recovery of value by the lenders. The second is to restore the capital and interest payment streams of viable corporations to sustainable levels, thereby enabling them to survive. In this way, the framework should create a "win-win" situation for debtors and creditors alike, while minimizing the risk for both. Without action of this kind, market conditions could continue to deteriorate to the lasting detriment of both sides.

The framework does not guarantee the viability of every Indonesian corporation. Those with no prospect of viability may have to close.

The framework will include the following:

Who can pay, must pay

a. Corporations able to continue to service their debts must continue to do so.

in the curr sit some comp already unable / unsustainable. i.e. C. is needed to allow time for new arrangement

b. A temporary pause in foreign currency debt service both of interest and capital for the rest to allow time for new arrangements between lenders and borrowers to be worked out & restructuring. This pause starts immediately, this morning. It introduces order to a disorderly situation which exists at present.
discuss regime within 8 days

c. A structure intended to encourage the borrowers to restore full debt service at the earliest possible date.

The details of the framework will be worked out by the Steering Committee in consultation with the other creditors, the Contact Committee, and the borrowers.

The design of the plan will reflect the circumstances of each debtor and be on terms acceptable to creditors and debtors.

The pause in debt service will only affect financial loans (bank loans, bonds, commercial paper and similar instruments). Genuine trade debts will be excluded from this framework, and where possible will continue to be serviced. It is also desirable that banks restore trade lines to allow the economy to continue to operate as near to normal as possible.

The guarantees announced today to domestic banks to enable them to honor external liabilities will assist this process.

The architecture and implementation is for private sector parties to carry out. It is in this sense that the arrangement is both informal and voluntary. For reasons of equity and effectiveness it does however have to start in a concerted and orderly way. That is why I am asking you to understand that the standstill must start immediately before you have had the opportunity to debate the issues.

Mr. Kent, who was until recently an Executive Director of the Bank of England, has been advising me on this issue. He will give you more details.

*****

MR. NEISS

cc: ROSS
DVY

20 pages

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*****

Office Memorandum

To: Mr. Neiss

January 26, 1998

From: Charles Enoch CE

Subject: **Indonesia--Your Questions**

You raised a number of questions in your fax of yesterday to Mr. Aghevli

1. You asked about the meaning of the references in the documentation to "BI enhanced supervisory functions" and "supervisory scrutiny". Regarding the first, with the introduction of the guarantee the risk reward tradeoff for banks and their customers changes, and the supervisors need to take a more direct role in managing certain aspects of banks' behavior. Thus BI will need to ensure that banks do not, for instance, offer deposit rates that are far out of line with prevailing market norms: this is to be achieved through establishing indices of average rates from a sample of banks (probably the largest seven), publishing these indices, and requiring for the guarantee to be effective that all banks stick within a given range of these rates. Similarly, in order to prevent switching from non-guaranteed liabilities to guaranteed liabilities, which may be a risk especially as regards trade credit, BI will establish prudential ceilings on credit growth rates over the coming months, probably designed to keep rates roughly constant in real terms.

As regards "supervisory scrutiny" BI has agreed to increase the resources it devotes to investigating fraud.

2. It is expected that BI will have criteria based on liquidity, solvency, and fit-and-properness of management. These may vary over time, depending on the general economic situation and the capacity of IBRA to accept large numbers of weak banks. In present conditions liquidity indicators are likely to be dominant, since they are available in real time. The mission was informed last week that 44 banks would miss a criterion of having BI support of at least 200% of capital, and around three quarters of these have liquidity support of at least 400% of capital. These are the sorts of numbers of banks that BI has in mind to send to IBRA for review. The "specified operational guidance" refers essentially to requiring that the banks comply with those undertaking the review. Until the reviews are completed it is at present envisaged that the banks remain under BI supervision, with BI having increased powers to guide their operations. The mission was in fact told last week that it feels that the first set of banks to be reviewed by IBRA will pass through this stage very quickly, as their condition is obviously dire.

3. We have deleted the date for the completion of the reviews, in part since the first of the reviews can be completed much more quickly than earlier stated. IBRA will take the final decision on whether to restructure, based on its analysis of the reviews and of the results of

shareholders' efforts to recapitalize themselves. We have been working particularly closely with the World Bank in this area, and they intend to provide consultants very shortly to help IBRA formulate a restructuring strategy. At the moment Mr. Stefan Ingves, Deputy Governor of the Bank of Sweden, and former head of the Swedish restructuring agency, is here under MAE auspices, and is working closely with the chairman-designate of IBRA.

4. The guarantee applies to all banks now open, i.e. not the 16 that were closed in October. It was earlier considered whether to have a further round of closing before the guarantee was introduced, but it was generally agreed that in the present environment such a strategy would be risky and not worth the possible cost savings.

5. We have sought to avoid the word "liquidation" because it has very negative connotations at the moment, following the closings of October, and we do not wish to give the impression that there are to be successive waves of bank closings. In practice it is understood that restructuring will in difficult cases involve the extraction of the great bulk of the balance sheet of a bank into the asset management company and other purchasers, so that the bank no longer exists in its present form. Infusions of public money will be accompanied by write-downs and elimination of existing equity, and generally a change of management.

6. The seven day limitation seems to have been misinterpreted, and we have modified the wording in the revisions to the documentation. The intention is that the maturity of LOLR lending is to be no more than seven days, as in a conventional lombard facility. This enables one to define a "penalty" interest rate. Rollovers and repeated use of the facility are of course quite likely in the present environment. However, protracted use of the facility--the definition of which is deliberately left to BI--will prompt a review by IBRA.

cc: Mr. Guitián
Mr. Knight
Mr. Aghevli
Mr. Felman
Mr. Frecaut
Mr. Roulier (World Bank)

Jan. 26, '98

INTERNATIONAL MONETARY FUND

TO Mr Neiss

FROM SF

1. I'm not sure what Zelikow was talking about. I didn't speak to him; perhaps I said to Geithner we needed to find out more about total return swaps, but I never disavowed the earlier results.

2. This business with people leaving as soon as a package is announced is a real problem.* But we did persuade Enoch to squeeze in Jakarta before some other place, & he may not be available.

There is a critical need to have someone there — pls. contact Manuel immediately & ask for help ~~to~~ Asia & if we can get a consultant if necessary.

* Jayosumarto & Zamani complained

INTERNATIONAL MONETARY FUND

TO

FROM

(2)

yesterday that in the first round we announced the 16 bank closings & left town — and then when the panic set in, there was no one from the Fund to advise.

CLOSED DOCUMENT
IN ACCORDANCE WITH THE POLICY ON ACCESS TO THE
IMF ARCHIVES

This [X] document or [ ] file has been removed as it belongs to the following category

- [ ] Legal documents and records that are protected by attorney client privilege,
- [ ] Personnel files and medical or other records pertaining to individuals,
- [ ] Documents and proceedings of the Grievance Committee,
- [ ] Records furnished to the Fund by external parties, including members, with security marking confidential or above (declassification can be requested)
- [X] Other sensitive
  Personal Note

Department/Division/ Collection	Asia Pacific Department Records
Series/Subseries	Asian and Pacific Department Director's Office Files - Asian Crisis
Box number	A8-024
File number	2
ADLIB ref number	250
File title & dates	Indonesia - Chronological Files, January 1998
Doc title & dates	Questions on the Indonesia Program, January 24, 1998

Jan 26, 97

Corporate Debt

Statement by Pen Kent,
Advisor to Dr. Prawiro
27th January, 1998

Principles of Debt Service Pause

Start Line: For reasons of equity it is necessary to have a common start line for the pause. This is the opening of business today, Jakarta time.

Coverage: It embraces all foreign currency claims of financial institutions on Indonesian private sector corporations, except genuine trade credits. These claims take the form of loans, overdrafts, bonds, commercial paper and other similar instruments.

Seniority and Security/Collateral

During a pause of this kind, seniority and security/collateral cannot effectively be exercised—and may have to be modified during restructuring. This matter will be considered in more detail by the Steering Committee. New money will always have "super seniority" (see below).

Voting and Decision Making

For the sake of rapid progress decisions be driven by commercial judgement rather than the legal fine print of loan documents. Of course the eventual agreements will need to be legally drafted and will be subject to a jurisdiction of an acceptable international standard. Decisions will be taken by a 75 percent vote by value, notwithstanding unanimity clauses.

Burden Sharing

So far it is possible the framework will seek equitable burden sharing both between different creditors and between creditors and borrowers.

Provisioning

Provisioning requirements and tax treatments vary from country to country. It will not, however, be possible to take account of this in the burden sharing process.

Openness and Transparency

Trust between all parties would be enhanced by the maximum openness.

Confidentiality

Participants will give confidentiality undertakings in relation to individual cases.

Structure

Mr. David Brougham, Director of Standard Chartered Bank has agreed to help put the structure of the Steering Committee in place. He has much experience of corporate restructuring and of the region. The membership has been deliberately kept fairly small, and consists of senior representatives of the major national groups of banks as measured by exposure.

The Steering Committee will have a counterpart from the borrowing side in the Contact Committee, although detailed negotiations with each borrower will have to be bilateral. The Steering Committee will devise a structure which facilitates these negotiations. It will not be able to handle the whole burden itself.

Objectives

The purpose is to restore to full creditworthiness as many of the borrowers as possible. It is possible that some of these will need to be restructured or change the management.

Restructuring

There will be 3 basic tiers of solution and involvement:

Borrowers

1. Healthy and with the prospect of a rapid recovery to full creditworthiness.

2. Those with the prospect of long-term viability; and

3. Those which are likely to be unviable without the injection of major new capital and management.

Banks

1. Those willing to play the most active part and where appropriate ready to provide new money for working capital. New money will be provided on a last-in, first-out basis--i.e., superpriority over other claims.

2. Those supporting restructuring but unwilling to provide new money in which case they would become junior lenders.

3. Banks not wishing to participate in anyway and ready instead to write off their claims and waive any rights.

Encouragement to Perform

The terms of each group will be structured to encourage graduation towards best performance.

Group 1 companies may have to offer some deferred fees, warrants, success rewards in exchange for new money from the banks. In return, the banks may have to use restraint in increasing margins to reflect risk.

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights. Safeguards to protect shareholdings from subsequent dilution would be necessary. The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions. Margins are likely to be widened. There may be other reward features for the banks, deferred until the recovery allows.

Group 3 companies may have to be closed unless new capital is injected. The treatment of this group is likely to be much more varied case-by-case.

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers expense. Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups. The structure should encourage and demand performance tests to validate such selection.

Timetables

Phase 1 is expected last about 3 months. The best performers may graduate out of the framework very quickly. During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources. The Contact Committee will be following a parallel course.

Liaison

Both committees will have the right to convene a meeting with the other.

Phase 2 will last for 9 months. During this period all negotiations with the major company groupings will have made substantial progress. Target dates for graduation out of the framework by Group 1 companies will have been set. A clear body of precedent for each of the 3 groups will have been set.

Phase 3 will aim to last for only 12 month. It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight. The Steering Committee would stand down at the earliest possible date.

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies; and will inform Dr. Prawiro of progress from time to time. In particular, they will jointly inform him when they believe their task has been completed.

Legal Fees will be paid by the borrower. Lenders commit themselves to pooling legal advice where possible and imposing discipline on fees.

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform.

* * * * *

Jan 26 - 98

old

Draft Statement on Corporate Debt

by Radius Prawiro

Over the past few months, the sharp decline of the rupiah exchange rate has made it increasingly difficult for Indonesian corporations to service their external debts. As this occurred, it has become increasingly important that a strategy be developed for restoring orderly relations between these corporations and their creditors. The President has accepted my recommendation for an informal, voluntary framework to manage the external debts of Indonesian corporations. As I said in my earlier statement on 28th December, there is no question of public sector finance, subsidies, or guarantees.

To develop this framework, a steering committee of lenders is needed. Mr. David Brougham, a Director of Standard Chartered Bank has agreed to help put the structure in place. The steering committee consists of senior international bankers from the main creditor countries [A list of its members is attached.] There will also be a Contact Committee of borrowers.

The international community including the Governments of the Group of Seven, the IMF and the World Bank are supporting this initiative.

This framework is being set up and managed by the private sector, and will be based on voluntary agreements between borrowers and lenders. It is important for both sides of the relationship that these agreements lead to the restoration of debt service in a sustainable way. The framework has two principle aims. The first is to maximize the recovery of value by the lenders. The second is to restore the capital and interest payment streams of viable corporations to sustainable levels, thereby enabling them to survive. In this way, the framework should create a "win-win" situation for debtors and creditors alike, while minimizing the risk for both. Without action of this kind, market conditions could continue to deteriorate to the lasting detriment of both sides.

The framework does not guarantee the viability of every Indonesian corporation. Those with no prospect of viability may have to close.

The framework will include the following:

b. A temporary pause in foreign currency debt service both of interest and capital to allow time for new arrangements between lenders and borrowers to be worked out. This pause starts immediately, this morning. It introduces order to a disorderly situation which exists at present.

c. A structure intended to encourage the borrowers to restore full debt service at the earliest possible date.

~~c. A structure to encourage the lenders to offer some restructuring to those unable to service their debts but on less favorable terms to the borrower than under the original contracts. There will have to be burden sharing by both lenders and borrowers.~~

(a) Corporations able to continue to service their debts must continue to do so.

The details of the framework will be worked out by the Steering Committee in consultation with the other creditors, the Contact Committee, and the borrowers.

The design of the plan will reflect the circumstances of each debtor and be on terms acceptable to creditors and debtors.

The pause in debt service will only affect financial loans (bank loans, bonds, commercial paper and similar instruments). Genuine trade debts will be excluded from this framework, and where possible will continue to be serviced. It is also desirable that banks restore trade lines to allow the economy to continue to operate as near to normal as possible. The guarantees announced today to domestic banks to enable them to honor external liabilities will assist this process.

The architecture and implementation is for private sector parties to carry out. It is in this sense that the arrangement is both informal and voluntary. For reasons of equity and effectiveness it does however have to start in a concerted and orderly way. That is why I am asking you to understand that the standstill must start immediately before you have had the opportunity to debate the issues.

Mr. Kent, who was until recently an Executive Director of the Bank of England, has been advising me on this issue. He will give you more details.

*****

CLOSED DOCUMENT
IN ACCORDANCE WITH THE POLICY ON ACCESS TO THE
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This [X] document or [ ] file has been removed as it belongs to the following category

[ ] Legal documents and records that are protected by attorney client privilege,

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[ ] Documents and proceedings of the Grievance Committee,

[ ] Records furnished to the Fund by external parties, including members, with security marking confidential or above (declassification can be requested)

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Series/Subseries	Asian and Pacific Department Director's Office Files - Asian Crisis
Box number	A8-024
File number	2
ADLIB ref number	250
File title & dates	Indonesia - Chronological Files, January 1998
Doc title & dates	Fax to Mr Hubert Neiss from Mr David Nellor on AsDB's Package, January 26, 1998

Office Memorandum

To Mr Fischer January 26, 1998

From Hubert Neiss HN

Subject **Indonesia—Bank Restructuring and Corporate Debt Restructuring Packages**

With regard to the issues raised during the informal Executive Board Meeting, the following actions have been taken

1 The drafting changes to the bank restructuring package (on the importance of amending the bankruptcy law and the reference to the AsDB in the deposit insurance scheme—attached) have been sent to the mission Mr Aghevli reported that the reference to the AsDB had been already incorporated in the draft The other change might be difficult at this stage because the document has been returned to the Indonesians and translated into Indonesian

2 On data issues

- Foreign currency deposits as of end-December 1997 amounted to \$23 8 billion of which \$20 2 were for residents and \$3 6 for nonresidents The distribution of these among banks is as follows

State Banks	\$8 6 billion
National private banks	\$10 billion
Foreign and joint venture banks	\$5 3 billion

  The reduction in foreign bank deposits between June and December was concentrated in national private banks Deposits in state banks and foreign banks increased slightly (table attached) However, Peter Dattels memo of January 26 indicates that state banks are now having difficulty retaining these deposits but no firm data are available

- The estimates of the initial cost of the restructuring agency is 12 percent of GDP (largely to refund BI liquidity injections) The full cost of the cleanup is also estimated at 12 percent of GDP The minister has not agreed to these numbers

- Deposits and liabilities of banking system are as follows

Total rupiah deposits (Nov)	Rp 227 7 trillion	37 % of GDP
Foreign currency deposits (Dec)	$23 8 billion	
Other domestic liabilities	Rp 43 2 trillion	7 % of GDP
Foreign liabilities	$14 6 billion	

Attachments

cc The Managing Director
The Deputy Managing Directors
PDR
Mr Russo
Mr Cross

Contributors
Ms Kelly
Mr Goldsbrough

cc: [illegible]

PROPOSED CHANGES

Draft
Jan 26, 1998, 11 40 a m

Program for the Rehabilitation of the Indonesian Banking Sector

In order to restore the confidence of depositors and creditors--domestic and foreign--in the Indonesian banking system, and to re-establish the soundness of the system, we are undertaking a comprehensive program to rehabilitate the system This program comprises two main elements First, the provision of a full guarantee by the Government of Indonesia to all depositors and creditors of locally incorporated commercial banks And second, the creation of the Indonesian Bank Restructuring Agency --IBRA--which will be responsible for rehabilitating those banks that are at present not sound and do not have good prospects of restoring themselves to soundness The relevant legislative and regulatory changes will be put in place shortly

Guarantee

Effective immediately, the Government of Indonesia is guaranteeing that the claims of depositors and creditors of all locally incorporated banks will be met Both rupiah and foreign currency claims are covered, in the case of foreign currency claims, payment of the guarantee will be in rupiah at the market exchange rate The only exceptions to coverage of this guarantee are shareholdings and subordinated debt The guarantee applies equally to private and state-owned banks Thus Indonesian banks are going to be able to meet their commitments We anticipate that most depositors and creditors will wish to keep their funds in the Indonesian banks by rolling over maturing claims, they can rest fully assured that they will receive payment if they do choose to withdraw those funds

In exchange for this guarantee, all locally-incorporated banks will be subject to the enhanced supervisory oversight that is necessary in present circumstances Banks will also be required to pay a fee based on the value of their liabilities in order to help defray the possible costs of that guarantee

The guarantee will remain in place for at least two years, and will not be terminated before the soundness of the banking system has been restored We will give at least twelve months' notice of the ending of the guarantee At that point, the guarantee ~~will~~ could be replaced by a deposit insurance system, the possible modalities of which will be worked out with assistance from the ADB

Prudential requirements

Bank Indonesia, in consultation with the IMF and World Bank is developing a comprehensive set of prudential requirements of a banking system operating with the guarantee In this connection, Bank Indonesia will be issuing additional prudential requirements in order to prevent irregular practices During the period of the guarantee, there will be limits imposed on rates to ensure that banks do not offer terms substantially in excess of market terms There will also be limits on the rates of growth of credit These limits, together with prudential norms on banks' customers' uncovered positions, will be announced by Bank Indonesia in the next few days

Indonesian Bank Restructuring Agency (IBRA)

As the second major element in the rehabilitation program, the government has established IBRA, the Indonesian Bank Restructuring Agency This is an autonomous agency, operating under the auspices of the Ministry of Finance It will be headed by [ ] [and will include on its board [seven] members, of whom [six] are designated by the Ministry of Finance, while the other--the chief executive--will be selected by the rest of the board The board will consist of both inside and outside members, IBRA will be reviewed by an independent review board which will publish its periodic assessments The agency will have a limited lifespan, and will be wound up once the bank rehabilitation program is complete The objective is to restore the banking system to soundness at least cost to the government within the constraints under which we are operating thus existing shareholders will be taking on a share of the burden We are also eliminating all restrictions on foreign ownership of Indonesian banks, so that foreign capital can help provide the resources for a fully capitalized banking system

In order to make IBRA fully operational at once, initial staff are being transferred on secondment from Bank Indonesia, the Ministry of Finance, and other public and private institutions, and the agency will be supported by foreign expert advisors

IBRA will have two main functions first, it will supervise the banks in need of restructuring, and it will manage the restructuring process, and second, it will be the management agency for assets that it acquires in the course of the bank restructuring In this connection, IBRA will also take over the claims relating to the emergency and other liquidity and solvency support that Bank Indonesia has provided to the banks in the past, this transfer will serve to increase the transparency of such operations and to restore Bank Indonesia's balance sheet

Bank Indonesia is assessing the condition of the banks Those that fail to meet certain standards are to be reviewed by IBRA Where relevant, shareholders of those banks are to be given the opportunity to recapitalize their banks In the event that recapitalization does not take place and a bank fails an IBRA-commissioned review, IBRA will assume full supervisory authority over it

IBRA will consider how to restore such banks to full soundness, whether through recapitalization or through merger or takeover, at least cost to the public, in any case where public money is involved, existing shareholders will have their equity written down or eliminated IBRA will take over responsibility for implementing the government's plans for merging state banks to improve their financial condition and/or operational efficiency This will include the merger of four state banks, by end-June 1998, and the introduction of new management by the end of February 1998 IBRA will, where appropriate, also purchase problem assets in cases in which it concludes that such purchases would enable higher realizations from the sale of the bank or of the asset IBRA will develop a specialized asset

management capability to maximize its recoveries After restructuring them, IBRA will aim to sell the banks and portfolios it has acquired This process will thus include the privatization of the state banks over which it exercises control, as well as those for which it assumes control as part of the restructuring process

The government will shortly issue bonds in order to provide the initial funding for IBRA Further issuances can be expected as IBRA's operations develop Over time, as recoveries increase, IBRA will be able to become more self-financing

Other measures

-- in conjunction with the strengthened bankruptcy law -- as well as

The government is also committed to revising the legal framework for banking operations, after a thorough review of the central bank and banking regulations. Areas of focus ~~will include~~ contract enforcement, and the ~~bankruptcy~~, banking disclosure, taking and realizing collateral and regulations on financial instruments There are to be improvements in the data that banks will be required to publish Prudential regulations will be reviewed, various sanctions will be enforced, including withdrawals of bank licenses and the imposition of appropriate penalties on management and directors who fail to conform to safe and sound banking practices

Bankruptcy procedures ~~and contract enforcement~~

The government intends to give high priority to ~~the~~ early ~~establishment~~ of more ~~effective~~ bankruptcy procedures, within the framework of ~~new~~ a modern bankruptcy law. ~~Additional areas of focus will include contract enforcement and the taking and realizing of collateral.~~

(2)

Conclusion

This comprehensive program reflects our determination to restore the soundness of Indonesia's banking system We are protecting fully the banks' customers while dealing forcefully with the banks themselves Once this process, is over Indonesia will have a banking system that will be able to meet fully the challenges of restoring rapid growth to the Indonesian economy

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INA.INDANA/IMF

TO: MARGARET KELLY

CC HN
DG

Table 1 Indonesia--DEMAND DEPOSITS, TIME AND SAVINGS DEPOSITS BY GROUP OF OWNERSHIPS AND BANKS
(In billions of rupiah)

End of	Bank Persero State Banks			Bank Swasta Nasional National Private Banks			Bank Pemerintah Daerah Regional Government Banks			Bank Asing & Campuran Foreign and Joint Venture Banks			Jumlah Total		
	Rupiahs	FE	FX($)	Rupiahs	FE	FX($)	Rupiahs	FE	FX($)	Rupiahs	FE	FX($)	Rupiahs	FE	FX($)
1997															
September	77,477 1	26 414 2	7 771 9	141 172 8	49 418 6	15 112 7	8 180 0	46 7	14 3	9 670 0	16 452 7	5 031.4	236 399.9	91 332 2	27 930 3
Resident	77 375 1	16 463 2	5 031 6	140 803 8	46 277 6	14 152.2	8 179 0	46 7	14 3	7 517 0	16 184 7	4 643 6	233 874.9	77 962 2	23 841 7
Non Residents	102 0	8 961 0	2 740.4	369 0	3 141 0	960 6	1 0	0 0	0 0	2 053 0	1 268 0	387 8	2 525 0	13 370 0	4 088 7
October	81 733 1	29 716 4	8 277 3	141 953 4	49,986 4	13 923 8	8 476 2	54 8	15 3	8 731 7	19 029 3	5 300 6	240 893.4	98 785 9	27 517 0
Resident	81 560 1	19 548.4	5,445 2	141 546.4	47 002 4	13 092 6	8,474 2	54 8	15 3	7 589 7	18 020 3	5 019 6	239 170 4	84 625 9	23 572 7
Non Residents	173 0	10 167 0	2 832 0	407 0	2 984 0	831.2	1 0	0 0	0 0	1 142 0	1 009 0	281 1	1 723 0	14 160 0	3 944 3
November	92 316 7	29 876 0	8,196 2	126 933 5	43 081 0	11 819 2	8 624 2	63.4	14 7	9 858 2	19 787 9	5 428 8	236 732 6	92 797 3	25 468 8
- Resident	92 145 7	20 788.0	5 703.2	125 615.5	40,220 0	11 034 3	8 623 2	53 4	14 7	8 387.2	19 109 9	5 242 8	234 771 6	80 171 3	21 994 9
Non-Residents	171 0	9 087 0	2,493 0	318 0	2 861 0	784 9	1 0	0 0	0 0	1 471 0	678 0	186 0	1 961 0	12 626 0	3 463 9
December	93 249 1	39 793 4	8,557.7	130 776 6	46 415 8	9,981 9	8 739 0	57 2	12 3	14 071 1	24 511 0	5 271 2	246 836 7	110 777 4	23 823 1
- Resident	92 984 1	27 108 4	5,829 8	130 360 5	42 878 8	9 221.2	8 738 0	57 2	12 3	10 478 1	23 665 0	5 089.2	242 560 7	93 709 4	20 152 6
Non Residents	265 0	12 685 0	2 728 0	416 0	3 537 0	760 6	1 0	0 0	0 0	3 593 0	846 0	181 9	4,275 0	17 068.0	3 670 5

1) Consist of foreign exchange private national banks non foreign exchange private national banks private development banks and private savings banks
2) Since April 1993 includes ex Non-Bank Financial Institutions
) Provisional figures

Jan 26, 98

Asian Markets—January 26, 1998

Most financial markets in the region gain strength as yen remains firm

	Thailand	Malaysia	Philippines	Indonesia	Singapore	Korea	Hong Kong SAR	Taiwan Province of China	Japan
Closing exchange rates (per $)									
January 26	54 67	4 41	43 05	13,000	1 75	1,688	7 74	34 00	125 68
January 23	54 75	4 53	43 40	12,500	1 76	1,745	7 74	33 92	126 33
Percent change (+ = appreciation, - = depreciation)	0 1	2 7	0 8	-3 8	0 6	3 4	0 0	-0 2	0 5
Cumulative percent change since last peak	-53	-43	-39	-81	-18	-47	0	-16	-10
(Date of last peak)	(Jul 1)	(Jul 11)	(Jul 9)	(Jul 8)	(Jul 2)	(Jul 7)	(Jul 24)	(Oct 10)	(Jul 9)
Stock market index									
January 26	425	570	1,731	474	1,256	519	8,974	8,085	17,073
January 23	423	559	1,704	451	1,260	487	8,920	8,085	16,789
Percent change	0 4	1 9	1 6	5 0	-0 3	6 5	0 6	0 0	1 7
Cumulative percent change since last peak	-38	-48	-39	-34	-37	-32	-46	-20	-17
(Date of last peak)	(Jul 29)	(Jul 2)	(Jul 1)	(Jul 30)	(Jul 8)	(Aug 11)	(Aug 7)	(Aug 26)	(Jul 28)
Overnight interest rate									
January 26	20 5	11 0	12 0	30 0/ 1/	0 4	25 5	5 3	8 6	0 46
January 23	20 5	12 0	12 0	30 0/65 8 1/	0 6	24 6	4 5	8 0	0 44

1/ First rate quoted is the overnight interest rate for the JIBOR, second rate is the average interbank rate for all banks

General comments by market participants

Japan Yen and Nikkei boosted by expectations of a rise in interest rates, further economic stimulus, and reports of upcoming intervention
Korea Won firms sharply on exporter sales and renewed hopes of an early conclusion to debt talks in New York
Indonesia Rupiah recovers from early lows amid reports of central bank intervention

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Jan 26, '98

Draft Statement on Corporate Debt

by Radius Prawiro

Over the past few months, the sharp decline of the rupiah exchange rate has made it increasingly difficult for Indonesian corporations to service their external debts As this occurred, it has become increasingly important that a strategy be developed for restoring orderly relations between these corporations and their creditors I am accordingly announcing today a voluntary framework to manage the external debts of Indonesian corporations As I said in my earlier statement on 28th December, there is no question of public sector finance, subsidies, or guarantees

Mr Kent, who was until recently an Executive Director of the Bank of England, has been advising me on this framework Mr David Brougham, a Director of Standard Chartered Bank and Mr Lim Ho Kee, Executive Vice President and CEO UBS East Asia, have agreed to help put a steering committee of lenders in place The steering committee will consist of senior international bankers from the main creditor countries There will also be a Contact Committee of borrowers I have asked Mr Antony Salim, Mr The Ning King and Mr Rachmat Gobel to assist in its formation

This framework is being set up and managed by the private sector, and will be based on voluntary agreements between borrowers and lenders It is important for both sides of the relationship that these agreements lead to the restoration of debt service in a sustainable way The framework has two principal aims The first is to maximize the recovery of value by the lenders The second is to restore the capital and interest payment streams of viable corporations to sustainable levels, thereby enabling them to survive In this way, the framework should create a "win-win" situation for debtors and creditors alike, while minimizing the risk for both Without action of this kind, market conditions could continue to deteriorate to the lasting detriment of both sides

The framework does not guarantee the viability of every Indonesian corporation Those with no prospect of viability may have to close unless new capital is injected At the

 there are some

same time, corporations able to service their debts must continue to do so However, we need to recognize that in the current disorderly situation in which companies are already unable to fulfil their commitments This ~~is~~ unsustainable and needs to be regularized Consequently, a temporary pause in foreign currency debt service, both of interest and capital, ~~is~~ would be needed for these companies to allow time for new arrangements to be worked out between lenders and borrowers / recommend that this ~~This~~ pause starts immediately with the expectation that arrangements will be worked out for the resumption of debt service as soon as possible To this end, a structure is being developed to encourage the borrowers to restore full debt service at the earliest possible date

The details of the framework will be worked out by the Steering Committee in consultation with the other creditors, the Contact Committee, and the borrowers The chairmen of these two Committees will keep me informed of progress

The design of the plan will reflect the circumstances of each debtor and be on terms acceptable to creditors and debtors

The arrangements regarding debt service will only affect financial loans (bank loans, bonds, commercial paper and similar instruments) Genuine trade debts will be excluded from this framework, and where possible will continue to be serviced It is also desirable that banks restore trade lines to allow the economy to continue to operate as near to normal as possible The guarantees announced today to domestic banks to enable them to honor external liabilities will assist this process

The architecture and implementation is for private sector parties to carry out It is in this sense that the arrangement is voluntary However, for reasons of equity and effectiveness it is important to have a decisive start That is why I am asking for your understanding that we were not able to consult you in advance

Mr Kent is giving more details to the foreign banking community at separate meetings

fax | ring hotel
6221-390-3868/69/70
~~dial 2 Ext~~
dial 6 2108
wait for answer
2108

recommend a 3 month pause
work out regime of amount falling within 8 days

CORPORATE DEBT

STATEMENT BY PEN KENT,
ADVISOR TO DR. PRAWIRO
27TH JANUARY, 1998

Steering committee will take over
accept majority voting to act with speed

Principles of Debt Service Pause

Start Line: For reasons of equity it is necessary to have a common start line for the pause. This is the opening of business today, Jakarta time.

6234607

7:15

Coverage: It embraces all foreign currency claims of financial institutions on Indonesian private sector corporations, except genuine trade credits. These claims take the form of loans, overdrafts, bonds, commercial paper and other similar instruments.

set aside

Maxwell – Just. Hoffman & NY lawyer reached accord everybody allowed to pursue legal proceed
superior results by acting together

Seniority and Security/Collateral

During a pause of this kind, seniority and security/collateral cannot effectively be exercised—and may have to be modified during restructuring. This matter will be considered in more detail by the Steering Committee. New money will always have "super seniority" (see below).

no force but leadership
explain process

no legal sticks; if they don't like it → failure
can walk away.

on active lender than exposed to more one borrower, UK bank community recognised by others & made it work enforceable rights. rights not enforced to enforce work appropriately necessary consensus delaying multiplies disruption

Voting and Decision Making

For the sake of rapid progress decisions be driven by commercial judgement rather than the legal fine print of loan documents. Of course the eventual agreements will need to be legally drafted and subject to a jurisdiction of an acceptable international standard. Decisions will be taken by a 75 percent vote by value, notwithstanding unanimity clauses.

C
provide leadership
freedom to negotiate collectively self interest in preserving value

A
degree of unreality
mandatory moratorium
nobody wants

by legal frames

C:\DOCS\IDN\KENT.STA January 26, 1998 (1:51pm)

by acting collectively than on individual right

B
desirabilities of certain actions
think about it → directionless chaos

Burden Sharing

So far it is possible the framework will seek equitable burden sharing both between different creditors and between creditors and borrowers.

Provisioning

Provisioning requirements and tax treatments vary from country to country. It will not, however, be possible to take account of this in the burden sharing process.

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There will be 3 basic tiers of solution and involvement:

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The terms of each group will be structured to encourage graduation towards best performance.

Group 1 companies may have to offer some deferred fees, warrants, success rewards in exchange for new money from the banks. In return, the banks may have to use restraint in increasing margins to reflect risk.

Group 2 companies may have to offer debt/equity conversion to give the banks both the possibility of some upside in a recovery, and some shareholder rights. Safeguards to protect shareholdings from subsequent dilution would be necessary. The banks will probably have to write down a proportion of their claims in order to reduce the cash drain on the borrowers to manageable proportions. Margins are likely to be widened. There may be other reward features for the banks, deferred until the recovery allows.

Group 3 companies may have to be closed unless new capital is injected. The treatment of this group is likely to be much more varied case-by-case.

Due Diligence

As far as possible, objective assessments of the viability of companies will be necessary at the borrowers expense. Where information is incomplete, there may have to be an element of self selection by borrowers into the three groups. The structure should encourage and demand performance tests to validate such selection.

Timetables

Phase 1 is expected last about 3 months. The best performers may graduate out of the framework very quickly. During this phase the Steering Committee will devise its own modalities, collect its own human and financial operating resources. The Contact Committee will be following a parallel course.

Liaison

Both committees will have the right to convene a meeting with the other.

Phase 2 will last for 9 months. During this period all negotiations with the major company groupings will have made substantial progress. Target dates for graduation out of the framework by Group 1 companies will have been set. A clear body of precedent for each of the 3 groups will have been set.

Phase 3 will aim to last for only 12 month. It is planned and hoped that all negotiations with individual borrowers will have been concluded or be within sight. The Steering Committee would stand down at the earliest possible date.

Accountability

The Chairman of the Steering Committee and the Chairman of the Contact Committee will be accountable to their own respective constituencies; and will inform Dr. Prawiro of progress from time to time. In particular, they will jointly inform him when they believe their task has been completed.

Legal Fees will be paid by the borrower. Lenders commit themselves to pooling legal advice where possible and imposing discipline on fees.

Insolvency Law

The Government of Indonesia will be encouraged to introduce legislative reform.

* * * * *

Jan 26, '98

No G-7 statements
but under statement possible

LS (a) FX guarantee not thru the
through
(b) precedent for Thail & K

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Bruce Longford

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ER

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KL

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laying down rules

1 6221-390-1234

Jan 26, 98

G-7 Deputies 9 am

1 26 98

HN - My view is that G-7 statement is not very important - I'll not try to persuade them very much

(S Fischer's handwriting(?))

CLOSED DOCUMENT
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IMF ARCHIVES

This [X] document or [ ] file has been removed as it belongs to the following category

[ ] Legal documents and records that are protected by attorney client privilege,

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[X] Other sensitive
G-7 Document

Department/Division/ Collection	Asia Pacific Department Records
Series/Subseries	Asian and Pacific Department Director's Office Files - Asian Crisis
Box number	A8-024
File number	2
ADLIB ref number	250
File title & dates	Indonesia - Chronological Files, January 1998
Doc title & dates	G-7 Statement on the Indonesian Reform Package, January 25, 1998

Jan. 25, 98

INTERNATIONAL MONETARY FUND

WASHINGTON, D.C. 20431

MESSAGE CENTER

Fax # (202) 623-4661 Tel # (202) 623-6262

MSG. NO.	DATE January 25, 1998	PAGE 1 OF 1

TO Mr. Aghevli

Room 2413
Grand Hyatt
Jakarta Indonesia

62 21 390-6426

Dear Bijan:

We all appreciate the efforts of you and your team. Please pass on to them my—and management's—thanks and our recognition of the considerable work pressures they have been under.

Management has decided that we need a continuous mission presence in Indonesia during these critical times—just as we had in Korea. Therefore, we will send a team consisting of a mission chief (David Goldsbrough or the other B4 'addition', if he/she can be released in time) plus Chris Ryan, Michael Sarel, and Ilan Goldfajn, and an assistant; we will also ask for a fresh PDR substitute. Since the new chief cannot arrive in Jakarta before Wednesday evening, you should plan to leave on Friday morning, in order to allow one full day of overlap. Please also have one or two of your team stay through Friday, in order to have adequate coordination with the new group. Charles Enoch should also stay at least for the next one-to-two weeks to monitor the bank restructuring.

Best regards and well done

HN

Hubert Neiss

Jan. 25, '98

Indonesia: Comments on Corporate External Debt Restructuring

1. The German proposal is too activist and should be set aside; at least for the time being.

2. The Pen Kent proposal is harmless and virtuous but it is an empty shell.

3. Setting up a **structure** to deal with corporate debt is a necessary first step, but by itself, its announcement not likely to have much impact. However, if it is announced as part of the strategy to deal with the banking system it could be useful.

4. More work will be required to develop the operational substance of the proposal. Some issues that will need to be addressed are:

- how will **debtors** be represented? They should not be represented by commercial banks.

- mechanisms for getting new money for corporations will have to be ensured by establishing seniority for new money.

- can export credit agencies be given the stiff?

- to get the process working the committee should begin with easy cases, e.g., corporates that mainly export (this would snowball in the right direction i.e., these companies would ensure that their suppliers get some credit).

- to make a plan work we will need to rely primarily on the self interest of parties involved.

- However, some sweeteners from the government may be needed. There are two types of options:

  - full or partial guarantee of creditors (possibly with a fee charged to creditors for the guarantee).

  - rupiah subsidies to domestic corporations to cover the gap between the actual exchange rate and what would be a reasonable exchange rate.

  - If possible, an open-ended subsidy share or guarantee (with potential adverse implications for the budget and inflation) should be avoided.

  - Instead, guarantees and subsidies should be targeted (e.g., to essential industries, and within those, to "viable" corporations only).

- the drawbacks and risks of government incentives have to be weighed against the disruptions caused by an "involuntary" rollover of corporate external debt.

Jan. 25 '98

Indonesia Banking Sector Crisis

Over the past several weeks, the state of Indonesia's banking system has **deteriorated seriously and rapidly** What was once a manageable problem, confined to a limited number of small banks has since November spread across the sector, affecting nearly every local bank in the country— including the large and previously state banks More and more banks have come under financial strain, and those already under strain have found that the pressures on them are intensifying **This situation has now reached a crisis stage**

The immediate problem is that the **public is fast losing confidence in the banking system** As fears about the financial position of banks have mounted, the public has begun to withdraw deposits, at an ever increasing pace During the third quarter of 1997 the amount of currency in circulation in the country increased hardly at all During the fourth quarter it increased by 17 percent And in the first three weeks of January alone it increased by an alarming 24 percent With such an increase in demand Bank Indonesia is having difficulty supplying adequate amounts of new notes—even though the printing plants are already working 24 hours a day

Without immediate action, this trend is likely to accelerate, since the deposit withdrawals are **based on well-founded fears about the solvency of the entire commercial banking system** Admittedly, the latest indicators show that the banking system is in reasonable health, with a large amount of capital and only a very small amount of non-performing loans These indicators, however, are highly misleading since they are measuring not the current reality, but rather the situation of several months ago before the rupiah began to plummet Since then, more and more corporations have been unable to pay their debts to the banks, owing to the economic slowdown high domestic interest rates and need to use available funds to repay their foreign debts As a result non performing loans have soared Based on reasonable estimates of the true loan repayment problem (assuming that 17 percent of loans are non-performing, a ratio smaller than in some neighboring countries) loan losses are likely to exceed the total amount of capital in the banking system In other words it is likely that **the banking sector as a whole is now technically bankrupt**

This situation has already had **grave consequence for the commercial banks** Despite the growing provision of funds by the central bank to enable the system to continue operating, commercial banks have nonetheless been increasingly unable to perform their usual functions

- **Banks are unable to lend to the corporate sector** With a shrinking deposit base, banks have fewer and fewer funds available to lend—at a time when corporations' need for credit is intensifying

Draft 1/22/98 -10 30 p m

Restructuring Plan for Indonesian Private and Public Banks

The objective of the banking system restructuring plan is to restore confidence rapidly by offering full protection to all depositors and creditors and by establishing an Indonesian Bank Restructuring Agency (IBRA) Several of the measures will require implementation through legislation or emergency decree Key elements of the bank restructuring plan are to be announced by the President on [Friday January 23]

Guarantee

1 **The government of Indonesia will guarantee all depositors and creditors of all locally incorporated commercial banks, including state banks,** except shareholders, subordinated debt holders and commitments that obviously contravene sound banking practices

- Arrangements will be made so that all payments can be effected promptly

- Payments will be made on provision of appropriate documentation, concerted efforts will be made to combat any attempts at fraudulent exercise of the guarantee

- The guarantee is expected to last for at least two years, and will be terminated only after notice of at least six months The guarantee will not be discontinued until the banking system is sound The guarantee will be promulgated by emergency decree

- At the termination of the guarantee it will be replaced by a deposit insurance system The deposit insurance system will be announced at least six months before the termination of the guarantee

- Liabilities and other commitments denominated in foreign currencies are to be paid in rupiah at the market exchange rate prevailing at the time as determined by Bank Indonesia (BI)

2 **In exchange for the guarantee BI will exercise enhanced supervisory functions**

- All banks will sign a contract with BI recognizing the authority of BI to exercise its enhanced supervisory functions and the authority of IBRA to intervene in banks facing financial difficulties

- In order to prevent abuse of the guarantee, BI may determine a maximum interest rate on deposits, set at a maximum spread over the average interest rates offered for different maturities by a representative sample of banks BI will collect and publish such information on the representative interest rates at least weekly In addition, BI may set bank-by-bank, a maximum rate of growth of credit for individual banks, on prudential criteria

- To prevent fraud BI will subject all institutions to supervisory scrutiny

Indonesian Bank Restructuring Agency

3 **The government will immediately establish an Indonesian Bank Restructuring Agency (IBRA), with a lifespan limited to the duration of the restructuring process**

- The main objective of IBRA will be to restore the banking sector to financial health at minimum cost to the government Various methods will be employed to achieve this objective including mergers, financial restructuring and operational restructuring

- The IBRA will be an autonomous agency, directly responsible to the newly established High Council under the chairmanship of the President

- A Board of Directors for IBRA with competence, independence and integrity will be responsible for ensuring appropriate standards of governance

- Initial staff will be seconded from BI, the Ministry of Finance, the relevant public and private institutions, and foreign specialists Facilities will be provided by BI

4 **BI will identify those commercial banks which are to be reviewed by IBRA**

- These banks will sign a contract with IBRA and operate under specified operational guidance

- Outside consultants will perform independent reviews on these banks by [31 July 1998]

- Shareholders of these banks will be required to prepare rehabilitation plans and to recapitalize the bank in accordance with transparent criteria and the findings of the reviews

- Banks which are unable to rehabilitate and recapitalize themselves as required by IBRA will be subjected to restructuring under the authority of IBRA

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Prasno

5 IBRA assumes full authority for all banks it has determined will be subjected to restructuring

- These banks will enter into a contract with IBRA setting out their various operating and financial obligations, and making senior managers and directors personally liable for gross negligence and wilful misconduct in the implementation of these contracts

- IBRA will assess the relative costs of capital injection merger take-over or other restructuring It will target its review also to assess to what extent problems are caused by bad banking rather than externalities If recapitalization is the least cost option or if the bank is one of a limited number of identified "systemically important banks , the IBRA will provide subordinated debt and/or capital Any subordinated debt will be converted to equity if not repaid

- Equity of existing shareholders will be written down or extinguished according to the amount of capital injection made by the IBRA

- Insofar as the IBRA acquires ownership of (part of) a bank, it will seek to sell that ownership as soon as this is commercially attractive, and in any case within the lifetime of the agency

- Remaining restrictions in foreign ownership of banks will be lifted to help in maximizing the value of recoveries and in recapitalizing the banking sector

- Any capital or subordinated debt infusion provided by IBRA will be accompanied by steps to reduce moral hazard, including generally a change in management

6 Problem assets in banks under IBRA's authority will be placed in a specialized work out company owned by IBRA

- Assets will be evaluated in accordance with transparent criteria established by IBRA sufficient problem loans will be left on the books of the rehabilitated banks so that such banks' problem loans are not brought below roughly the average level of problem loans for healthy banks Sales will be on the basis of professional evaluations prepared by IBRA consultants

- IBRA will dispose of these assets so as to maximize its return on them

7 Liquidity support will continue to be provided by BI to those banks outside IBRA's authority only for the management of short term fluctuations

- Such BI lending will be for no more than seven days, and at a penalty interest rate

1 of fax. + pages

Office Memorandum

To: Mr. Fischer

January 24, 1998

From: Bijan Aghevli BA

Subject: **Indonesia**

I am attaching some preliminary notes on the design of the corporate debt restructuring plan and a statement drafted by Pen Kent (which has comments incorporated from Josh and I). We have already had some discussions on these principles with Radius as well as Widjojo and Wardhana. We will continue to discuss this with the Indonesian authorities tomorrow.

I would appreciate any early reaction by fax.

Attachments

cc: Mr. Neiss

Corporate External Debt Restructuring

1 Establishment of a representative steering committee of major creditors led by two prominent bankers from a major international bank and an Indonesian banker

2 The steering committee will aim to secure a short voluntary breathing space of a few months duration including both interest capital maturities Corporations able to continue to service their debts free to do so

3 No guarantees or public sector funds or subsidies are involved in this program

4 Genuine short-term trade credits are excluded from the program as these will have to be paid on time to permit commercial life to continue (These are guaranteed under the Bank Restructuring Plan)

5 Restructuring of capital and interest payment streams to a sustainable level (incl cp)

6 Design of restructuring plans to reflect the circumstances of each debtor and on terms acceptable to both creditors and debtors

7 A mechanism will be devised to identify corporations which have the prospect of viability and will benefit from the scheme Corporations which are not likely to be viable will not be eligible Similar debts owed to overseas export credit agencies and similar organizations will be treated on the same basis as will state enterprises except those which are already covered by government guarantees

8 Timetable ready to announce Monday all the above including leadership of steering committee

9 Process driven by commercial interest, not legal fine print

Draft Statement on Corporate Debt

by Radius Prawiro

Over the past few months, the sharp decline of the rupiah exchange rate has made it increasingly difficult for Indonesian corporations to service their external debts As this occurred it has become increasingly important that a strategy be developed for restoring orderly relations between these corporations and their creditors This is why I am pleased to announce today that the President has accepted my recommendation for a framework to manage the external debts of Indonesian corporations

This framework is to be set up and managed by the private sector, and will be based on voluntary agreements between borrowers and lenders It will not involve any public sector finance, funds, subsidies, or guarantees either from the Indonesian or other governments

To develop this framework, a steering committee is being set up immediately This committee, which will report to me, will be headed by (a foreign bank) and (an Indonesian bank) The full composition of the steering committee has not yet been established

The steering committee will establish a debt restructuring framework with two principle aims The ~~first~~ second is to maximize value to the lenders and shareholders The ~~second~~ first is to restore the capital and interest payment streams of viable corporations to sustainable levels, thereby enabling them to survive In this way, the framework should create a "win-win" situation for debtors and creditors alike, while minimizing the risk for both

The framework does not guarantee the viability of every Indonesian corporation Those with no prospect of viability may have to close It will however go a long way to preserve jobs

The detail of the framework is a matter for the steering committee, in consultation with the creditors and borrowers but will include the following

b for these companies, A temporary breathing space in debt service to allow new arrangements between lenders and borrowers to be worked out

c Incentives for the borrowers to restore debt service at the earliest possible date

d Incentives for the lenders to offer some rescheduling to those unable to service their debts, but on less favorable terms to the borrower than under the original contracts

a Corporations able to continue to service their debts will be ~~free~~ expected to do so

State enterprises will be treated on the same terms as the private sector except those which are already covered by government guarantees

The design of the restructuring plan will reflect the circumstances of each debtor and be on terms acceptable to creditors and debtors

The pause in debt service will only affect financial loans (bank loans, bonds, commercial paper and similar instruments) Similar debts owed to overseas export credit agencies and similar organizations will be treated on a similar basis Trade debts will be excluded from this framework, and will continue to be serviced to allow the economy to continue to operate as near to normal as possible guaranteed by banks lotax - + pages

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January 23rd, 1998

DISCUSSION PAPER(VERSION 3)

To: Mr. Radius Prawiro
Professor Dr. Irzan Tandjung

From: The Advisory Group

Re: Private Sector Debt Restructuring Scheme

The private sector debt problem is the key problem to be solved to help Indonesia recover from the present financial crisis.

We think the Government must now take a leading role in (i) co-ordinating the negotiations for the restructuring of the private sector debt and (ii) implementing the restructuring agreements that will result from such negotiations.

The basic principle that we think should be followed is that the whole scheme will be made available to both Indonesian private sector companies and their lenders on a voluntary basis. The companies will choose between the various options open to them depending on their financial strength, their relationship with their lenders and their willingness to maintain a respectable credit standing in the international markets.

We see three main options:

- *Option 1* would be chosen by the strongest companies i.e. to serve their debt punctually or negotiate on a bilateral basis with their lenders. This option would not require government intervention.
- *Option 2* would be chosen by companies that need essentially a breathing space. It is outlined below under Trust No. 1 (The Dollar Trust)
- *Option 3* would be available to companies that think they will have great difficulty recovering from the current situation. It is outlined below under Trust No. 2 (The Rupiah Trust)

I. TRUST No. 1 – THE DOLLAR TRUST

1. Debt is dealt with by the Trust in dollars.
2. Eligible debt includes arrears, if any, and instalments due in 1998 and 1999.
3. The Trust represents the borrowers and co-ordinates the restructuring negotiations.

1) A multilateral agreement (Heads of Terms) is signed between the Trust and the participating lenders or a Steering Committee representing the lenders, covering

   - a detailed description of the categories of eligible debts,
   - the new agreed maturity (for example 8 years)
   - the new agreed grace period (for example 4 years)
   - the new interest rate applicable to be determined as a margin over LIBOR
   - a clause allowing the capitalisation of interest for a certain period (for example two years, by using special notes such as a five year FRN)

2) Bilateral agreements are signed between each borrower and its own lenders incorporating

   - all conditions agreed in the multilateral agreement,
   - a detailed list of all relevant transactions to be restructured

4 Companies choosing Trust No 1 will retain freedom to borrow new dollars without the prior authorisation of Bank Indonesia, unless they default on their restructured debt

When Heads of Terms have been agreed between the Trust and the Steering Committee of lenders, both borrower and lender will assess whether the agreement enhances or detracts from the position they would hold were they to opt out of Trust 1 and begin bilateral negotiations The borrowers may want to opt out if the Heads of Terms are harder to meet than their resources allow The lenders may want to opt out if the Heads of Terms are more generous to their debtors than they believe fair However depending on the distribution of the debtors that enter the scheme according to their ability to pay, this effect will be mitigated by the great uncertainties of bilateral negotiations and the extent to which Government support is extended to Trust 1

II TRUST No 2 – THE RUPIAH TRUST

Trust No 2, in addition to extending the maturity of borrowers' liabilities, removes the foreign exchange risk from them as well It provides for the termination of debt claims on the debtor by the creditor and replaces them with fixed claims on the Trust or a deposit with Bank Indonesia and an equity style claim on the debtor It is designed to induce both lender and borrower to be honest about how much they expect to recover or can pay respectively It does not act to favour either lender or borrower but rather sets up an impartial framework In formal terms therefore the Trust acts to overcome the asymmetry of information between borrower and lender

To achieve these goals, entry into the Trust involves a series of sequential decisions These are

1 Both borrower and lender agree to abide by and be bound by the outcome of choices they make as they enter the Trust They present their agreement to the Trust in legally binding form

2 Upon receipt of this agreement, the Trust would invite the borrower to select which sub-Trust it wished to join The borrower would have a fixed and short period to make its selection Formal irrevocable entry into the Trust would occur upon payment of an amount in rupiah equal to

Face value of loan in dollars x the Fixed Exchange Rate appropriate to the sub-Trust selected

Once this payment had been received the Trust would issue a Notice to the lender requiring him to elect which repayment option he wishes to select Failure to reply to this Notice within seven calendar days of receipt would give the Trust the right to choose which repayment option to employ

We describe below the key mechanics of the Trust

1 Dollar debts are brought by the borrower to the Trust and converted into Rupiah at a Fixed Exchange Rate ,

2 The Trust therefore removes the dollar liabilities of the private sector companies as long as the latter are able to produce the rupiah amounts corresponding to their dollar liabilities (comprising principal and interest debt service maturities within the period considered) at the Fixed Exchange Rate,

3 The eligible debt includes arrears if any, and 1998 and 1999 instalments (principal + interest)

4 The Scheme starts when all the rupiah payments to the Trust have been made

- Companies which cannot provide the rupiah amounts equivalent to their dollar liabilities at the Fixed Exchange Rate are considered ineligible and cannot enter the Trust
- Rupiah loans can be negotiated with their relationship banks for companies that would otherwise not have sufficient liquidity in rupiah to allow them to enter the Trust on time,
- dollar credits are rolled over by the lenders until the deadline to join the Trust is reached, and interest can be capitalised in the meantime

5 The borrowers will be offered four levels of Fixed Exchange Rates

- Rp 3000 for joining Trust 2 - A
- Rp 4000 for joining Trust 2 - B
- Rp 5000 for joining Trust 2 - C
- Rp 6000 for joining Trust 2 - D

6 The lenders will be offered two options from each of Trusts A, B C and D

6 1 Fixed claim option The lenders will refinance the dollar liabilities assumed by Trust A, B, C and D resulting from the conversion of the dollar debt of the borrowers into rupiah at the respective Fixed

Exchange Rates They will receive dollar denominated notes issued by the Trust such that their value equals the initial dollar liabilities multiplied by the Fixed Exchange Rate (new rupiah liabilities) and divided by the Rupiah Market Rate Maturity and grace period and other conditions would need to be discussed (for example 7 years with 2 years grace) As the scheme is envisaged at present, it may be the case that the face value of the Notes is not equal to their actual value

The Trust will enter into swap agreements to hedge its currency mismatch with Bank Indonesia and other counterparties in the private sector

By opting for this option the lenders will agree to forgive a portion of their loans equivalent to the difference between the Rupiah Market Rate and the Fixed Exchange Rate

6 2 **Deferred Claim option** The lenders will receive the rupiah paid to the Trust by the borrower in the form of a blocked account at Bank Indonesia This account would bear interest at a rate equivalent to the 12 month SBI The lender would be permitted to make withdrawals from his account according to a schedule subject to the overall negotiations

The Trust will not give the rupiah received from the borrowers to the lenders immediately in order to avoid their immediate sale for dollars

The borrower will also issue the Trust a preference share that will give the Trust the right to receive all distributions of capital, retained earnings or proceeds from a wind-up before ordinary shareholders In addition, the preference share would give the Trust the right to nominate a majority of the Directors The preference share would give to the Trust the right to veto any related party transaction with either the lender, management or original owner(s) It would also give the Trust the power to set borrowing limits for the Company
In return, the owners of the ordinary shares would be issued with a call option This option would give the ordinary shareholders the right to purchase the preference share at any time at a price equivalent to the difference between the debt stock in dollars converted at the initial rupiah market rate (calculated as the average rate over a certain period at inception) and the debt stock converted at the Fixed Exchange Rate ("The Deferred Amount") plus accrued interest at a rate to be determined less all dividends and/or distributions of retained earnings or capital to the Trust and less any prepayments made by the borrower

The price of the call option may be reduced with the prior approval of the lender for example to facilitate an acquisition of the company Such a reduction would be irreversible

Such strict collateralisation of the Deferred Amount is necessary to avoid any temptation by borrowers to under-estimate their dollar payment capacity

If the preference share is not bought back by the borrower within ten years the Trust will hand it over to the lender who will thereafter have full control of the company

The above described sequential approach should induce a fair assessment by both parties by penalising them if they attempt to extract an unreasonable amount from the Trust process

a <u>The borrower</u> has apparently an incentive to join the sub-Trust that has a low Fixed Exchange Rate However, if he does this, he risks losing the chance of achieving a final settlement of his liabilities and finding that his ownership of the company is subject to the repayment of his debts <u>in full</u> (Deferred Claim Option)

Therefore the borrower will have an incentive to choose a level that the lender will perceive as fair and as a result, the lender will then be inclined to accept a final dollar payment from the Trust in full settlement of his claims (Fixed Claim Option)

b <u>The lender</u> will wish to extract full payment of his loans outstanding However, once in the Trust he has to decide whether the Fixed Exchange Rate chosen, and therefore the degree to which his loan will be written off, is fair If he chooses not to allow for some portion of his loan to be forgiven (Fixed Claim Option) but tries to extract full payment via the Deferred Claim Option he will receive no initial payment will be subject to rupiah risk and may never realise the full amount of his claims anyway Therefore he too will have an incentive to reveal his true valuation of his outstanding assets allowing any discount to be formally granted quickly

The outline described above covers the major features of a scheme that could be presented by the Government to the lenders and the borrowers A number of other points would have to be considered as soon as the Government agrees to the major principles underlying such scheme, they would include for example

- the choice of a cut-off date for the eligibility of the various categories of private sector debt to the scheme for instance all loans signed before the flotation of the rupiah (August 14th 1997) and subsequent loans borrowed to refinance such loans,

- a deadline for the borrowers to join the scheme, once launched, would have to be set Given the urgency, that period should not be too long, say six weeks,

- a number of legal aspects would have to be reviewed, implying the appointment of an Indonesian and international law firm,

- the appointment of an accounting firm to register the various loans of the various borrowers joining the scheme might have to be considered

- the beneficial owner of any assets or liabilities remaining with the Trust at the end of the scheme will have to be chosen It could be the State through the Ministry of Finance, or Bank Indonesia, or any other public sector entity

Of course the scheme described above would be the starting point for negotiations to be held between the various parties and will be adjusted during the negotiating process The Government obviously will also have to be prepared to some flexibility as far as its own support is concerned The whole idea behind the scheme is to provide for a fair burden sharing between borrowers lenders and the Government

To: Stan Fischer

23rd January 1998

MEMORANDUM

To: Professor Widjojo Nitisastro
Mr. Radius Prawiro
Professor Dr. Irzan Tandjung

From: The Advisory Group

Re: Concise summary of proposed plan to alleviate the external private sector debt problem

---

As you requested in our meeting today, we summarise below the key features of the scheme explained in full in our Discussion Paper of 21st January 1997 which we presented in that meeting.

The scheme seeks to provide an opportunity for an organised solution to the private sector debt problem. It excludes both those companies that have no need for assistance and those that should properly go bankrupt. It offers choices to both the lenders and ~~the~~ borrowers, both between the comprehensiveness of the schemes' involvement in their relationship, and also between the form that a resolution will take. The scheme will be operated on a voluntary basis, requiring both lender and borrower approval for entry.

Neither scheme *requires* Government support beyond conducting normal market transactions. ?

Those that enter the scheme will fall into two broad categories. The first includes borrowers who are fundamentally facing a working capital problem, i.e. a short term cash flow crisis. These borrowers need the average maturity of their liabilities to be extended. They are catered for in Trust 1 ("The Dollar Trust").

The Dollar Trust provides a setting in which numerous borrowers and lenders can agree a multilateral agreement that transforms short term external debt into longer term external debt. It does this by extending both the maturity of the loans, allowing for grace periods and by adjusting the interest rate payable. All these features would be subject to negotiation and agreement by both the Trust, on behalf of the borrowers, and a committee of lenders. The Government's role would be limited to acting as a catalyst, at least to start with, and to providing the Trust with personnel.

The second group of borrowers includes those companies that cannot afford to repay their debts at current exchange rates, even if the principal repayments were stretched over a longer maturity and grace periods granted. These companies need either debt forgiveness or to be relieved from future rupiah depreciation risk.

The problem in designing any scheme intended to promote debt forgiveness is assessing 'ability to pay' Indeed any scheme that assigned a role for the Government in determining this would we believe, be unworkable Therefore within a framework initiated and supported by the Government the Rupiah Trust is designed to encourage both lender and borrower to make a reasonable and fair assessment of how much the borrower can afford to pay and of what the lender can expect to receive It does this by giving both lender and borrowers *choices*

To ensure that the Rupiah Trust is voluntary both the lender and the borrower must agree to take part However they must also agree that once the outcome of their entry into the Rupiah Trust is known they must abide by it However, there is nothing preventing any borrower coming to an understanding with its lenders on their respective option selection before actually joining the Rupiah Trust Entry into the Rupiah Trust immediately nullifies the original loan agreement between them for the relevant instalments of the eligible debt, subject to the completion of the procedures of the Rupiah Trust scheme

Once a joint decision to enter the Rupiah Trust has been made the borrower must choose at what exchange rate he can afford to repay his external debts He is discouraged from choosing too low a rate by the structure of the Rupiah Trust (an explanation of why is provided below) When he has taken this decision he must pay over to the Rupiah Trust an amount in rupiah corresponding to his external debt liability when converted at this rate he has chosen Inability to pay over rupiah at this stage renders the borrower ineligible to enter the Rupiah Trust

This raises the question of the borrower finding sufficient rupiah to enter the scheme The reason that the borrower is required to find rupiah is that this imposes a minimum 'quality' threshold on companies The scheme is intended to help companies that have fundamentally sound long term businesses and not to bailout the reckless The rupiah that are required should be forthcoming either from companies own resources or from their relationship banks in the first instance If rupiah are not available from these sources they might become available by recycling the money that enters the Rupiah Trust through the banking system and maybe via one selected bank In any event such lending to the companies would require a fresh credit assessment Failure by the companies to submit to such a process would deny them access to funds and hence to a resolution of their problems via the Rupiah Trust

Once the borrower has paid over the appropriate amount of rupiah to the Rupiah Trust as determined by his choice of fixed exchange rate the lender is given a choice between two forms of payment The first of the two options he has allows him to receive an equivalent amount of dollars when converted at the actual market exchange rate, to the amount paid over in rupiah by the borrower In fact the lender, if he chooses this option, will not receive *cash* but will receive dollar denominated notes whose resale value is approximately equal to the amount due to him under this option Importantly, the Notes will be issued to the lender *by the Rupiah Trust* The effect of the lender selecting this option will be that he ends his relationship with the borrower completely having allowed a significant degree of forgiveness The advantage to him of doing this is that it allows him a clean break' from the current crisis

If the lender takes this first option, the Rupiah Trust retains the rupiah paid in by the borrower However, it now incurs a dollar liability whose initial value equals this amount of rupiah Although the initial amounts have an equal value they are denominated in different currencies This means that the Rupiah Trust would be exposed to changes in the exchange rate To counteract this, and ensure the Rupiah Trust has no risk it would enter into a swap agreement for the relevant amounts with Bank Indonesia This would be the total extent of the Government's involvement in the Rupiah Trust except for providing logistical support We would note that a swap is a market instrument and would be priced as such **Therefore the Government is not subsidising the Rupiah Trust**

?

The second option open to the lender would be to receive the rupiah paid to the Rupiah Trust directly These would be paid into an account at Bank Indonesia in his name However the account would carry restrictions on how quickly the lender could draw it down to avoid him selling these rupiah in the market for dollars until after the crisis has been resolved The account would pay a market rate of interest linked to the SBI rate

In addition, the lender would receive a further, Deferred Amount This amount would be calculated as the dollar amount of the loan on entry into the Rupiah Trust multiplied by the market exchange rate at that time *less* the amount paid into Trust by the borrower when he entered The Deferred Amount would be paid to the lender by the Rupiah Trust upon receipt of the rupiah required to pay it from the borrower (see below for details of how the Rupiah Trust will receive the rupiah) After ten years, if the lender still had not been paid, the Trust would no longer owe the lender the deferred amount

In the meantime the company/borrower would be required to issue the Trust with a Preference Share The share would carry the right to receive all forms of financial gain deriving from ownership of the company The original owners therefore would no longer receive any financial benefits from the company until the Preference Share had been repurchased The original owners would have the right to purchase the Preference Share upon payment of the Deferred Amount (the source of rupiah referred to above) The Deferred Amount would be adjusted to reflect the rupiah interest that that had accrued on it any payments made to the Trust by the company and any prepayments made by the original owners If the Preference Share has not been purchased by the original owner after ten years, it would convert into outright ownership of the company with no further opportunity for the original owners to participate This ownership would be transferred by the Rupiah Trust to the lender

Effectively if the lender chooses the second option he loses the chance to receive a dollar denominated asset that he can sell and receive immediate, if partial repayment for In return he receives rupiah in a blocked account and the chance to receive further rupiah payments that, if made, would fully repay his loan expressed in rupiah at the market rate when the loan was entered into the Rupiah Trust

We noted above that the scheme contains an incentive for both the borrower and the lender to choose options that were fair We set out below why this is so

Total : 8 pages

Office Memorandum

cc: HN
Foss
DV4

To: Professor Widjojo
Minister Mar'ie Muhammad
Governor Djiwandono
Minister Tunky

January 23, 1998

From: Bijan B. Aghevli BBA

Subject: **Bank Restructuring Plan and the Guarantee Scheme**

I am attaching a note describing the gravity of the financial sector problem and the need to put in place immediately the proposed bank restructuring and guarantee plans. These proposals have now been basically finalized with Bank Indonesia. It is now necessary to put in place all the steps required to make the announcement by Monday. I cannot exaggerate the need for action.

Attachment

Indonesia Banking Sector Crisis

Over the past several weeks, the state of Indonesia's banking system has **deteriorated seriously and rapidly** What was once a manageable problem, confined to a limited number of small banks, has since November spread across the sector, affecting nearly every local bank in the country—including the large and previously state banks More and more banks have come under financial strain, and those already under strain have found that the pressures on them are intensifying **This situation has now reached a crisis stage**

The immediate problem is that the **public is fast losing confidence in the banking system** As fears about the financial position of banks have mounted, the public has begun to withdraw deposits, at an ever-increasing pace During the third quarter of 1997, the amount of currency in circulation in the country increased hardly at all During the fourth quarter, it increased by 17 percent And in the first three weeks of January alone, it increased by an alarming 24 percent With such an increase in demand, Bank Indonesia is having difficulty supplying adequate amounts of new notes—even though the printing plants are already working 24 hours a day

Without immediate action, this trend is likely to accelerate, since the deposit withdrawals are based on **well-founded fears about the solvency of the entire commercial banking system** Admittedly, the latest indicators show that the banking system is in reasonable health, with a large amount of capital and only a very small amount of non-performing loans These indicators, however, are highly misleading, since they are measuring not the current reality, but rather the situation of several months ago, before the rupiah began to plummet Since then, more and more corporations have been unable to pay their debts to the banks, owing to the economic slowdown, high domestic interest rates, and need to use available funds to repay their foreign debts As a result, non-performing loans have soared Based on reasonable estimates of the true loan repayment problem (assuming that 17 percent of loans are non-performing, a ratio smaller than in some neigboring countries), loan losses are likely to exceed the total amount of capital in the banking system In other words, it is likely that **the banking sector as a whole is now technically bankrupt**

This situation has already had grave **consequence for the commercial banks** Despite the growing provision of funds by the central bank, to enable the system to continue operating, commercial banks have nonetheless been increasingly unable to perform their usual functions

- **Banks are unable to lend to the corporate sector** With a shrinking deposit base, banks have fewer and fewer funds available to lend—at a time when corporations' need for credit is intensifying

- **Foreign banks are refusing to lend to Indonesia banks** In particular, foreign banks are no longer accepting Indonesia bank letters of credit, forcing companies to pay 100 percent of the costs of imports, in foreign exchange, even before goods are delivered

- **Even domestic banks are refusing to lend to each other** Since banks no longer trust the financial condition of other banks, they will lend only for very short-term, and at a very high interest rates, ranging up to 100 percent

Faced with this situation, **Bank Indonesia has been forced to assume more and more of the normal commercial banking functions**, in order to keep the overall system afloat It has stepped into the interbank market, to recycle funds from banks with ample funds to those which are facing liquidity shortages shortage It is offering swap facilities for exporters which do not which to entrust their dollars to commercial banks And it is offering schemes to help exporters obtain letters of credit Each of of these ad hoc schemes is justifiable and necessary in the current situation **But none of them solves the underlying problem**, since it does nothing to address the financial weaknesses of the commercial banks As a result, with each passing day, the problems have steadily mounted, while confidence has continued to dissipate, locking the banking system into an ever-worsening downward spiral

Against this background, **there is no alternative but to put in place a comprehensive bank restructuring plan and a general guarantee scheme—immediately** Admittedly, any plan to rescue the banking system will necessarily impose large—and, at present, unknowable—costs on the budget Yet the government has already begun to take on financial exposure to the banking system, through Bank Indonesia's liquidity support (i e , loans) to banks, which have now grown to over 10 percent of GDP With a comprehensive restructuring plan, there would at least be some prospect that these loans might someday be repaid

Moreover, there is no doubt that **the costs of inaction will be far greater** If the banking system ceases to function, firms will be unable to obtain financing, even to purchase the raw materials and other supplies they need to to continue to produce Even those few firms that do not need financing because they have their own funds will still be unable to produce, since the banks will no longer be able to transfer these funds to their suppliers In short, if the banking system collapses, it will bring the entire economy down with it Production will cease, millions will become unemployed, and the standard of living for those who still have jobs will plummet

For these reasons, Indonesia needs to adopt **the strategy that every other country facing a similar situation has chosen** It needs to introduce a comprehensive guarantee for all depositors and creditors of commercial banks, together with a new agency charged with the task of restoring the banking system back to financial health (A description of the proposed plan, designed to meet the particular circumstances of Indonesia and based on discussion with Bank Indonesia, is attached)

Why is a guarantee necessary? For several reasons The situation is so serious that the only way to calm the public's fears, and convince foreign creditors to roll-over their external loans is for the government to puts its full faith and credit behind the commercial banks Admittedly, this guarantee will not be fully credible from the outset It is only with some time, as the public sees that the guarantee is being honored, fully and promptly, and that the banking system is truly being restructured, that confidence will gradually begin to return

Why is a new agency necessary? Again, for several reasons The most important of these is financial Bank Indonesia needs to be insulated from the costs of the bank restructuring program, which need to be borne by the budget Otherwise, Bank Indonesia itself will soon begin to to incur financial losses, which will make it very difficult for it to conduct monetary policy and keep inflation under control In addition, Bank Indonesia needs to be insulated from the political consequences of restructuring, since difficult decisions will need to be taken about which banks will need to be taken over, recapitalized, and merged

What has been the experience of other countries? In some countries, these measures have entailed significant fiscal costs, typically of around 10 percent of GDP, spread out over a number of years In other countries, such as Sweden, the eventual costs have been very small, since as the situation improved, the government was eventually able to recover three-quarters of the amount it had intially provided

But every case had one aspect in common **in every country, this strategy has worked** Once the public was reassured that their deposits were safe, and that action was being taken to make sure that their banks would eventually be fully sound, confidence began to return Within a short span of time, deposits began to rise again and the banking system began to resume its normal functions, helping to stabilize the overall economic situation Eventually, the banking sector was returned to full financial health cc. MRK via E-m.

From: Michael Deppler
To: sfischer,hneiss
Date: 1/23/98 11:55am
Subject: Indonesia

The report to the Board was moderately encouraging. I trust, however, that those on the case are clear that no amount of restructuring or guaranteeing of the banking system will stabilize the system unless the exchange rate is stabilized. My unease in this regard (rooted in the altogether too reminiscent Bulgarian experience) stems from the seemingly slower progress on corporate debt.

GERMAN NON-PAPER

NON - PAPER

Jan 23, 98

Indonesian Corporate Debt Restructuring Bank – "IRB"

(Incorporated in Indonesia)

Problem to be solved: At the moment about USD 80 bio corporate debt of Indonesian borrowers are in various stages of default. The debt consists of short term commercial paper, mostly denominated in IDR and USD, bilateral off-shore loans, syndicated loans, bonds and project financing. The moneys are owed by 228 corporates (probably less than 200 groups), and on the lenders side there is an innumerable amount of private investors, banks, merchants banks, funds etc.

The above constellation is not ideal for a quick restructuring process that allows viable Indonesian companies to overcome the current grave situation. Suggestion therefore is to create the above institution, which has the aim:

1) to ease and make more efficient the negotiation of creditors with debtors;
2) to provide fast solutions to debtors with liquidity problems rather than credit standing problems;
3) to bridge viable businesses over the Indonesian economy's adjustments phase;
4) to reschedule eligible debt once the Indonesian economic situation has cleared and once it can be determined over how many years the financial burden can be repaid;
5) to assist Indonesian borrowers to get working capital from Indonesian local banks and to keep the operations running.

What needs to be done parallel, is that the Indonesian banking system, and here I am only talking about foreign banks, the well managed ones of the large private owned banks and the government banks, are supplied with liquidity to lend working capital to viable borrowers, i.e. they have to be supplied with adequate capital and liquidity to immediately resume their vital role in the economy. In particular, it has to be avoided that Indonesian banks are now starting to default on their off-shore debt,

The Indonesian government has to assume responsibility for this debt, otherwise the whole banking system will collapse completely.

Shareholders of the Bank: A World Bank subsidiary such as IFC, or an organization such as the ADB, and initially a few founding commercial banks with strong ties to Indonesia, such as Deutsche Bank, Citibank and Bank of Tokyo-Mitsubishi or the Government of Indonesia.

Management of the Bank: A few experienced international bankers, assisted by a strong team of credit, restructuring, and work-out specialists and a reputed chartered accountancy firm that is able to assess the value of debt. or WORLD BANK, IFC, ADB.

Capitalization of the Bank: The debt to be rescheduled would be transferred by the individual lenders to IRB. IRB would take on this debt either in full or at various discounts agreed to between the chartered accountant, the management of IRB and the original lenders The proceeds from buying the loan from the original lenders would be put by the lenders with IRB, partly on deposit partly paid up as equity The ratio deposit/equity would be dependent on the quality of the debt with the equity stake always being 10% of the original debt amount For example a high quality debt with little or no discount taken over by IRB, could have 90% of the proceeds on deposits and 10% paid up as equity A low quality debt, say 70% discounted, would result in a deposit of 20% with an equity stake of still 10% This would make the equity stake proportionately higher

To induce individual lenders to invest in IRB s equity the Indonesian government would have to guarantee

1) the due repayment of the equity or a certain amount of the debt,
2) the payment of interest to some extent on the liabilities of IRB For this the government could create a fund that would guarantee the shortfalls of interest payments to depositors of IRB up to a certain sum,
3) not allowing Indonesian borrowers to hide behind the lengthy procedures and uncertain outcomes of the Indonesian legal system

The IRB would then be open to buy corporate debt either in full or at various discounts (supervised by the accountancy firm), or to take equity stakes in Indonesian parties in exchange for debt The funding of the Bank and the equity would automatically grow because the seller of the debt would always loan the respective amount to the IRB and would provide additional equity

The IRB would then negotiate settlement/restructuring/agreed discount with the debtors

<u>Profit distribution</u> Naturally dividends would be distributed according to the share in the equity of the IRB i e banks which originally sold better debt (at no or little discount) ultimately get a higher yield than the banks that sold higher discounted debt The lower return would, in the latter case, result from a higher equity portion

<u>Winding up of the Bank in, say, five years</u> All debt will have been taken back in normal arrangements, or might have been securitized and the Bank may be wound up at a considerable profit for the equity holders

The above proposal might still not be attractive enough for lenders to seek rescue under the IRB scheme Therefore the suggestion is that the Indonesian government would ensure that any debt not transferred to IRB would lose its claim against the original borrower After agreement on the value of the debt the proceeds from the loan would be transferred to IRB under a claim of deposit This claim to the Bank would be backed up by a USD XX bio AAA-rated security, which would guarantee the payback of the assessed current market value of the debt to the original lender The payback could be up-front or in form of a zero coupon bond Any realized profit would then be used to cover cost and subsequently be distributed amongst the shareholders

Another possibility, rather than guaranteeing the equity, would be for the Indonesian government to back up the liabilities of IRB After agreement on the value of the debt, the proceeds from the loan would be transferred to IRB under a claim of partly deposit, partly equity The claim to the Bank on the deposit would be backed up by a USD XX bio AAA-rated security However, the original lender would participate in any upward potential of the debt value, by sharing in the realization of any profits over the assessed value in the debt

Jan. 23, 98

Indonesia: Comments on Corporate External Debt Restructuring

1. The German proposal is too activist and should be set aside; at least for the time being.

2. The Pen Kent proposal is harmless and virtuous but it is an empty shell.

3. Setting up a **structure** to deal with corporate debt is a necessary first step, but by itself, its announcement not likely to have much impact. However, if it is announced as part of the strategy to deal with the banking system it could be useful.

4. More work will be required to develop the operational substance of the proposal. Some issues that will need to be addressed are:

- how will **debtors** be represented? They should not be represented by commercial banks.
- mechanisms for getting new money for corporations will have to be ensured by establishing seniority for new money.
- can export credit agencies be given the stiff?
- to get the process working the committee should begin with easy cases, e.g., corporates that mainly export (this would snowball in the right direction i.e., these companies would ensure that their suppliers get some credit).
- to make a plan work we will need to rely primarily on the self interest of parties involved.
- However, some sweeteners from the government may be needed. There are two types of options:
  - full or partial guarantee of creditors (possibly with a fee charged to creditors for the guarantee).
  - rupiah subsidies to domestic corporations to cover the gap between the actual exchange rate and what would be a reasonable exchange rate.
  - If possible, an open-ended subsidy share or guarantee (with potential adverse implications for the budget and inflation) should be avoided.
  - Instead, guarantees and subsidies should be targeted (e.g., to essential industries, and within those, to "viable" corporations only).
- the drawbacks and risks of government incentives have to be weighed against the disruptions caused by an "involuntary" rollover of corporate external debt.

01/23/98 10:46 ☎202 623 7066 IMF ADM-TAU 001/002

01/23/98 07:26 ☎202 623 7230 INT'L FAC. UNIT 002

FRI, 23-JAN-98 8:00

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cc: AS KKS DN4 TO HANDLE.

Alassane D. Ouattara
~~M.D.~~

Date:

1).

Mr. ~~Michel Camdessus~~
Managing Director
International Monetary Fund
Washington D.C. 20431

Post-it® Fax Note 7671		Date 1/23/98	# of pages ▶ 2
To Allie		From Alex. Cagui	
Co./Dept. APD		Co. ADM / ISSD-TAU	
Phone #		Phone #	
Fax # 34745		Fax # 37066	

Ouattara
Dear Mr. ~~Camdessus,~~

As you know, the Government of Indonesia has for some time been working closely with the IMF, through the office of the Fund's resident representative in Jakarta. In recent months, this cooperation has increased considerably, both at the policy and technical levels, as we have begun to implement an economic reform program supported by a three-year standby arrangement with the Fund. As this has occurred, it has become increasingly clear that successful implementation of this program will require an expansion of the Fund's representation in Jakarta. Accordingly, we would like to request the Fund's office be expanded to include a deputy resident representative.

From our discussions with Mr. Al-Eyd, the Fund's senior resident representative, we understand that the IMF also shares this view and that it intends to nominate Mr. Dattels to the position of deputy resident representative. In our view, Mr. Dattels would be an ideal candidate. He has already been able to establish good relations with Bank Indonesia staff, and in addition to his credentials as an economist, he brings to Bank Indonesia considerable experience with central bank operations in financial markets. We would therefore fully endorse Mr. Dattels' nomination.

Bank Indonesia would propose supporting this new position in the following ways We would expand the office space of the Fund s resident representative office, and provide another secretary and additional support staff We would also assign a chauffeur-driven car to this new representative ~~Unfortunately, Bank Indonesia will not be able to provide~~ financial ~~support for the representative's housing, but we could, if he wished, make available a house from our existing stock~~

Yours sincerely,

Governor Bank Indonesia

FOR

Total 6 pages

13 JAN 98 10:47 ASIA/PACIFIC

UNOFFICIAL TRANSALATION

cc: FOSS
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PRESS RELEASE

THE REVOCATION OF PRESIDENTIAL DECREE NUMBER 47/1997 CONCERNING THE CHANGE IN STATUS OF SEVERAL GOVERNMENT PROJECTS, STATE-OWNED ENTERPRISE PROJECTS AND STATE-RELATED PRIVATE PROJECTS THAT HAD PREVIOUSLY BEEN POSTPONED OR PLACED UNDER REVIEW

As set forth in
PRESIDENTIAL DECREEE NUMBER 5 / 1998

On 20 September, 1997, the Government of Indonesia announced the decision to postpone or review a large number of development projects. This measure was taken so as to strengthen the national economy in the face of the ongoing regional currency crisis. With these postponements and reschedulings, the government seeks to restrain short-term import growth, economize on foreign exchange earnings, and improve the current account so as to bring about a rapid improvement in the overall economic situation.

In Presidential Decree Number 47/1997 dated November 1, 1997, the fifteen of these projects were allowed too proceed. However, since the enactment of the change of status of the fifteen projects, the monetary crisis has intensified and spread beyond Southeast Asia. The value of rupiah continued to depreciate as a result of excessive monetary volatility.

For that reason, it is considered necessary to enact policy measures to economize on expenditures in all sectors After conducting a more thorough review, with respect to the decision to continue implementation of several government projects, state-owned enterprise projects and state-related private projects, continuation of which had previously been announced on the basis of Presidential Decree Number 47/1997, it has been found that they would require enormous financing and could undermine the government's effort to overcome the monetary crises

In connection with that problem, it is considered necessary to revoke Presidential Decree Number 47/1997, which is enacted in Presidential Decree Number 5/1998 dated January 10, 1998

The Projects that will have their status restored to be placed under review are Toll Road Semarang Section C, Toll Road Ujung Pandang, Toll Road Pondok Aren-Serpong, JAMSOSTEK Tower, Geothermal Power Plant Patuha (unit 1), Geothermal Power Plant Asahan 1, Geothermal Power Plant Tanjung Jati "A", and Geothermal Power Plant Tanjung Jati "C" The Projects that will have their status restored to be postponed are Toll Road Aloha Waru-Tanjung Perak, Geothermal Power Plant Karaha (Stage 1 PLN), Geothermal Power Plant Sarulla, Geothermal Power Plant Darajat Unit I and II, Combined Cycle Power Plant Palembang Timur, Build and Operate of new airport to replace Polonia-Medan Airport, and Improvement of Meteorological and Geophysical Equipment

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UNOFFICIAL TRANSLATION

DECREE OF THE PRESIDENT OF THE REPUBLIC OF INDONESIA
NUMBER 5/1998
CONCERNING

THE REVOCATION OF PRESIDENTIAL DECREE NUMBER 47/1997 CONCERNING THE CHANGE IN STATUS OF SEVERAL GOVERNMENT PROJECTS, STATE-OWNED ENTERPRISE PROJECTS AND STATE-RELATED PRIVATE PROJECTS THAT HAD PREVIOUSLY BEEN POSTPONED OR PLACED UNDER REVIEW

PRESIDENT OF THE REPUBLIC OF INDONESIA

Considering a that in the context of efforts to overcome the monetary upheaval that has occurred in Indonesia over the past few months it is considered necessary to enact policy measures to economize on expenditures in all sectors

b that after conducting a more thorough review, with respect to the decision to continue implementation of several government projects state-owned enterprise projects and state-related private projects, continuation of which had previously been announced on the basis of Presidential Decree Number 47/1997 it has been found that these projects require enormous funds and will create great difficulties for the effort to overcome the upheaval,

c that in connection with this problem it is considered necessary to revoke Presidential Decree Number 47/1997 concerning the Change of Status of Several Government Projects, State-Owned Enterprise Projects and State Related Private Projects that had Previously Been Postponed Or Placed Under Review,

In light of

In light of

1 Article 4 paragraph (1) of the 1945 Constitution,

2 Presidential Decree Number 39/1997 concerning the Postponement/Review of Government Projects State-Owned Enterprise Projects and State-Related Private Projects

IT IS DECIDED

To Enact

PRESIDENTIAL DECISION CONCERNING THE REVOCATION OF PRESIDENTIAL DECISION NUMBER 47/1997 ON THE CHANGE OF STATUS OF SEVERAL GOEVERNMENT PROJECTS, STATE-OWNED ENTERPRISE PROJECTS AND STATE-RELATED PRIVATE PROJECTS THAT HAD PREVIOUSLY BEEN POSTPONED OR PLACE UNDER REVIEW

FIRST

Presidential Decision Number 47/1997, concerning the Change of Status of Several Government Projects State-Owned Enterprise Projects and State-Related Private Projects that had Previously Been Postponed Or Placed Under review, is revoked

SECOND

The Projects meant in the First Point above will have their status restored as follows

A Projects placed under review

* They were already completed and have not been canceled

1 Toll Road Semarang Section C, *
2 Toll Road Ujung Pandang, *
3 Toll Road Pondok Aren-Serpong
4 Jamsostek Tower, *
5 Geothermal Power Plant Patuha (unit 1),
6 Geothermal Power Plant Asahan 1,
7 Geothermal Power Plant Tanjung Jati "A",
8 Geothermal Power Plant Tanjung Jati "C",

<u>Projects to be postponed</u>

B Projects to be postponed

9 Toll Road Aloha Waru-Tanjung Perak,

10 Geothermal Power Plant Karaha (Stage 1 PLN),

11 Geothermal Power Plant Sarulla,

12 Geothermal Power Plant Darajat Unit I and II,

13 Combined Cycle Power Plant Palembang Timur

14 Build and Operate of new airport to replace Polonia-Medan Airport,

15 Improvement of Meteorological and Geophysical Equipment

THIRD This Presidential decree comes into effect on the date of enactment

Enacted in Jakarta
On January 10, 1998
PRESIDENT OF THE REPUBLIC OF INDONESIA

SOEHARTO

Seven projects shelved again

JAKARTA (JP) The government announced last night that it was shelving seven megaprojects and put another eight under review for the second time in five months

The decision was contained in a decree signed by President Soeharto yesterday Minister/State Secretary Moerdiono was quoted by *Antara* as saying

The news agency said Moerdiono phoned it with the story

The 15 projects — eight power projects four toll road projects one airport project, one building project and one equipment-provision project — were among dozens originally shelved or reviewed in September in a bid to save billions of dollars of badly needed foreign currency

They were revived Nov 1 but the presidential decree only became known to the public a week after it was signed

When news of their resurrection came, there were allegations of nepotism because they were projects tied to politically well-connected business groups

The sudden about face also raised doubts about the government's commitment and ability to see through tough economic reforms

The latest decision was taken by the government to reaffirm its commitment to handle the monetary crisis *Antara* said

The government had intended to continue with the projects, but after another review, it was learned they required huge financing that could undermine the government's effort to deal with the monetary crisis, Moerdiono said

"That's why the President decided to shelve them," he said

One of the projects affected is the controversial Tanjung Jati C power project in Jepara, Central Java The 1 320-megawatt (MW) coal-fired power project worth $1 77 billion was awarded to Consolidated Electric Power Asia (CEPA) Indonesia in reward for its willingness to reduce the price of another power project, Tanjung Jati B also in Jepara

Other power projects include the 1 320-MW coal-fired Tanjung Jati A power plant, also in Central Java being developed by a consortium made up of President Soeharto's daughter Siti Hediati Prabowo and the Bakrie Group, the 330-MW Sarulla geothermal power project in North Sumatra owned by a consortium of the U.S Unocal Corp and the Nusamba Group of Muhammad 'Bob' Hasan and the 55-MW Patuha geothermal power plant in West Java by a consortium controlled by California Energy

The other power projects are the Karaha geothermal power plant, unit one and two of the Drajat geothermal power plant, the Asahan I hydropower plant and the Palembang Timur combined-cycle power plant in South Sumatra, which is sponsored by PT Astra International (emb/prb)

Projects put under review

No.	Project	Value (US$m)	Location
* 1	Semarang Section C toll road	na	C. Java
* 2	Ujungpandang toll road	51	S Sulawesi
3	Pondok Aren-Serpong toll road	na	W Java
* 4	Jamsostek tower project	na	Jakarta
5.	Patuha 1 geothermal power plant	95	W Java
6.	Asahan 1 hydropower plant	160	N Sumatra
7	Tanjung Jati A steam power plant	1,660	C Java
8	Tanjung Jati C steam power plant	1 770	C Java

Projects postponed

No	Project	Value (US$m)	Location
1	Aloha Waru-Tg Perak toll road	247	E. Java
2	Karaha 1 geothermal power plant	380	W Java
3.	Sarulla geothermal power plant	330	N Sumatra
4	Darajat 1 2 geothermal power plant	475	W Java
5	Palembang Timur combined cycle power plant	169.5	S. Sumatra
6.	Construction and management of new airport in Medan	na	N. Sumatra
7	Improvement of meteorological and geophysical equipment project	na	

* They have not been cancelled
They were already finished

comm.

cc: Foss
Div. 4

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CABLE ADDRESS
INTERFUND

ASIA/PACIFIC

4 FEB 98 2:56

January 23, 1998

Mr. Lengkap Bangun
Chairman
Association of Depositors of SBU Bank
Nibung Raya 154
Medan 20112
Indonesia

Dear Mr. Bangun:

Thank you on behalf of Mr. Michel Camdessus, Managing Director, International Monetary Fund, for your recent letter on behalf of the **Depositors of the Liquidated Banks in Indonesia**. Its contents will be brought to the attention of the Managing Director and shared with all relevant parties in the Fund.

Sincerely,

Pamela J. Bradley

Pamela J. Bradley
Chief, Public Affairs Division
External Relations Department

CC: MD
MR. FISCHER
MR. OUATTARA
MR. SUGISAKI
EXR
APD
OAP
MR. CROSS

HN

Office Memorandum

FOSS
004

To: Mr. Alberto Mulas January 22 1998

From: Stanley Fischer SF

Subject: **Your mission to Indonesia**

On behalf of IMF management, let me say how delighted we are that you have agreed to visit Indonesia to work on the corporate debt problem. In Jakarta you will be joining Mr. Kenn Pent, former Executive Director of the Bank of England, who should be arriving there today, with the same mission.

You will be working with Mr. Bijan Aghevli, Deputy Director of the Asia Department, who is heading the current mission to Indonesia. The mission includes staff from the World Bank, which whom we are collaborating closely in Indonesia; the Asian Development Bank is also playing an important role in banking sector restructuring. The Indonesian government has agreed to the appointment of a high level IMF representative in Jakarta, who will have direct access to the President. That representative, who is likely to be Mr. P.R. Narvekar, former Deputy Managing Director of the IMF, should arrive shortly, and you would then report to him. You should also feel free to contact me directly as necessary.

1. The extent of the corporate debt problem in Indonesia is difficult to determine. Most observers say that at the highly depreciated exchange rates of recent days, most companies' liabilities exceed their assets. IMF staff now in Jakarta has made a calculation at the aggregate level that tends to support this view. However, it is not clear why devaluation and inflation have not significantly reduced the real value of the domestic debts of many corporations, and why the prospects for exporters have not improved in a way that should improve the positions of some companies.

2. It is also common wisdom that the rupiah will not stabilize until a plan is announced for dealing with the corporate debt problem. Here too a note of caution is necessary, since the political uncertainties associated with the President's health, succession, and intention to carry out the IMF program, must play a critical role in determining the exchange rate.

3. The first need is to try to determine the extent and nature of the corporate debt problem, particularly how much of it relates to external and how much to internal debt. In doing this, Mr. Kent and you will have the full assistance of the mission headed by Mr. Aghevli.

4. It will then be necessary to develop a framework in which debtor-creditor relations can be dealt with. Given reports that few Indonesian companies are servicing their debts, most creditors must already be showing some form of forbearance. Until the economic situation

stabilizes, and perhaps unless the currency appreciates, continued forbearance is likely to be necessary On the domestic side, this will create difficulties for the banks, a problem which is being dealt with separately by the Fund mission Stefan Ingves, Deputy Governor of the Bank of Sweden, is now in Indonesia working on banking sector reform and restructuring together with Fund and Bank teams

5 We would like to make rapid progress on the corporate debt issue, and possibly have preliminary recommendations for the Government of Indonesia early next week

6 The Indonesian government, working together with the Government of Singapore, has appointed a small group under Mr Radius Prawiro to help deal with the external debt of the corporations held by Singapore banks The group contains some prominent businessmen and one or two people formerly in government service The precise function of this group has not yet been defined, and we have asked the Singaporan authorities to develop a terms of reference so that we can understand their mandate and its restrictions You may find this a useful group to work with, and I am sure you will want to meet with them However, you should not feel constrained to accept either their mandate or the current constitution of the group, and could propose some other institutional arrangements on the Indonesian side

7 Given the current vacuum on this issue, whatever Mr Kent and you suggest will likely set the pattern for dealing with this problem in Indonesia As you well know, there is a clear tendency in such situations for both the creditors and the debtors to see virtue in the government's solving the problem We would prefer that to the maximum extent possible, the solution involve negotiations between individual debtors and creditors, rather than groups of creditors and debtors, and that government financial involvement be avoided, or -- if absolutely necessary -- be minimized incentives

8 We need also to bear in mind that whatever is done in Indonesia could serve as a precedent for dealing with similar problems in other countries in the region In formulating any plan to deal with Indonesia's corporate debt problem, we will need to give due regard to the delicacy to the financial situation in the region, and the driving concern behind Fund programs to avoid countries having to impose an overall standstill on debt servicing

Good luck, and thank you for taking on this assignment

cc The Managing Director
Mr Ouattara
Mr Sugisaki
Mr Boorman
Mr Neiss
Mr Aghevli
Mr Kent

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Department/Division/ Collection:	Asia Pacific Department Records
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ADLIB ref number	250
File title & dates	Indonesia - Chronological Files, January 1998
Doc title & dates	Conversation with Mr Regling, January 22, 1998
Doc Classification	Strictly Confidential

From Michael Cross
To MLH1S PO20 SANJARIA
Date 1/22/98 6 28pm
Subject Mr Zamani's complaint about comments on Indonesia -Reply

OK The MD has asked me to ask Hubert Neiss to draft him a memo in response to Mr Zamani The MD was annoyed by the tone of Mr Zamani's note the last para of which he regarded as pompous and arrogant He asked that the response should say (1) that he is surprised at how much credence Mr Zamani gave to the article and (2) that he should concentrate more on the MD's statement to the press in Jakarta

>>> Shailendra Anjaria 01/22/98 06 22pm >>>
Just saw it

May I suggest you cc it to Jack Boorman also?
tks

CC MLH3S PO05 HNEISS, MLH3S PO05 OGOODGER

INTERNATIONAL MONETARY FUND

ASIA/PACIFIC

23 JAN 98 8:42

cc: MRK (to handle)

TO: Mr Neiss

FROM: Michael Cross

Hubert

The MD asks that you draft him a memo to send to Mr Zamani in response to this.

The MD is annoyed at the tone of Zamani's memo, which he regards as arrogant, (particularly the underlined sentence in the last para).

He suggests the response should stress

(1) the MD's surprise at the credence Mr Zamani gives to press reports

(2) that Mr Zamani should read the MD's statement to the press in Jakarta (cd you please attach a copy to the memo?)

Thank you, Michael

Office Memorandum

To: The Managing Director January 14, 1998

From: Zamani Abdul Ghani

Subject: **"Rescue Plan For Indonesia In Jeopardy", Washington Post, January 7, 1998**

I would like to draw your attention to the attached news report in the Washington Post of January 7, 1998 on "Rescue Plan for Indonesia in Jeopardy", particularly the adverse role played by Fund officials in the report. In paragraph 5 of the report, IMF officials were stated as saying that "...the fault lies mainly with the Jakarta regime for failing to follow through on pledges to restructure the nation's economy that were made in exchange for the bailout". Furthermore, a senior Fund official was quoted in paragraph 7 as saying, "We would like to see the senior leadership in Indonesia stand up and be counted on the reforms. ... I think the markets are asking themselves the question of just how much the senior Indonesian leadership is committed to this program, and particularly to the reform measures that affect the family" (of Indonesian President Suharto).

The authorities and my office regretted that such premature statements were made as they add further to the jittery in the financial markets and unnecessary panic among Indonesian citizens. They, in a way, strengthen the fears of a worsening in the Indonesian economic and financial situation should further drawing from the Fund's SBA be halted. Furthermore, the statements catalyzed speculations by various parties over the future of the Indonesian leader which had dampened the sentiment further. The Indonesian rupiah fell sharply and negatively affect the performance of regional currencies, especially the Thai baht, Malaysian ringgit and the Singapore dollar.

It is hoped that in future Fund officials should be careful in issuing such statement. No doubt the Fund has been criticized for its handling of the Asian financial crisis. On its part, the media should not be the channel to express disappointment over shortfall in the authorities' commitment to reform measures under a Fund program. Instead, it should first be sorted out with the authorities. Only after the Board has met and discuss the subject thoroughly should any statement be issued.

Attachment

cc: Executive Directors

The Washington Post Wednesday January 7 1998

Terms of Indonesian Bailout Endangered

Rescue Plan For Indonesia In Jeopardy

By Paul Blustein
and Sandra Sugawara
Washington Post Staff Writers

The $43 billion international rescue plan for Indonesia's economy is in danger of coming unstuck government officials and private analysts warned yesterday as the Asian nation's currency plunged to a record low and its government announced a budget that failed to meet targets set by the country's creditors

Indonesia's troubles are the latest sign that Asia's financial crisis is worsening despite more than $100 billion in international bailouts that have been mustered by the International Monetary Fund for several of the region's once-prosperous economies

The currencies of Indonesia Thailand Malaysia and the Philippines have hit new lows on each trading day of the new year And yesterday the Indonesian rupiah—which lost 56 percent of its value against the dollar last year—again fell the furthest dropping 15 percent In morning trading today Southeast Asian currencies were down again led by the rupiah's 7 5 percent decline

The relentless turmoil in Asian markets is intensifying worries that the IMF led rescues are failing to reverse the region's slide toward economic and political chaos South Korea's $57 billion bailout the biggest ever had to be strengthened two weeks ago because capital was continuing to flee the country forcing the IMF and the world's richest countries to speed loans to Seoul ahead of schedule The free fall of the rupiah is raising the prospect that Indonesia's rescue package will also have to be supplemented or altered in some significant way

IMF officials acknowledged yesterday that the ~~Indonesian situation~~ is becoming particularly worrisome but they said the fault lies mainly with the Jakarta regime for failing to follow through on pledges to restructure the nation's economy that were made in exchange for the bailout

Clinton administration officials who have been heavily involved designing the IMF packages hold similar views although they declined to be quoted yesterday

"We would like to see the senior leadership in Indonesia stand up and be counted on the reforms" a senior IMF official said "I think the markets are asking themselves the question of just how much the senior Indonesian leadership is committed to this program, and particularly to the major reform measures that affect the family" of Indonesian President Suharto A number of Suharto's relatives own or control giant companies that would lose lucrative subsidies and benefits if the IMF's prescriptions were followed faithfully

One possible outcome is that the IMF, which disbursed $3 billion in loans to Indonesia in November, will refuse to approve a second installment of $3 billion that is scheduled to be advanced in mid March after a review of Indonesia's performance

Government sources stressed that a decision is far from being made but the senior IMF official said "It will be a key moment for all of us—not just the Indonesians but for all of us trying to think through how to deal with this situation successfully"

Analysts said the budget unveiled yesterday by Suharto made a suspension of IMF assistance much more likely because Jakarta was failing to fulfill promises to run a budget surplus and was balking at cutting spending on politically popular items that the IMF views as inefficient such as gasoline subsidies

"The next step will probably be the IMF freezing the forwarding of funds to Indonesia, pending a revision of the budget" said David Durrant a senior currency strategist at IDEA a New York based international economic consultancy "That will create a lot more concern within the Asian region, which is exactly what the Asian region doesn't need at this time"

IMF and U S officials are anxious to restore stability in Indonesia partly because of the impact an economic collapse there would have on the economies of its neighbors and partly because the giant multiracial archipelago has a history of bloody conflict between the Muslim majority and the small ethnic Chinese minority that controls the bulk of the wealth

Indonesia could move from a financial crisis to a political crisis to an ethnic pogrom" said David Hale an economist at Zurich Kemper Investments in Chicago "This thing is still very serious"

A collapse of the Indonesian rescue wouldn't necessarily raise the risks of an international financial crisis that IMF and U S officials have feared in the South Korean case

The worry in Korea has been that the country would run out of the U S dollars Japanese yen and other 'hard' currencies it needs to pay its short term debts to foreigners And because those debts are owed mainly by large Korean banks the danger is that a default would cause a run on the nation's banking system that would spread to creditor banks abroad

Indonesia holds substantial currency reserves according to IMF officials and much of the $60 billion that it owes to major foreign financial institutions is owed by private conglomerates and companies rather than banks Many of them have reportedly gone into virtual default to foreign creditors because as the rupiah tumbles they become less able to pay debts owed in dollars But pursuing bankruptcy claims in the nation's courts is notoriously difficult, so many lenders have refrained from pressing the matter at least for the time being

One of the factors driving the rupiah lower in recent days has been concern about Suharto's health and the prospect that a succession battle could trigger civil strife IMF officials said other factors might also be responsible for the currency's weakness including unusually high payments due this month on Eurobond debt that could be forcing Indonesian companies to scramble for dollars

Whatever the reason, analysts broadly agreed that currencies are falling in Southeast Asia because local citizens and businesses are trading in local currencies for desperately needed dollars

Draft 1/22/98 -10 30 p m

Restructuring Plan for Indonesian Private and Public Banks

The objective of the banking system restructuring plan is to restore confidence rapidly by offering full protection to all depositors and creditors, and by establishing an Indonesian Bank Restructuring Agency (IBRA) Several of the measures will require implementation through legislation or emergency decree Key elements of the bank restructuring plan are to be announced by the President on [Friday January 23]

Guarantee

1 **The government of Indonesia will guarantee all depositors and creditors of all locally incorporated commercial banks, including state banks,** except shareholders, subordinated debt holders and commitments that obviously contravene sound banking practices

- Arrangements will be made so that all payments can be effected promptly
- Payments will be made on provision of appropriate documentation, concerted efforts will be made to combat any attempts at fraudulent exercise of the guarantee
- The guarantee is expected to last for at least two years, and will be terminated only after notice of at least six months The guarantee will not be discontinued until the banking system is sound The guarantee will be promulgated by emergency decree
- At the termination of the guarantee, it will be replaced by a deposit insurance system The deposit insurance system will be announced at least six months before the termination of the guarantee
- Liabilities and other commitments denominated in foreign currencies are to be paid in rupiah at the market exchange rate prevailing at the time, as determined by Bank Indonesia (BI)

2 **In exchange for the guarantee BI will exercise enhanced supervisory functions**

- All banks will sign a contract with BI recognizing the authority of BI to exercise its enhanced supervisory functions and the authority of IBRA to intervene in banks facing financial difficulties
- In order to prevent abuse of the guarantee, BI may determine a maximum interest rate on deposits, set at a maximum spread over the average interest rates offered for different maturities by a representative sample of banks BI will collect and publish

such information on the representative interest rates at least weekly In addition, BI may set, bank-by-bank, a maximum rate of growth of credit for individual banks, on prudential criteria

- To prevent fraud, BI will subject all institutions to supervisory scrutiny

Indonesian Bank Restructuring Agency

3 The government will immediately establish an Indonesian Bank Restructuring Agency (IBRA), with a lifespan limited to the duration of the restructuring process

- The main objective of IBRA will be to restore the banking sector to financial health at minimum cost to the government Various methods will be employed to achieve this objective including mergers, financial restructuring and operational restructuring

- The IBRA will be an autonomous agency, directly responsible to the newly established High Council under the chairmanship of the President

- A Board of Directors for IBRA with competence, independence and integrity will be responsible for ensuring appropriate standards of governance

- Initial staff will be seconded from BI, the Ministry of Finance, the relevant public and private institutions, and foreign specialists Facilities will be provided by BI

4 BI will identify those commercial banks which are to be reviewed by IBRA criteria

- These banks will sign a contract with IBRA and operate under specified operational guidance

- Outside consultants will perform independent reviews on these banks by [31 July 1998]

- Shareholders of these banks will be required to prepare rehabilitation plans and to recapitalize the bank in accordance with transparent criteria and the findings of the reviews

- Banks which are unable to rehabilitate and recapitalize themselves as required by IBRA will be subjected to restructuring under the authority of IBRA

5 IBRA assumes full authority for all banks it has determined will be subjected to restructuring

- These banks will enter into a contract with IBRA setting out their various operating and financial obligations, and making senior managers and directors personally liable for gross negligence and wilful misconduct in the implementation of these contracts

- IBRA will assess the relative costs of capital injection, merger, take-over, or other restructuring It will target its review also to assess to what extent problems are caused by bad banking rather than externalities If recapitalization is the least cost option, or if the bank is one of a limited number of identified "systemically important banks", the IBRA will provide subordinated debt and/or capital Any subordinated debt will be converted to equity if not repaid

- Equity of existing shareholders will be written down or extinguished according to the amount of capital injection made by the IBRA

- Insofar as the IBRA acquires ownership of (part of) a bank, it will seek to sell that ownership as soon as this is commercially attractive, and in any case within the lifetime of the agency

- Remaining restrictions in foreign ownership of banks will be lifted to help in maximizing the value of recoveries and in recapitalizing the banking sector

- Any capital or subordinated debt infusion provided by IBRA will be accompanied by steps to reduce moral hazard, including generally a change in management

6 Problem assets in banks under IBRA's authority will be placed in a specialized work out company owned by IBRA

- Assets will be evaluated in accordance with transparent criteria established by IBRA, sufficient problem loans will be left on the books of the rehabilitated banks so that such banks' problem loans are not brought below roughly the average level of problem loans for healthy banks Sales will be on the basis of professional evaluations prepared by IBRA consultants

- IBRA will dispose of these assets so as to maximize its return on them

7 Liquidity support will continue to be provided by BI to those banks outside IBRA's authority only for the management of short term fluctuations

- Such BI lending will be for no more than seven days, and at a penalty interest rate

- Repeated recourse will lead BI to recommend the review of the bank by IBRA as indicated above

8 All unrecovered costs of IBRA, as well as possible costs resulting from the exercise of the guarantee will be borne by the government through the issuance of bonds at a market-related interest rate The servicing costs will be incorporated in the budget

- In return for the guarantee, bank will be required to pay a fee to IBRA, based on the size of their liabilities

FACSIMILE TRANSMITTAL

CHEVRON OVERSEAS PETROLEUM, INC.

1401 EYE STREET N W, SUITE 1200
WASHINGTON, DC 20005

cc HW
MRK
DJ4

DATE Thursday, January 22, 1998

PAGES 3

TO Virginia Murray, DOS
Conrad Willett, DOT
Mike Kostiw, Texaco
John Brodman, DOE
Bijan Aghevli, IMF -

COPY William Irwin
Diana Sedney

MRK will attend this meeting

FROM Warner M Williams
Manager, International Relations
TEL 202/408-5815 or CTN 457-5815
FAX 202/408-5842 or CTN 457-5842

SUBJECT Meeting on Monday, January 26 - 2 00pm/State Department (Indonesia)

NOTE Please see attached We have prepared a summary for your review prior to the meeting referenced above

Thank you

W M Williams /VS

SUMMARY

Issue Indonesian Presidential Decree No 5 1998 dated 1/10/98 postponed without cause PLTP Darajat Unit I and II Geothermal Power Plant projects being executed by Amoseas Indonesia jointly owned by Chevron and Texaco (Note that Darajat Unit I and II stated in the decree are correctly referred to as Darajat Unit II and III in the text below)

History

Chevron and Texaco (C&T) have been involved in Indonesia for more than a half century through its affiliate P T Caltex Pacific Indonesia (CPI) Jointly owned by C&T CPI produces over 750 000 barrels per day of oil as a Production Sharing Contract (PSC) operator for the Indonesian national oil company Pertamina (PN) This production is well over half of Indonesia s total oil production and accounts for a significant amount of Indonesia's GNP C&T fund the capital development of CPI through use of their own company equity

A sister company to CPI Amoseas Indonesia (AI) similarly owned by C&T was formed in 1970 to explore for and produce crude oil and natural gas in all areas of Indonesia outside of CPI s area of responsibility – Sumatra While being involved in oil and gas development in Indonesia, AI also recognized the value of another in-ground natural resource – steam Indonesia s volcanic activity referred to as the ring of fire has created a geologic condition which traps steam underground at high pressure, much as oil and gas are With similar technologies for oil and gas already in hand in 1984 AI signed a joint operating contract ('JOC") with Pertamina for the exploration and development of the Darajat steam resource and an Energy Sales Contract (ESC) with the national power company PLN This contract along with Unocal s Salak contract were executed contemporaneously and were the first two geothermal contracts signed in Indonesia Initial evaluation of the resource indicated that reserves existed for at least one steam driven power plant of 55 Mega-watts (MW) This natural resource provides a 'green , renewable and non-exportable source of energy to drive power plants

After conducting further exploration development of the plant and field began in 1991 and AI began selling steam to PLN for use in their 55 MW Darajat power plant Darajat I (DJI) in 1994

Current and Future Plans

Concurrent with the development of DJI, AI began an exhaustive program of reserves delineation to determine the extent of the resource at Darajat Simultaneously at the request of Pertamina and PLN, it began negotiations on amending the JOC and ESC to provide that AI would build, own and operate not only the steam field, but also the power plant in essence selling electricity to PLN, rather than steam This request from Pertamina/PLN was due to their lack of funds to build the plants themselves, which they were contractually required to do anytime AI gave notice of its intent to proceed with steamfield development Completion of the amended contracts in 1996 coincided with definition of an additional 70MW of reserves and plans were begun to construct Darajat II (DJ II) which is referred to in several Indonesian documents as 'Darajat Plant 1' The amended contracts allow for development of up to 275 MW of electricity and obligated PLN to take this amount (actual 'take or pay is at 85% for each Unit) if the reserves of steam to generate it are present

C&T, through AI took on an Indonesian national partner, Prasarana Nusantara Jaya (PNJ) managed by the Tahija group which hold 20 1% of all future development rights to Darajat (excluding DJI) Together we have designed a power plant for DJ II which is slated to come on-line in the third quarter of 1998 The project is approximately $125 MM US of which over $80 MM is already spent (Spending will continue at the rate of about $5 MM per month over the next several months) This project is financed with equity from Chevron and Texaco, though PNJ does have a cash secured bank loan for their share

It has long been thought by AI that the Darajat resource has 250 - 300 MW of total reserve potential while these first 2 plants account for only 125 MW AI has recently determined that reserves clearly exist for a

Darajat III plant of 70 MW (referred to in Indonesian literature as Darajat Plant 2) and infrastructure development has begun Under the terms of our Engineering Procurement and Construction (EPC) contract with Stone & Webster consortium both DJ II and DJ III are covered by that contract In 1997, the instruction was given to the contractor to begin construction of the turbine generator for DJ III AI has already invested upwards of $25 MM in commitments for DJ III through use of C&T and PNJ equity Discussions have been held with PNJ for C&T to provide them with a loan for their share of DJ III rather than having them go for outside financing

As mentioned above, the JOC and ESC in place define the economic terms for all development at Darajat for these and future plants Darajat IV and Darajat V, if reserves exist for that magnitude of development The JOC is executed with Pertamina a state owned entity and the ESC was originally executed with PT PLN (Persero) the state owned limited liability electric company P T PLN (Persero) has since assigned the contract to P T PLN Pembangkitan Tenaga Listrik Jawa Bali I aka 'PJB I' in a restructuring of PLN that took place in 1996/97 At that time PLN hoped to float shares of PJB I to the public but that has never materialized It is important to note that in relation to the recent Presidential decrees the government of Indonesia is not a party to either contract and there is no provision in either contract for 'postponement by Pertamina PLN or the Indonesian government The only provision relating to events of force majeure provides that only C&T can claim Indonesian government actions as an event of force majeure such that we are not obligated to perform under the contract Neither Pertamina nor PLN can use Indonesian governmental actions as an excuse not to perform

Essentially, the only obligations of PLN under the ESC contract are to purchase the electricity and to construct the linking transmission facilities (e g the switchyard) Neither Pertamina nor PLN are obligated to spend funds in the plant construction As mentioned above all funds expended by Chevron and Texaco are equity funds—a point that seems to have escaped the Indonesian government officials of the investment coordinating board Our understanding of the decrees related to infrastructure postponement was that their intent was to postpone or review projects which required major financing by export credit That is not the situation here but we have learned that the officials who originally put Darajat on the list a) did not know that construction was already well underway and b) believed that the project had not yet commenced because there was no approval of a financing package by their office—the latter is understandable because there was no financing package to approve and the former resulted from the officials failure to consult with either Pertamina or PLN when putting the list together (We do note however that Unocal's Salak project (executed contemporaneously with Darajat) for which Unocal has an influential local partner connected to the President is a continued" project even though it requires significant export credit financing) Two other geothermal projects have also been listed as 'continued projects" both requiring export credit financing Members of the Presidents family hold interest in these projects Darajat has lowest contract electricity price of all geothermal project

The problem appears" to be that Darajat has been lumped together with projects which a) have not yet commenced or b)for which financing has not closed or c) require the expenditure of large amounts of state funds in the construction phase The problem persists because it continues to be lumped with these other projects The easiest way for the Indonesian govt to satisfy the IMF about "postponed' projects it tried to continue in Decree 47 of 1997 was by annulling that decree (which it did by Decree 5 of 1998)
There was little time for the govt officials to separately consider the situation in Darajat or to try to handle it by a special decree of its own therefore it went back on the postponed' list by default On the other hand, if the reason for ' postponement is that the govt is saying it will not let PLN pay for the electricity when the plant comes online in late 1998 that would be a breach of the contract and would have serious ramifications to investment in Indonesia Additionally if a condition to IMF bailout is that PLN ' postpone ' its electricity purchases under executed contracts that too would be a breach of contract with serious implications for American investment in Indonesia We do not have any reason to believe that these latter two scenarios are the case but until we have a definitive decree removing Darajat from this postponed list we are operating (and spending money) under a cloud of uncertainty We cannot mothball the project without incurring significant additional costs cancellation costs and deterioration of existing construction, not to mention personnel difficulties It is simply not appropriate, economic legal or feasible to postpone' this project at this stage

From Margaret Kelly
To Hneiss
Date 1/22/98 1 02pm
Subject Indonesia

I looked at the TOR sent from MAS on the corporate debt issue

They are fairly vague The issues that could cause concern is the suggestion (last point) for the government to allocate part of its foreign exchange to viable Indonesain borrowers strictly for debt servicing) But this suggestion is not clear - if the corporations have the rupiah they don't need a special deal with BI,

I think the main message that needs to be given to MAS and the Indonesians is the need for coordination among all parties invovled in providing advice to the Goverment

CC SFischer

From	Margaret Kelly
To	Baghevli JFelman
Date	1/22/98 12 56pm
Subject	Indonesia

1 The LEG department wanted to know if you have the revised performance clauses etc I've said that we have not seen anything yet but assume that there is time when the mission returns to Washington to circulate the revisions (this on the assumption that the review and next purchase is not accelerated)

If otherwise, or if you have something that you want departments to look at at this stage let me know But given your other concerns I can understand that this is nto hihg on your list

2 Fischer's office put through a call to me this morning from Herman VanderWick from London (he is with one of the three Investment banks that advise the Indonesian Government) He was expressing hs concerns about the need to do address the financial and corporate debt issues and indicated what they are advising BI to do and what data they have I said youmwere meeting with their people inJakarta (he knew that) so i assume you have any info I have I will put a brief note together later - but if you want any details earlier give me a call

CC Hneiss, Spratt

From Margaret Kelly
To Hneiss
Date 1/22/98 1 03pm
Subject Indonesian

The French ED wants to know if you plan to brief the Board on Indonesia

The German office asked if I would meet them for 20 minutes - I can do the latter and also brief the French but wanted to check with you first

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ASIA/PACIFIC-
21 JAN 98 1: 13

cc: Foss
SVY

INTERNATIONAL MONETARY FUND

January 21, 1998

To: Mr. Neiss

You will be interested in the attached *Reuters* report quoting London analysts that Indonesian banks are repaying foreign currency debts in rupiah.

You may wish to ask the mission to verify the accuracy of this report. In due course, we will need to be prepared to confirm or deny it.

Attachment

cc: Mr. Fischer
Mr. Ouattara
Mr. Sugisaki
Mr. Boorman
Mr. Cross

S.J. Anjaria
(12-518, ext. 38357)

EMERGING MARKETS-Rupiah repayments the last resort

By Mike Dolan

LONDON Jan 20 (Reuters) - Indonesian banks have been repaying distressed hard currency debt in rupiah for more than a week, a worrying development that could bring the country's financial crisis to a head London analysts said

The repayment of dollar-denominated loans in rupiah at current rates has only added to selling pressure on the Indonesian unit and is aggravating the crisis they said

Either Jakarta decides to guarantee a selected amount of the outstanding debts or the failure of the currency to recover will force the country to call a unilateral halt to repayments and a nationwide debt moratorium

"It looks more and more like they will have to opt for the Chilean solution from the 1980s and allow the central bank to provide dollar liquidity to a number of key corporates and let the rest sink or swim " said one analyst at a European bank in London

Bankers in London who declined to be quoted because of the sensitivity of repayment negotiations confirmed reports from Singapore on Tuesday that repayments in rupiah have been seen for at least a week and in increasingly significant amounts

Companies unable to find scarce dollars on the local market are asking Indonesian banks to accept foreign currency loan repayments in rupiah rather than dollars The banks are then negotiating similar deals with western bank creditors

"Many creditors are beginning to think it is better to accept dollar debts in rupiah rather than run the risk of not getting paid at all " said one analyst at a European bank

"The rupiah is then being immediately hedged though the foreign exchange market and it is exaggerating the rupiah's weakness - and ultimately the whole situation '

Indonesia's huge private-sector foreign currency liabilities have spiralled as a result of the rupiah's 75 percent collapse against the dollar since July of last year

This has brought their ability to repay into question and the consequent scramble for dollars to cover these loans has in turn exaggerated the rupiah's slide A vicious circle has ensued dealers said

Indonesian President Suharto's statement last week that the government would not bail out troubled companies sent shivers through western creditors and has prompted some to accept rupiah for the loans for fear of large scale bankruptcies

"What we've got in Indonesia is an unsolved debt crisis Tight budget measures and IMF commitments are all very well but corporates and banks simply can't find enough dollars to pay off these overseas debts and any that do appear locally are gobbled up in a flash " said one analyst at a UK bank

'Until we get some idea of how these debts are going to be dealt with, the rupiah will find it almost impossible to strengthen "

If creditors were to hold the rupiah at current levels as a punt on a sharp recovery in the currency, then there may be some hope But none want to remain exposed to the ailing Indonesian currency

Moreover the hedging of this newly repaid rupiah has created disproporionate pressure on the currency in offshore markets The recovery of the rupiah to about 7 000 per dollar last week quickly reversed to more than 10 000 on Tuesday

2 000 business executives heads of state and top officials

Although Hillary Clinton is expected, her husband U S President Bill Clinton is not

REUTERS

Rtr 16 09 01-20-98

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Estimates from the IMF and the Indonesian government put the country's external debt at around $140 billion at the end of last year or about two-thirds of gross domestic product (GDP) and of this some $20 billion was short-term

Around $65 billion of this lies in corporate hands and there is around $15 billion of commercial paper

The large number of Indonesian companies reeling from the currency collapse makes a forum for restructuring the country's debt extremely difficult analysts said

In South Korea, where western banks are currently rolling over maturing hard currency debts and negotiating a restructuring the debtors were mostly part of large conglomerates and the government has offered to guarantee the debts in any case

'The line on Korea was that it was too big to fail The problem here is that we're still not sure that's the case for Indonesia," said one trader at a U S investment firm

((London newsroom +44 171 542 6762, fax 583 7239,
uk emergingmarkets news@reuters com))
REUTERS
Rtr 15 26 01-20-98

SUBJECT INDO SKOR BOND FX

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Romania ex-refmin sees inflation up after VAT rise

BUCHAREST Jan 20 (Reuters) - Romania's decision to raise value added tax (VAT) will push up monthly inflation to about 20 percent a former cabinet minister said on Tuesday

Mircea Cosea, reform minister in the leftist government ousted in November 1996 said official forecasts of a limited increase generated by the VAT rise would only apply "in a sound economy "

"In this market, which relies largely on foreign goods the higher VAT will boost retail prices by up to 28 percent " he said

Consumer price inflation in the early months of the year "will not be below 22 percent " he said

Under a government decree approved on Monday VAT will rise four percent to 22 percent No VAT will be levied on household electricity or thermal power and on fuel for household heating VAT for most staple foods will rise to 11 percent from nine

"This was a desperate measure which Finance Minister Daianu had to take because of the state of the 1997 budget when he took over " Cosea said 'The budget is in bad shape as far as input is concerned "

Some analysts estimated price rises will be confined to 10 percent after the increase

The Finance Ministry said the hike in VAT presented as a cornerstone of reforms reflected a "new philosophy" of increasing indirect taxes and lowering direct ones in drawing up the 1998 budget to meet International Monetary Fund demands

Daniel Daianu a technocrat appointed last month acknowledged before the increase was approved that price rises were inevitable But he stood by pledges to prune monthly inflation to about two percent by June against 4 5 percent in December

Raising tax revenue has always been difficult in Romania with tax evasion rampant despite heavy penalties

Although data on the 1997 budget were unavailable Finance Ministry officials put the estimated budget deficit at 4 5 percent of gross domestic product in line with targets agreed with international lenders

Romania introduced a uniform VAT in May 1993 but some goods had reduced levels including staple foods, while others were exempt The introduction of the tax resulted in a monthly inflation of more than 30 percent

((Luli Popescu Bucharest newsroom +40-1 312 0264))

REUTERS

Rtr 15 00 01-20-98

SUBJECT ROMA NIA

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2/7

Office Memorandum

To: Mr. Neiss

January 21, 1998

From: Kadhim Al-Eyd K.A

Subject: **Indonesia -- Program Implementation**

- The rupiah plunged today, to close at 11,400; 16.3 percent lower than yesterday's close. The market reacted negatively to press reports that Minister Habibie is now the leading candidate for the post of Vice President. President Soeharto met yesterday with the leaders of Golkar and military commanders and declared his readiness to serve for another five-year term. The rupiah slide also reflects mounting concerns about the ability of Indonesian banks and corporations to meet their obligations.

- Share prices continued their upward trend. The index rose by 4 percent.

- The National Economic Resilence Commission held its first meeting today under the chairmanship of President Soeharto. The President approved several decrees enacting the fiscal, monetary and deregulation measures contained in the Letter of Intent. Attached is an advance copy of the Press release, which will be issued at 8:00 p.m. today (8:00 a.m. Washington time).

Attachments.

HN

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cc: POSS DV 4

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Attachments

ICTLY CONFIDENTIAL

Indonesia Daily Monitoring

	June	July	August	September	October	November	December	Jan 98 2	5	6	7	8	9	12	13	14	15	16	19	20	21
ign exchange market																					
/USD open (bid side)	0	0	0	0	0	3 640	5 200	5 500	6 000	6 950	7 400	8 000	10 700	8 500	8 700	7 900	7 300	8 700	8,200	10 000	10 000
/USD close (bid side)	2 431	2 578	2 935	3 265	3 580	3 63	4 850	5 625	6 600	7 025	8 100	9 500	7 550	8 525	7 800	7 000	7 800	8,350	9 350	9 650	11 250
rate in trading	2 431	2 578	2 935	3 265	3 685	3 665	5 600	6 100	6 750	7 763	8 425	9 800	10 300	9 050	9 400	8 100	8 250	9 000	9 800	10 700	
night forward rate (percent)	2 2	4 8	0 0	65 0	0 0	2 0	0 0	6 1	8 6	14 6	21 6	47 5	77 1	370 8	410 1	70 8	135 4	41 4	-16 3	34	
nth forward rate (percent)	5 8	7 4	0 0	10 3	7 3	9 1	0 0	6 4	0 7	1 2	1 2	1 4	3 0	2 5	2 7	2 2	0 0	1 0	0 4	0 0	
nth forward rate (percent)	6 5	8 1	0 0	12 0	9 5	9 1	0 0	8 1	4 4	3 5	3 5	2 5	0 7	0 4	-0 3	1 0	1 5	1 4	3 0	1 9	
nth forward rate (percent)	6 6	8 2	0 0	12 1	9 0	10 0	0 0	7 5	5 0	3 7	3 7	3 6	2 6	1 9	1 7	2 0	2 5	2 1	3 1	2 1	
ume (spot fwd & swap-$ million)	9 058	9 493	7 390	0	5 680	4 140	0	2 568	1 969	1 407	2 916	3 251	2 710	2 679	2 872	2 073	3 252	1 909	1 665		
ume (spot $ million)	2 926	3 311	2 948	0	2 315	1 356	0	804	1 121	366	1 613	1 256	1 163	1 185	1 361	1 007	1 393	1 125	981		
nth swap cost rupiah (percent)	0	0	0	0	0	14 8	5 7	12 1	6 4	6 9	6 9	7 0	2 6	3 1	2 9	3 4	5 6	6 6	6 0	5 6	
s Reserves (value date $ billions)	28 9	28 9	27 7	27 6	24 6	24 5	21 5	21 1	20 9	21 3	21 4	21 1	21 3	21 1	20 1	20 2	20 2	20 1	20 1	20 3	20 2
rest rates (Percent)																					
ghted average overnight rate	14 6	15 7	70 8	38 5	35 2	37 0	44 2	42 3	42 8	45 2	48 0	45 3	43 7	19 1	49 1	19 3	51 2	51 1	61 5	65 8	68 4
ge (high and low)	11 25	6 31	15 300	17 110	12 85	11 81	23 150	25 105	27 100	27 160	18 162	16 160	14 50 175	20 185	27 197	17 205	25 230	16 312	26 350	16 350	16 350
ume	0	0	0	0	0	5724	4876	4447	5404	5576	5892	6606	4914	5110	5049	4889	5530	5810	6298	6469	7162
er market overnight (offer)	0	0	0	0	0	14 8	30 0	30 0	29 0	32 5	28 0	28 0	18 0	27 5	30 0	32 5	29 0	31 0	35 0	24 3	40 0
OR (overnight)	13 8	18 3	81 9	19 1	14 5	21 6	32 3	33 0	32 8	35 2	31 7	32 6	32 5	33 5	34 4	35 7	35 7	36 3	37 0	39 0	38 6
OR (one month)	13 7	17 2	52 5	23 5	20 6	22 0	28 5	28 7	29 2	30 0	30 6	30 2	30 2	30 1	30 6	31 2	31 8	33 5	32 8	33 7	34 0
OR (three month)	0	0	0	0	21 2	22 6	25 8	26 0	26 3	26 5	26 5	26 7	27 5	27 5	27 8	27 9	28 5	29 0	28 6	29 2	29 6
OR (six month)	0	0	0	0	21 3	22 4	24 5	24 6	24 6	24 8	24 6	24 9	25 1	25 2	25 4	25 8	25 7	25 6	25 1	25 9	26 0
certificates (one month)	0	0	0	0	20	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0	20 0
bank deposit rate (one month)	13 4	13 4	27 6	23 9	23 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0	19 0
bank deposit rate (three month)	13 5	13 5	26 2	21 6	21 0	17 6	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0	17 0
bank deposit rate (six month)	14 4	14 4	17 0	16 9	17 0	14 6	14 0	14 0	14 0	14 0	14 0	14 0	14 0	14 0	11 0	14 0	14 0	14 0	14 0	14 0	14 0
k lending rate (working capital)	18 6	18 6	25 1	26 4	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41	26 41
k Indonesia (billions of Rp)																					
money	41 6 4	41 276	41 954	41 062	42 790	44 982	46 690	47 010	46 692	46 454	46 497	46 822	48 855	50 237	50 697	50 825	51 196	52 021	52 621	52 857	
	70 183	73 687	82 918	89 563	89 496	88 013	99 881	98 566	97 495	100 420	166 050	166 174	166 3 6	165 975	160 559	160 14	150 624	151 790	152 011	150 665	
(residual)	49 610	49 610	49 610	-49 610	46 696	43 031	53 191	51 526	50 803	53 966	119 553	119 352	117 471	115 738	109 862	109 317	99 428	99 769	99 390	97 813	
ency	23 754	23 566	24 427	23 916	25 481	25 622	28 110	28 331	29 106	29 051	29 099	29 412	31 316	32 580	33 028	33 389	33 810	34 698	34 929	35 251	
t balance	1 733	1 391	5 753	3 664	8 926	1 113	1 915	2 009	2 265	2 105	2 750	3 200	4 279	9 888	12 482	12 957	13 965	16 067	17 267	19 184	
ive balance	1 375	13 311	9 303	11 671	12 116	11 599	12 012	11 628	11 5 8	11 536	11 615	12 223	9 505	9 521	8 509	10 101	9 381	9 066	9 078	8 731	
balance	12 150	11 917	4 050	8 007	3 190	7 486	10 067	9 619	9 273	9 131	8 865	9 023	5 226	367	3 973	2 856	4 584	7 001	8 189	10 450	
uired reserves	12 406	12 860	12 633	12 131	12 199	12 382	12 616	12 723	12 723	12 723	12 723	12 899	12 899	13 035	13 083	13 083	13 083	12 973	13 092	13 092	
s reserves	2 6	943	8 583	4 424	9 309	4 896	2 549	3 104	3 450	3 292	3 858	3 876	7 673	13 402	17 056	15 939	17 667	19 974	21 281	23 542	
c factors																					
market operations (change)	1 669	865	2 376	129	3 158	1 024	183	630	161	898	1 628	829	226	1 491	1 956	310	376	408	31 176	30 111	
BI position (stock)	17 378	14 756	16 778	16 863	13 925	12 878	7 033	7 088	7 257	7 179	7 012	6 827	6 811	6 667	6 399	6 481	6 293	6 151	36 980	5 991	
SBPU position (stock)	2 126	413	65	21	211	4 003	3 155	4 140	4 118	3 172	1 107	2 021	1 779	141	1 832	2 274	1 660	1 926	1 579	701	
ount facilities (stock)	0	11	0	3 623	4 953	12 758	1 125	1 425	1 425	1 125	1 125	1 125	1 125	1 125	1 125	1 125	1 125	1 125	890	890	
l liquidity from polic (change)		876	2 387	3 494	4 488	1 021	8 602	630	161	1 198	1 628	829	226	1 191	1 956	310	376	408	31 411	30 111	
k market index						402		410	410	402	394	347	342	348	382	409	387	413	439	448	466
rcent change)						0 8		2 3	0	2 1	2 0	12 0	1 2	1 5	9 8	7 3	5 5	6 9	6 1	2 1	4

rce Bank Indonesia

cludes 16 liquidated banks as of Nov 3

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6/8

Investment

The President has issued INPRES No 6/1998 to the Head of the Capital Investment Coordinating Board (BKPM) to remove barriers to foreign investment in palm oil plantations, and to complete processing of pending applications for Presidential approval Investment and production in this important export industry is expected to increase as a result

Domestic Trade

- The President has issued KEPPRES No 21 1998 establishing the right of all farmers and traders to freely buy and sell cloves to and from all agents at a freely determined market price In addition, the Clove Support and Marketing Board (BPPC) should complete all activities by June 30, 1998 at which time it will be disbanded
- The President has issued KEPPRES No 19/1998 assigning BULOG to manage the stable supply and price of rice This means that all agents are free to import, buy and sell all types of sugar
- At the same time, the President has issued INPRES No 5/1998 to the Minister of Agriculture, the Minister of Home Affairs and to all Provincial Governors to release farmers from all formal and informal requirements for planting sugar cane
- The Minister of Industry and Trade SK No 21/MPP/Kep/1/1998 frees BULOG from the responsibility of distributing flour Flour millers will be permitted to sell or distribute flour to any agent effective February 1, 1998

In accordance with the Memorandum of Economic and Financial Policies, the Minister of Industry and Trade has been instructed to remove any restrictive marketing arrangements for cement paper and plywood and to prohibit organizations from forced marketing, requiring fees or commissions, setting production volumes, and setting market shares or marketing areas

- To accomplish this the Minister of Industry and Trade issued Circular (Surat Edaran) No 48/MPP/1/1998 to remove any restrictions on cement distribution, including any prohibition or restriction on local trade in brands
- The Minister of Industry and Trade also issued a letter to the relevant authorities authorizing cement producers with a general exporter's license to export cement freely
- The Minister of Industry and Trade has issued SK No 27/MPP/Kep/1/1998 revising the status and role of APKINDO in the wood industry
- Trade in all types of paper will now be determined by the market

All of the above changes will become effective February 1 1998

8/8

Provincial Regulation

- The President has issued clear instructions to all Provincial Governors through INPRES No 2/1998 prohibiting any intervention or restriction on trade within or between provinces on any commodity. This instruction specifies that all commodities including cloves, cashews, oranges and vanilla may be bought or sold by any party across any district or provincial boundary
- The President's INPRES No 1 1998 also requires the immediate enforcement of the prohibition of retribusi at all levels on export goods, and he has instructed the Minister of Industry and Trade to reinforce this by issuing all necessary decrees immediately. Minister of Industry and Trade, the Minister of Home Affairs and the Minister of Agriculture among others have been instructed to monitor and supervise the full implementation of this decision

These measures fulfill the first stage of the program presented to the International Monetary Fund on January 15, 1998. The President continues to work on the next stage of program implementation

Indonesia

4/7

PRESS RELEASE

Wednesday, January 21, 1998

The National Economic Resilience Commission Announces the First Stage of Implementation of the Program of Economic and Financial Reform and Restructuring

The President this morning chaired the first meeting of the Economic Resilience Commission which reviewed the steps required to effectively implement the first stage of the Program of Economic and Financial Reform and Restructuring. The President announced afterwards a list of Government Regulations (PP), Presidential Decisions (KEPPRES), and Presidential Instructions (INPRES) which have been signed, together with a wide range of Ministerial decrees and measures. The President's actions address the revised Government budget for 1998/99, and implement changes in the financial and real sectors, as detailed below.

The Budget

The President has asked his Ministers to complete as quickly as possible revisions to the proposed Government budget for FY1998/99. These revisions should be based on the assumptions of 0% growth, 20% inflation, and an exchange rate stabilizing at Rp 5,000/US$. He has also instructed his Ministers to incorporate the Reforestation Fund and the Investment Fund (RDI) into the Government's budget, and to safeguard budget allocations for basic health and education.

The National Car

KEPPRES No. 20/1998 cancels KEPPRES No. 42/1996 on the establishment of the National Car Program.
Consistent with the President's instructions, all special tax and customs privileges previously granted to the National Car Program will be discontinued through Minister of Industry and Trade SK No. 19/MPP/Kep/1/1998 and SK No. 20/MPP/Kep/1/1998, and a Minister of Finance decree.
The President also instructed the Governor of Bank Indonesia to remove any special credit privileges to the project, including notifying banks that had been asked to provide credit.

IPTN

INPRES No. 3/1998 instructs the Minister of Finance to discontinue immediately all budgetary and extra-budgetary funding of IPTN. The Minister of Finance has notified the Managing Director of IPTN of this action

Public Enterprises	The President has signed PP No. 12 Tahun 1998 and PP No.13 Tahun 1998 which include the transfers sole oversight of public enterprises from the line Ministries to the Ministry of Finance. This is the first step in rationalizing the management of public enterprises and will lead to their privatization.
The Financial Sector	• The President encouraged the Governor of Bank Indonesia to continue working with experts in this field including the IMF, and to announce as quickly as possible transparent and equitable rules for resolving any liquidity and solvency problems of private banks. • The President approved the issuance of Minister of Finance SK No. 15/KMK.017/1998 which lifts the restrictions on branching of joint-venture banks and sub-branching of foreign banks.
Bank Indonesia	In order to give Bank Indonesia autonomy to implement an effective monetary policy that will achieve the Government's policy objectives, the President issued KEPPRES No. 23/1998 granting it this authority immediately. Moreover, the Government will undertake a comprehensive review and revision of the Central Bank Law to submit to Parliament to formalize Bank Indonesia's autonomy.
Foreign Trade	The President has issued KEPPRES No. 22/1998 which eliminates all import restrictions on all new and used ships. Local content regulations on dairy products have been eliminated by the President's instruction contained in INPRES No. 4/1998 together with a decree of the Minister of Industry and Trade. The Minister of Finance has issued the following decrees: • SK No. 16/KMK/01/1998 cuts tariffs on all food items to a maximum of 5% in order to ensure the lowest cost food supplies to the population. This will include all food products for human consumption and will reduce tariffs on more than 500 items. • SK No. 17/KMK/01/1998 reduces tariffs on all non-food agricultural items such as wool and flax by 5% in order to reduce production costs and increase efficiency in domestic industry.

All of the above changes will become effective February 1, 1998.

Investment

The President has issued INPRES No 6/1998 to the Head of the Capital Investment Coordinating Board (BKPM) to remove barriers to foreign investment in palm oil plantations, and to complete processing of pending applications for Presidential approval. Investment and production in this important export industry is expected to increase as a result.

Domestic Trade

- The President has issued KEPPRES No. 22/1998 establishing the right of all farmers and traders to freely buy and sell cloves to and from all agents at a freely determined market price. In addition, the Clove Support and Marketing Board (BPPC) should complete all activities by June 30, 1998 at which time it will be disbanded.
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- At the same time, the President has issued INPRES No. 5/1998 to the Minister of Agriculture, the Minister of Home Affairs and to all Provincial Governors to release farmers from all formal and informal requirements for planting sugar cane.
- The Minister of Industry and Trade SK No. 21/MPP/Kep/1/1998 frees BULOG from the responsibility of distributing flour. Flour millers will be permitted to sell or distribute flour to any agent effective February 1, 1998.

In accordance with the Memorandum of Economic and Financial Policies, the Minister of Industry and Trade has been instructed to remove any restrictive marketing arrangements for cement, paper and plywood, and to prohibit organizations from forced marketing, requiring fees or commissions, setting production volumes, and setting market shares or marketing areas.

- To accomplish this, the Minister of Industry and Trade issued Circular (Surat Edaran) No. 48/MPP/1/1998 to remove any restrictions on cement distribution, including any prohibition or restriction on local trade in brands.
- The Minister of Industry and Trade also issued a letter to the relevant authorities authorizing cement producers with a general exporter's license to export cement freely.
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- The President's INPRES No. 1/1998 also requires the immediate enforcement of the prohibition of retribusi at all levels on export goods, and he has instructed the Minister of Industry and Trade to reinforce this by issuing all necessary decrees immediately. Minister of Industry and Trade, the Minister of Home Affairs and the Minister of Agriculture, among others, have been instructed to monitor and supervise the full implementation of this decision.

These measures fulfill the first stage of the program presented to the International Monetary Fund on January 15, 1998. The President continues to work on the next stage of program implementation.

e-m - WT, mk
cc DDu

Office Memorandum

To Mr Fischer

January 16, 1998

From Bijan B Aghevli

Subject **Indonesia--Financial Crisis and Possible Options**

We have just finished a long meeting, with the whole mission (APD, MAE, and the World Bank) trying to assess the situation The consensus is that the crisis is reaching a critical stage The gravity of the situation is apparent from the following developments

- Currency holdings, which were programmed to increase by about 7 percent during the fourth quarter, have increased by 17 percent over this period, and by a further 18 percent just in the past two weeks Bank Indonesia is having difficulties supplying bank notes—we have been told that there is even a risk that they may run out of fresh notes

- As demand for currency has increased and deposits have been withdrawn from the banking system, liquidity support from Bank Indonesia has expanded dramatically from 2 percent of GDP at end-October, to 7 1/2 percent at end-December Alarmingly, it grew by another 2 percent of GDP during the first two weeks of January

- Despite this sharp increase in liquidity support, broad money (at constant exchange rates) has remained essentially unchanged since end-October, while credit has actually declined (2 percent)

- About 42 private banks, representing 73 percent of total assets of private national banks, have risk-adjusted capital below regulatory norms

- The three largest private banks in the country are all in trouble two have borrowed about 2 percent of GDP (apiece) from Bank Indonesia, while the third has a capital adequacy ratio of just 3 1/2 percent

- More and more, commercial banks are unable to fulfill their normal functions, forcing Bank Indonesia to assume a greater and greater role in financial intermediation Since November, the interbank market has become highly segmented, requiring Bank Indonesia to intervene to recycle liquidity from surplus to deficit banks More recently, the currency swap market has also begun to break down, as local banks are defaulting on their obligations to deliver dollars, forcing Bank Indonesia to consider active intervention in this market, as well

- Since early January, foreign banks have cut their credit lines to Indonesian banks (even state banks), and the latters' letters of credit are no longer acceptable To open LCs, importers must now provide margins of 100 percent

- Reportedly, Indonesian corporates have not made repayments as scheduled on external short-term borrowing

In brief, there is a danger that the financial system may be entering into a meltdown In this environment, standard solutions may no longer be applicable and unconventional approaches may be called for We have come up with a number of possible options Not everyone on the mission agrees with every option, but we hope these proposals can generate a debate and further ideas in Washington (SOS!)

These options are in the attached notes the first note on bank restructuring has been prepared by Olivier Frecaut (who has not had time to clear it with MAE), and the second note on corporate and external debt by Josh Felman, with contributions from others

cc Mr Mussa
Mr Boorman
Mr Guitian
Ms Tseng
Ms Kelly

Indonesia Options for Restoring Banking Sector Stability

Owing to the scope and the complexity of the bank restructuring program, a specific agency (the **Indonesia Banking Restructuring Agency,** or IBRA) is established and begins its activities immediately It acts on behalf of the government It is housed and staffed mostly by Bank Indonesia (BI), relying on BI staff already involved in bank restructuring and on other specialists from the ministries of finance, justice and other relevant public institutions, assisted by experienced foreign experts as needed

All facilities extended so far by BI to support banks facing liquidity shortages or solvency difficulties are transferred to IBRA This includes the lender of last resort facilities extended in the last few months (which are in excess of normal central bank refinancing), the subordinated loans granted to banks rescued under BI's auspices, and any equity participation by BI in commercial banks All these assets are replaced in BI's balance sheet by an advance to IBRA This cleans up the central bank's balance sheet and clarifies the fiscal nature of bank restructuring costs At the same time, IBRA's financial position will make transparent the cost of the bank restructuring operation, i e the difference between its assets (claims on troubled banks) and its liabilities (current account with BI)

IBRA offers immediately to all private national commercial banks, on a voluntary basis and regardless of their financial condition, a guarantee covering all their liabilities, in domestic and foreign currencies, except subordinated debt The permanently updated list of the banks benefitting from IBRA's guarantee is available to the public on BI's Internet site

The terms of the guarantee are described in a contract, drafted exclusively by IBRA with the assistance of BI's lawyers, and non negotiable The banks' choice will then be limited to taking it or leaving it Realistically, all banks except maybe a very limited number will be obliged to request the guarantee As the contract will be the same for all banks, uniformity, transparency and equity will be assured The contract includes a periodic fee, based on the amount of liabilities guaranteed, ceilings on rates served to the depositors, other norms regarding the banks' activities and management, and a mandate authorizing IBRA to take, on behalf of the shareholders, specific measures whenever, in IBRA's opinion, the bank is not complying anymore with the applicable requirements on loan-loss provisioning and capital adequacy

These measures include the faculty to prescribe the booking of provisions against impaired assets and the corresponding losses, to net these losses against shareholders' equity, and, after the shareholders have been given an opportunity and have failed to adequately recapitalize their bank, to sell it to IBRA itself or a third party, merge it, or appoint a team of liquidators on behalf of the shareholders The mandate also allows IBRA to convert any claim it might hold against the bank into equity, after netting of the former shareholders' interest against the losses

IBRA absorbs all costs associated with the resolution of guaranteed banks The claims of all third parties are fully protected at IBRA's expenses, except for those of subordinated debt holders, of parties related with the owners and the management of the bank, and of other parties to which the bank had extended unusually favorable conditions

The banks which have outstanding liquidity suppc.t from BI (now transferred i..'o IBRA's books) are suspended and closed for business, unless they repay immediately or .ign the guarantee contract Banks will be informed about the guarantee and given an opportunity to sign the contract before the guarantee is announced to the public However, they will be allowed to reopen upon full repayment of the facilities extended by BI and verification of their compliance with loan provisioning and capital adequacy requirements, but this second solution will apply in a very few cases if any

Banks not guaranteed by IBRA which fail to meet their commitments are also closed and liquidated following the provisions of the relevant laws

With the assistance of reputable international auditing firms, which would be funded through ADB's loans, IBRA will conduct an in-depth review of the solvency status of all guaranteed banks, beginning with the heaviest users of its resources Undercapitalized banks will be dealt with by giving priority to the minimization of disruption for users of financial services as long as the macroeconomic situation will not be stabilized, and by progressively switching priority towards cost minimization as the overall economic situation returns to normal In this framework, IBRA will foster mergers and acquisition, including by foreign investors, with a view to consolidating the banking sector

At the same time, monthly credit ceilings, consistent with the overall monetary stance, are allocated to each bank BI is responsible to monitor individual bank compliance with the ceilings Failure to comply is notified to IBRA which initiate supervisory intervention

After stabilization of the macroeconomic situation, banks will be encouraged to withdraw from IBRA's guarantee To this end, the fee charged by the IBRA will be raised in steps IBRA's current account with BI will be repaid by an issue of government bonds, and IBRA itself will be terminated

An additional scheme would be for IBRA to purchase certain loans (excluding the riskiest assets or loans made to related parties) from banks in return for government long-term bonds, carrying market short-term interest rates The transfer price for these assets will be based on the effective market price, specified as book value less an adequate amount of provisions, as established by the agency Moreover, the amount of the purchases will be linked, in a specified ratio, to the amount of capital infusion provided by new and existing shareholders In this way, currently weak banks will emerge from this program with a stronger capital base, a healthier asset portfolio, and a more assured interest income

Options for Dealing with Corporations' Debt

Corporations' domestic debt burden

The actions to address the problems of domestic banks will need to be complemented by measures to alleviate the domestic debt burden of the corporations, since the financial health of the two sectors are inextricably linked The most pressing need is to find a way of lengthening the loans' maturity, since at the present time companies are not in a position to repay This cannot be done, however, simply by lengthening nominal maturities, since all of their debt is at floating rates The reason is that inflation is set to rise, making it likely that nominal interest rates would also increase—which would effectively shorten the maturity of the loan again

One way to deal with this problem would be to reschedule loans at **fixed real interest rates** (specified by the government), with the principal indexed to inflation To do this, banks could transfer the fixed rate loans to trust accounts, which would then issue paper with the same terms to a government agency, thereby balancing their position This agency, in turn, would then issue floating rate notes to the banks, ensuring that its position, too, remained balanced In this case, the corporation would obtain cashflow relief and the certainty of a fixed real rate, while the bank would obtain a secure floating rate asset, which would improve its income and improve its ability to lend[1], thereby easing the current credit crunch The government, however, would be assuming a potential liability in the form of interest rate risk

Another possibility would be to allow corporations which cannot pay their bank loans to apply for **financial assistance from IBRA** The IBRA would then pay on their behalf, and in return would acquire claims on the corporations, which could be converted into equity, at IBRA's initiative

External Debt Repayment

Another critical task is to find some means of helping corporations repay their external debt In part, this is necessary because the fears of default, and the exchange controls it might entail, are an important factor behind the weakness of the exchange rate (Certainly, it is striking that Korea's exchange rate began to stabilize as soon as the country announced a plan for dealing with its debt service problem) In addition, though, it is necessary because at current exchange rates the only alternative for most corporations is to default In this case, any remaining financing to corporations, such as suppliers' credits, will dry up completely,

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[1]This would happen because these new assets would raise banks' risk-weighted capital, thereby allowing them to lend more and still comply with their minimum capital adequacy ratio And the reason they would raise their risk-weighted capital would be that the risk weighting on government paper is zero

forcing them to make even more wrenching adjustments, which will only intensify the already-severe economic downturn

One way to help corporations would be to use some of the country's foreign exchange reserves —say, $10 billion, or about half of the central banks' gross foreign assets—to fund an agency that would repay some of the country's private external debt Private corporations would then reimburse the agency, but over a long time period, and possibly on subsidized terms For example, to help reduce the corporations' debt burdens, the loan could be converted into rupiah at a more appreciated accounting rate, rather than the actual market rate

Of course, since such a facility would be highly attractive to corporations, it would be necessary to find ways of limiting its use, especially since the agency's resources would not be sufficient to repay the entire private external debt of $65 billion There would seem to be (at least) two type of criteria that it could use to limit eligibility

- The agency could attempt to pay all of the debt falling due (according to the original contract) over a **specified period** Since short-term debt is about $20 billion, the agency could effectively guarantee payment for the next six months, after which their currency crisis may well have eased
- The amount of lending could be specified as a ratio to any **external debt relief** obtained by the domestic corporation from its foreign creditors In this way, the agency could provide an incentive for foreign creditors to roll over Indonesian debt

Working Capital Shortages

Exporters are finding it difficult to obtain working capital credit from banks to finance imports of materials At the same time, as letters of credit of domestic banks are no longer accepted, exporters must provide 100 percent margin against the value of imports In addition, large-scale exporters are particularly hard hit as banks have reached ceilings for single-lender limits for many exporters as a result of the depreciation of the rupiah

Preshipment export credit

To provide credit to this vital sector, Bank Indonesia could expand and promote their preshipment export credit facility To ease problems facing large scale exporters, lending under this facility could be excluded from the single-borrower limit According to a survey, such a facility, if properly implemented, could benefit 260 exporters in need of working capital finance

Letter of credit enhancement

Letters of credit of domestic banks need to be accepted internationally to facilitate trade activity of Indonesian companies Until domestic banks are restored to health, their letters of credit could be enhanced by additional backing The backing could be provided by a multilateral institution, possibly through state banks The multilateral institution would charge a fee for the backing

Office Memorandum

CONFIDENTIAL

January 16, 1998

To Mr Aghevli

From Stanley Fischer SF

Subject **Indonesia—Options for Restoring Banking Sector Stability**

Following are the main comments on the proposal for restoring banking sector stability Ms Kelly will send you a separate set of detailed comments

1 Management agrees that a **guarantee scheme** (details to be further elaborated in Jakarta) will be needed

2 We favor a **blanket guarantee**—a voluntary guarantee would be confusing to depositors and creditors and could backfire (deposits might start to flow from sound to unsound banks)

3 Bank Indonesia should ensure that it has **adequate supplies of bank notes** available If it runs out of notes the confidence crisis could get worse

4 It is agreed that a **restructuring agency** will be needed—in the Indonesian case this will help deal with the lack of credibility of Bank Indonesia and it is also desirable to clean up Bank Indonesia's balance sheet and show the fiscal costs of restructuring in a transparent way

5 It is important that **further bank closings not be announced until Bank Indonesia or a new restructuring agency is in place** that can promptly close and resolve the failed institutions The objective is to minimize the deterioration of assets in the failed/closed banks

6 You will have to consider the implications of the guarantee for **liquidity management by the central bank**

7 We will need more details about what is meant by "dealing with undercapitalized banks by giving priority to the minimization of disruption for users of financial services as long as the macro situation is not stabilized, and progressively switching priority toward cost minimization as the overall economic situation returns to normal"

8 If the problem is only a typical bank run, guarantees and a bank restructuring along the lines suggested would be sufficient However, if there is also a run out of rupiah assets, the guarantees and the ensuing increase in liquidity will result in serious macroeconomic instability since it would be tantamount to printing cash to fund capital outflows (If the run is on rupiah assets, the public would exercise the guarantee and spend the cash on foreign assets, goods, and real assets with a resulting inflation-depreciation spiral) This underscores the need for the Indonesians to quickly devise a plan to quickly deal with corporate sector restructuring We will provide some guidance after the seminar on this issue with the Mexicans next week

cc The Managıng Dırector (o/r)
Mr Ouattara
Mr Sugısakı
FAD, MAE, PDR, RES
Mr Khalızadeh-Shırazı (IBRD)

Indonesia--Comments on Options for Restoring Banking Sector Stability

Following are some specific comments in addition to those provided by Mr Fischer

1 There is agreement that **something has to be done** to deal with the situation While you can work separately on the banking sector and corporate sector restructuring strategy, the banking sector strategy is unlikely to be credible unless a plan to deal with corporate sector debt (including external debt) is announced We will provide input on the corporate sector issues after the seminar next Tuesday with the Mexicans

Critical Issues

2 Is the guarantee in domestic currency, or in foreign currency if the claim is in foreign currency? (This matters to foreign creditors if there is a lag between calculation of the domestic currency amount and possible exchange into foreign currency) If in foreign currency, is it credible? I e do they have the reserves to pay it off? Otherwise, one could think of giving foreign creditors bonds

3 We assume that the guarantee would cover both debt liabilities and off-balance sheet items

4 How do we make sure there are no loopholes through which those in political favor can benefit? The only ones we see immediately are in

- the price at which IBRA would buy banks (last para first page)
- the price at which IBRA would, in the "additional scheme", purchase certain loans, and how these "certain loans" would be chosen (last para 2nd page), but there may be others We have no bright ideas on how to minimize IBRA's discretion on these points, but we should try

5 **The following issues need to be clarified**

- Has the shift out of bank deposits been accelerating in recent days or is showing signs of slowing following the "New" program? This will help assess the amount of time available to develop a strategy,
- Is the run on bank deposits across both state and private banks, does it reflect the lack of confidence in <u>all</u> banks?
- How will IBRA know whether a bank is truly unable to pay its liabilities, or is seeking, say, liquidity with which to speculate against the rupiah? (Presumably, the Thai FIDF has experience with this)

- Why is it necessary to shift to monetary management by way of monthly bank-by-bank credit ceilings in this context?

- Are state banks, with implicit guarantee, constrained by capital constraint from taking deposits?

6 It is **important** for the restructuring agency to identify **systemically important banks (SIBs)**

- SIBs will not be permitted to fail and will be recapitalized and get liquidity

- Non-SIBs will over time be allowed to fail as soon as arrangements are in place for

  (i) all depositors/creditors to be paid through a SIB
  (ii) assets to be transferred to the new asset recovery agency

7 Is the guarantee valid only for liabilities outstanding on the day it is announced (what about interest on these?), or does it cover future liabilities as well? We assume it would have to cover future as well, given rollover of short-term obligations But there should probably be a time limit (a couple of years?)

8 **Specific comments (by Carl Lindgren) on Olivier Frecaut's note**

- The establishing the IBRA and segregating all BI support operations into that agency is fine, whether we define the fiscal cost as the total stock of resulting claims or the carrying cost of that stock need to be clarified, in Thailand we used the carrying cost

- We should advise against making the guarantee voluntary If confidence is to be restored, all liabilities (except subordinated debt and capital) should be guaranteed, if uncertainties remain about which claims are covered and which ones are not the guarantee may not work In order to avoid the contractual arrangements an emergency decree may have to be passed to provide the IBRA with the necessary authority

- It should be very clear that the government/state stands fully behind the guarantee If the IBRA is the entity honoring the guarantee it must have an open, automatic and immediate line of credit with the BI in order to meet withdrawals on demand Once the guarantee is in place it will be tested and must be met unconditionally in order to be credible

- The fee, the cap and prudential credit limits on individual banks designed to limit the moral hazard of the guarantee may be announced up front but the plan to increase the fee and other parts of the exit strategy should not be mentioned at this point publicly--it would only be confusing

- The guarantee will give a cover for a strong restructuring of the banking sector The decision to close/suspend cannot be part of a contract negotiation as proposed, the decision has to be made and imposed by the BI

- The note is ambiguous about the closing/suspension of banks Either that is done before the guarantee is extended in which case losses can be distributed to the private sector and public costs limited If those institutions are also to be covered by the guarantee, it may be better for market confidence not to suspend/close them up front but instead maintain them as running concerns and instead change management and transfer them to government control first de facto and later de jure

- It should be stressed that the IBRA should vigorously seek to establish the solvency of the banks and write down capital and sub debt where called for

- The authorities should be aware that the share-write-down is going to affect a growing number of banks and at some point, which by nature is arbitrary, they may have to decide to write down the capital but not to zero—in other words they will need the private owners and managers as allies for governance purposes

- In proposing bank-specific credit ceilings it should be stressed that they are for prudential reasons and to limit the moral hazard of the guarantee—not a return to direct monetary controls

- The last point in the proposal, i e , purchasing the worst assets from banks against government debt should be done very carefully, and such as scheme should not be introduced until the capital of the worst banks has been written down We have advised against this sort of scheme in Thailand At this stage it should be used only in banks where the IBRA already has written down the assets and taken over the management of the bank, as the government has responsible for all the losses anyway

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INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

cc: BBA
WT
Div 4

FIRST DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

January 16, 1998

Hon. Urban Bäckström
Governor
Bank of Sweden
Stockholm, Sweden

ASIA/PACIFIC

20 JAN 98 10:57

Dear Governor:

As you are aware, the IMF is centrally involved in the international efforts to stabilize the economies of several East Asian countries, which are facing currency and banking crises of unprecedented intensity and scale. In order to contain the problems and find workable solutions for them, it is necessary for us to bring in the very limited technical expertise that is available internationally. About a month ago we called upon you to release your Deputy, Mr. Stefan Ingves, to assist us in Korea at a critical stage in the negotiations with the authorities. You were kind enough to do so, and Mr. Ingves did an outstanding job, which was much appreciated both by the authorities and our mission in the field.

We are sorry to have to call upon you and the Riksbank again, but the circumstances are critical--this time in Indonesia, where the central bank and its senior staff are having great difficulty managing the crisis. We have been asked to provide the central bank with one or two very senior advisors to advise the Governor, in a quasi-executive role. The situation requires a presence of the principal advisor in Jakarta for at least a month and we have therefore approached a couple of former central bank governors with experience of running a central bank in a banking crisis (including your predecessor, Mr. Dennis, who was interested but not available). Mr. Roberto Zahler, the former governor of the Central Bank of Chile, may be prepared to accept the assignment but we would like to be able to complement him with an expert of the caliber of Mr. Ingves, who could advise on how to manage a central bank in the presence of massive banking problems. We are also approaching a third expert.

I am therefore inquiring about the possibility of the IMF again being able to count on the services of Mr. Ingves for a visit to Jakarta next week; we envisage that he would need to stay about two weeks, and, if possible, be prepared to make additional visits subsequently.

I would appreciate your early response on this matter. With best wishes and hoping you can help.

Yours sincerely,

Stan Fischer

Stanley Fischer

17 January 1998

To: Mr.Bijan Aghevli
IMF (Guest at Borobodur Hotel, Jakarta)

From: Paul M.Dickie
Director, IED, Asian Development Bank

17/1/98

Dear Bijan:

Let me assure you again that we will move as quickly as we can in the banking area. However, it may be helpful to emphasize that despite credit enhancement from the Bank, the commercial co-financing that constitutes most of the funding for the SME and exporters' facility is crucially dependent on the level of external confidence. I have just communicated with the Bank mission putting together a similar facility for Thailand and, based on their recent discussions with commercial bankers, they inform me that it is highly unlikely we could put together such a facility for Indonesia in the coming weeks if confidence does not improve from current levels. I believe an effective implementation of the Fund's program will be the key for the recovery of confidence.

I do not share your view that a formal deposit guarantee scheme would help restore confidence. You indicated your belief that the blanket 3 year guarantee in Korea did not work because it was not legally binding. In this connection, you may be interested in knowing that the Philippines has experienced the same large scale flight to quality by depositors, and there can be no doubt about the legal standing of the Philippines deposit guarantee scheme. In my view, credibility cannot be legislated where confidence is lacking in the legal systems of these economies.

After you left our meeting, we did answer your banking group's questions relative to an earlier version of our Policy Matrix, which had been provided to them. Your banking group then requested a revised copy, and I indicated my position that while I am prepared to violate the Bank's confidentiality rules and so inform our Board, I am not willing to do so when the cooperation is only one-way. I stand ready to exchange a copy of our Development Policy Letter and Policy Matrix for a copy of your Letter of Intent (LOI) and the Memorandum of Economic and Financial Policies of 15 January 1998. Our Program covers a set of measures to improve governance in the areas of public finance, the corporate sector (both public and private) as well as in the banking sector, and I am not going to insult your banking group by segmenting out only the banking provisions. As a result, the co-operation between our missions remains dysfunctional.

The Fund's drawdown schedule which you indicated you would fax over to me did not arrive.

Best Regards.

cc: T.Patterson,
ADB Resident Representative, Indonesia

Kadhim Al-Eyd
IMF Resident Mission, Indonesia

January 21, 1998

Hubert:

Just a few quick notes I am dictating on the fly:

1. ADB's intervention is extremely counterproductive as they have apparently also written a letter to the government expressing their opposition to both the guarantee scheme and the formation of IBRA.

2. The suggestion that we take our time and await the results of their study while Rome is burning is absurd (unrealistic in our lingo).

3. The ADB team negotiated a whole program covering all financial aspects without any direct involvement or close consultation with us. We had seen an earlier matrix of their policy proposals which they had sent us much earlier but we were told directly by Paul Dickie that they will not provide us with the final Memorandum of Understanding as we did not give them our letter of intent. This is of course, completely untrue as the ADB had been involved closely in the preparation of the last letter of intent. They saw the final draft of the sections relating to the financial sector and their comments were incorporated. They, of course, wanted to have been involved in every aspect of the program which was unrealistic given our deadlines.

4. We are not complaining that we were not included in their negotiations last week. We should take the high road and point out that in a crisis situation we must trust each other and allow each institution make its own decisions. However, it is ironic that while they did not include us in their negotiations, they expect us to clear everything with them.

5. In our meeting with ADB here, I specifically asked that they assign someone to our team this week so that they can be part of the discussions. They told me that they were all busy in the preparation of their documents for the Board.

6. In substance, the creation of IBRA is based on solid criteria and in line with experience of many other countries. ADB is concerned that this will undermine confidence in Bank Indonesia. Our priority however is to give confidence to the market and our judgement is that a separate agency with the right person at its head will accomplish it much better.

7. As for the guarantees, we have heard it all by now and I do not see what they can contribute to the debate. We have made the judgement as an institution that the guarantee is unavoidable at this stage, notwithstanding the litany of sins it entails.

8. You are of course aware that their scheme is essentially the same as Bank Indonesia will soon own the whole banking system. Liquidity credit is already over 10 percent o. GDP and soaring. This passive way to deal with the crisis is hardly the way to gain market confidence. If Bank Indonesia were to continue to be the main agent to deal with this issue through the provision of increasing amounts of liquidity, this would completely undermine confidence in its ability to conduct monetary policy in an effective manner.

9. I am sure you will put all this much more elegantly.

Cheers!

Bijan

ASIAN DEVELOPMENT BANK

20 January 1998

Mr Stanley Fischer
First Deputy Managing Director
International Monetary Fund
Washington, D C

Dear Mr Fischer,

Proposals to Address the Indonesian Banking Crisis

We would like to express our appreciation to you personally for the efforts and the major contributions you made in conjunction with the Managing Director in strengthening and reinforcing the economic program in Indonesia Our support is evidenced by the conclusion of our Financial Governance Reform Program amounting to $1 5 billion for which loan negotiations were completed yesterday

We believe it is particularly important that the global financial market appreciates the resolve of the Government in addressing the ongoing banking crisis in Indonesia As you know, the market generally responds negatively to surprises and inconsistency in reform packages In this regard, we wish to express our grave concern about proposals that the IMF staff have made to Bank Indonesia (BI) and the Government without consulting the Bank We were told of their proposal on the morning of the 19th of January after it had been presented to Government officials on the 18th of January

As we understand it, the IMF staff propose to establish a separate agency to address the issues of the restructuring of the commercial banks The Agency would not report to the Governor of Bank Indonesia but would expect Bank Indonesia's Managing Directors responsible for banking supervision to report to it Serious consideration is being given to appointing a foreign national to head this Agency We feel that this proposal which they contend will signal resolve to the market will actually do the opposite as it will undermine BI and the program negotiated and agreed with the Bank yesterday We also feel it will demoralize the supervision staff who must have absolute resolve in addressing the crisis Further it will take time to put this agency in place as current Government procedures require that its Terms of Reference, leadership and staffing be approved by the President Its program of action can not substantively differ from the existing agreed program of seeking an advisor firm to address mergers/sales and recapitalization of weak banks together with due diligence reviews of the financial statements of most domestic commercial banks It is our considered opinion that this program will surprise the market and will suggest confusion in policy decisions by BI and the Government We would urge you to reverse this proposal

The second proposal is to establish a deposit insurance scheme to guarantee commercial bank depositors We feel that such a proposal is inappropriate, particularly at this time as it significantly increases moral hazard in banks and provides an escape from the resolve needed by bank supervisors to be resolute in their enforcement of banking regulations The most important step in addressing confidence in the short term is to ensure that all banks have sufficient liquidity to meet deposit withdrawals There is no greater confidence builder than that The resolve to place under close supervision and/or if appropriate conservatorship those banks which most need liquidity and to develop rehabilitation plans including mergers and in extreme cases liquidation will build confidence in the banking system over the coming weeks A clear and well published exit policy for weak banks will assure the market that problem banks will be attended to with resolve The policy matrix outlining the Government's program for financial governance reform agreed to with the Bank also includes a study of a deposit insurance scheme for Indonesia We would urge you to await the results of that study which is scheduled for completion by June 1998

We would like to again state our commitment to fully support the enhanced Fund program and in fulfilling our responsibilities in addressing the current crisis in the banking sector We look forward to your response concerning these two major issues that have arisen unexpectedly on the areas of responsibility undertaken by the Bank

Yours very truly,

Peter H Sullivan
Vice President (East)

(HN)

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CABLE ADDRESS
INTERFUND

January 20, 1998

Mr. Widodo Sutiyo
Assistant to the Minister/State Secretary for Foreign Affairs
Office of the President
Jakarta

Dear Pak Widodo:

Last week, in his meeting with Mr. Fischer, the President asked that we immediately inform him whenever any problems arose with the economic program. Unfortunately, one such problem has already arisen. I refer to the deepening of the rupiah crisis.

Notwithstanding, the very strong reform program announced by the President, the rupiah has continued to plummet. There are a number of factors accounting for this serious development.

First, markets remain unsettled because the government has not yet announced a strategy for dealing with the problems of the banking sector, which are intensifying with each passing day. We are working closely with Bank Indonesia to develop such a plan, and we are doing everything possible so that the plan can be approved and announced by this Friday.

Second, some of the statements in the press may have given rise to a misconception that the commitments under the program may not be fulfilled fully. Specifically, I am referring to statements regarding the National Car and the IPTN airplane. While the details of these statements do not necessarily contradict the undertakings of the program, the general impression that they convey--that these projects will continue unaffected--is very counterproductive. While it is difficult to be certain, it is commonly perceived that the headline in the Jakarta Post on the National Car may have played a role in today's sharp drop in the rupiah. We would strongly advise that instructions be given so that everything possible is done to ensure that no public statements are made that would undermine public confidence in the program.

We are optimistic that the announcement of the High Council, under the President's Chairmanship and Professor Widjojo as the Secretary General, together with the introduction of the relevant decrees to implement the initial program commitments, will help improve sentiment in the financial markets. We will continue to do our utmost to provide all the assistance and support we can, but ultimately it falls on the Indonesian policymakers to overcome the present crisis It is therefore essential that the policymakers continue to be not only of the highest professional caliber but also be publicly perceived to be fully devoted to reform

Yours sincerely,

Bijan B Aghevli
Chief of IMF Mission

HN

Office Memorandum

To: Mr. Kent January 21 1998

From: Stanley Fischer SF

Subject: **Your mission to Indonesia**

On behalf of IMF management, let me say how delighted we are that you have agreed to visit Indonesia to work on the corporate debt problem. In Jakarta you will be working with Mr. Bijan Aghevli, Deputy Director of the Asia Department, who is heading the current mission to Indonesia. The mission includes staff from the World Bank, which whom we are collaborating closely in Indonesia; the Asian Development Bank is also playing an important role in banking sector restructuring. The Indonesian government has agreed to the appointment of a high level IMF representative in Jakarta, who will have direct access to the President. That representative, who is likely to be Mr. P.R. Narvekar, former Deputy Managing Director of the IMF, should arrive shortly, and you would then report to him. You should also feel free to contact me directly as necessary.

1. The extent of the corporate debt problem in Indonesia is difficult to determine. Most observers say that at the highly depreciated exchange rates of recent days, most companies' liabilities exceed their assets. IMF staff now in Jakarta has made a calculation at the aggregate level that tends to support this view. (I believe you have already received that note.) However, it is not clear why devaluation and inflation have not significantly reduced the real value of the domestic debts of many corporations, and why the prospects for exporters have not improved in a way that should improve the positions of some companies.

2. It is also common wisdom that the rupiah will not stabilize until a plan is announced for dealing with the corporate debt problem. Here too a note of caution is necessary, since the political uncertainties associated with the President's health, succession, and intention to carry out the IMF program, must play a critical role in determining the exchange rate.

3. The first need is to try to determine the extent and nature of the corporate debt problem, particularly how much of it relates to external and how much to internal debt. In doing this, you will have the full assistance of the mission headed by Mr. Aghevli.

4. It will then be necessary to develop a framework in which debtor-creditor relations can be dealt with. Given reports that few Indonesian companies are servicing their debts, most creditors must already be showing some form of forbearance. Until the economic situation stabilizes, and perhaps unless the currency appreciates, continued forbearance is likely to be necessary. On the domestic side, this will create difficulties for the banks, a problem which is being dealt with separately by the Fund mission. Stefan Ingves, Deputy Governor of the Bank

of Sweden, will be arriving in Indonesia today to work on banking sector reform and restructuring

5 We would like to make rapid progress on the corporate debt issue, and possibly have preliminary recommendations for the Government of Indonesia early next week

6 The Indonesian government, working together with the Government of Singapore, has appointed a small group under Mr Radius Praviro to help deal with the external debt of the corporations held by Singapre banks The group contains some prominent businessmen and one or two people formerly in government service The precise function of this group has not yet been defined, and we have asked the Singaporan authorities to develop a terms of reference so that we can understand their mandate and its restrictions You may find this a useful group to work with, and I am sure you will want to meet with them However, you should not feel constrained to accept either their mandate or the current constitution of the group, and could propose some other institutional arrangements on the Indonesian side

7 Given the current vacuum on this issue, whatever you suggest will likely set the pattern for dealing with this problem in Indonesia As you well know, there is a clear tendency in such situations for both the creditors and the debtors to see virtue in the government's solving the problem We would prefer that to the maximum extent possible, the solution involve negotiations between individual debtors and creditors, rather than groups of creditors and debtors, and that government financial involvement be avoided, or -- if absolutely necessary -- be minimized

8 We need also to bear in mind that whatever is done in Indonesia could serve as a precedent for dealing with similar problems in other countries in the region In formulating any plan to deal with Indonesia's corporate debt probelm, we will need to give due regard to the delicacy to the financial situation in the region, and the driving concern behind Fund programs to avoid countries having to impose an overall standstill on debt servicing

9 Yesterday in Washington we met with a group of Mexican officials who have dealt with similar problems during the last few years We will be asking one of them, Mr Alberto Mulas, to join you in the next few days

Good luck, and thank you for taking on this assignment

cc The Managing Director
Mr Ouattara
Mr Sugisaki
Mr Boorman
Mr Neiss
Mr Aghevli

Jan 21, 98

Indonesia Financial Position of the Largest 300 Conglomerates

This note provides a rough assessment of the impact of the recent depreciation of the rupiah on the financial health of the corporate sector, based on data from the Indonesian Business Data Centre for the 300 largest conglomerates that account for most of the corporate sector It does not look at the impact of high interest rate in recent months or the impact of the economic slowdown, both of which are likely to be significant

The table below is based on the exchange rate moving from Rp 2,450 per U S dollar at end-June 1997 to around Rp 9,000 per U S dollar in recent weeks They indicate the following

1 Post-crisis, debts amount to 150 percent of assets, i e , the 300 conglomerates as a group are insolvent Just the foreign debts are still larger than assets

2 Post-crisis, the debt/equity ratio (gearing) for the 300 conglomerates is at an untenable level of 470 percent Just foreign debt relative to equity is 330 percent

In short, the Indonesian corporate sector as a whole is now bankrupt Of course, the export-oriented companies will be better off than the sector as a whole, but other domestic-market-oriented companies will be even worse off

	Pre-crisis	Post-crisis
(In percent)		
Debt/assets	70	150
Foreign debt/assets	30	110
Domestic debt/assets	40	40
Debt/equity	229	470
Foreign debt/equity	90	331
Domestic debt/equity	139	139

Prepared by Keon Lee

Table 3 Indonesia External Debt by Maturity

	End-Jun 1997	End-Sept 1997
Total external debt	142 3	131 1
Total medium- and long-term external debt	109 0	109 2
Loans	105 1	106 0
Rupiah-denominated securities	2 6	1 0
Foreign-currency denominated securities	1 3	2 2
Total short-term external debt 1/	33 3	21 9
Loans	13 9	12 1
Rupiah-denominated securities	14 2	4 6
Foreign currency-denominated securities	5 2	5 2
Memorandum items		
Principal debt payments falling due during	Oct-Dec 97	Jan-Mar 98
Total	11 6	8 4
Loans	6 2	5 1
Maturing securities	5 4	3 3

Sources Bank Indonesia, and Fund staff estimates
1/ Virtually all of short term debt is owed by the private sector

From	Shailendra Anjaria
To	Hneiss
Date	1/21/98 10 02am
Subject	Briefing on Indonesia

Hubert
As you probably know, the MD will tape an interview with Ted Koppel tomorrow, Thursday, on arrival in Washington from Paris, for broadcast tomorrow night Although he is fully familiar with Asia, it would be helpful if you could suggest specific language addressed to TV he might use in responding to the following question

"Exactly one week ago, you were in Jakarta witnessing the signature by President Suharto of a strengthened economic program that was supposed to restore confidence Yet, since then, the value of the Indonesian rupiah has continued in a free fall Does this mean that the Indonesian program is not working, and what do you plan to do to fix it?"

We plan to send briefing material to MD for his reading on the flight in Accordingly, we would appreciate receiving the suggested language by 5 pm today Thank you very much

Shail

CC Ogoodger

Mr. Neiss
Given the tight deadline I have given this directly to MD

MSG

Shail,

On the Indonesian question, please send me a draft on which I will comment.

thanks

Hubert

HN

Office Memorandum

To Mr Fischer

From Hubert Neiss HN and David Goldsbrough DG

January 21, 1998

Subject **Banking Crises in Mexico and Asia**

As you suggested, we have put together some points of the Mexican experience that could be useful for our tasks in Asia

Attachment

cc RES
MAE
PDR

Lessons for Asia from the Mexican Banking Crisis

In general, the Mexican authorities moved with imagination and pragmatism within a framework of general, well accepted principles But when, in their view, the situation required some deviation from these principles, they did not hesitate to do so, explaining that this prevented much larger damage While the Mexican situation differs in some respects from Asia--in particular there were no runs on banks as the guarantee was credible--many elements in the resolution of the crisis are suggestive to the task--yet to be fully tackled--in Asia The following points are especially noteworthy

- When widespread solvency problems threaten a potential collapse of the financial system, there may be no practical alternative to a **broad-based guarantee** of banks' liabilities To be credible, however, people and markets must have confidence in the government, and the guarantee needs to be backed by an adequate external financing package (both conditions were present in Mexico, but not, for instance, in Thailand and Korea)

- The guarantee, which inevitably interferes with efficient financial intermediation, can be difficult to remove—it is still in effect in Mexico after three years **The best approach may be to announce a specific time period for the guarantee when it is introduced** (This was not done in Mexico, Thailand, and Korea, but, was done, for instance, in Japan)

- Any **foreign currency liquidity support**, provided by the central bank should be **at clearly penal rates** (around LIBOR plus 20 percent in the case of Mexico) and with shareholders' equity as collateral The high penalty rates encouraged early repayment (in about 9 months) in Mexico (Penalty rates in Korea has helped reduce liquidity support by increasing banks' efforts to mobilize other sources for foreign exchange)

- The **use of public funds for recapitalization of (non-intervened) banks will be needed,** once improved loan classification standards and strengthened provisioning requirements are introduced, in order to raise banks' capital ratios and promote confidence In Mexico, the capital injections were in the form of purchases of convertible debentures (In Thailand, we recommended shares, as these could be sold later at a profit)

- **A pragmatic approach to the writedown of existing shareholders' equity in intervened banks** is required if, as in the case of Mexico, the legal system does not provide for a full up-front writeoff Allowing the existing shareholders to retain a small equity share (heavily diluted by the recapitalization process) may be the necessary price of avoiding lengthy litigation Wherever possible, the remaining equity share should be linked to performance on loan collections, in order to provide the appropriate incentives for loan recovery (In Korea, there are also legal issues that delay and inhibit a full up-front writeoff)

- **Incentives for the early injection of new private capital should be provided,** in the case of Mexico, this was done by linking the amount of Government purchases of banks' loan portfolios explicitly (i e , two for one) to the amount of fresh capital injected (The non-transparent pricing of bad loans and the implicit subsidy to shareholders makes this a bit problematic, but it was a resounding success in Mexico)

- **Barriers to foreign equity participation in banks should be removed at an early stage,** and the Government's newly acquired equity stake sold as quickly as possible, in order to encourage a decisive restructuring of the banking system (This was done in Mexico, but also in Thailand, and to some extent in Korea and Indonesia)

- The restructuring does not necessarily require the temporary or permanent **closure of banks** In Mexico, insolvent banks were not liquidated but taken over by the government and kept running (liquidation would have been too costly and risky for the stability of the banking system), they were then reduced in size by selling the branch network However, early intervention to replace the management of clearly insolvent institutions is critical (The small number of banks in Mexico, or for instance in Thailand, makes such an exercise more manageable With several hundred banks in Indonesia, such an exercise would be more difficult)

- **It takes time to establish the appropriate procedures and institutions** For example, the temporary capitalization program only began four months after the initial crisis, and the loan purchase mechanism after only six months (The same was also true, for instance, in Sweden) However, **slippages from the announced timetable should be avoided in order to preserve credibility**

- It is very important for the government to explain regularly to the international financial community, starting at an early stage, the restructuring strategy and the measures put in place This will discourage speculation and uncertainty about government policy and restore confidence

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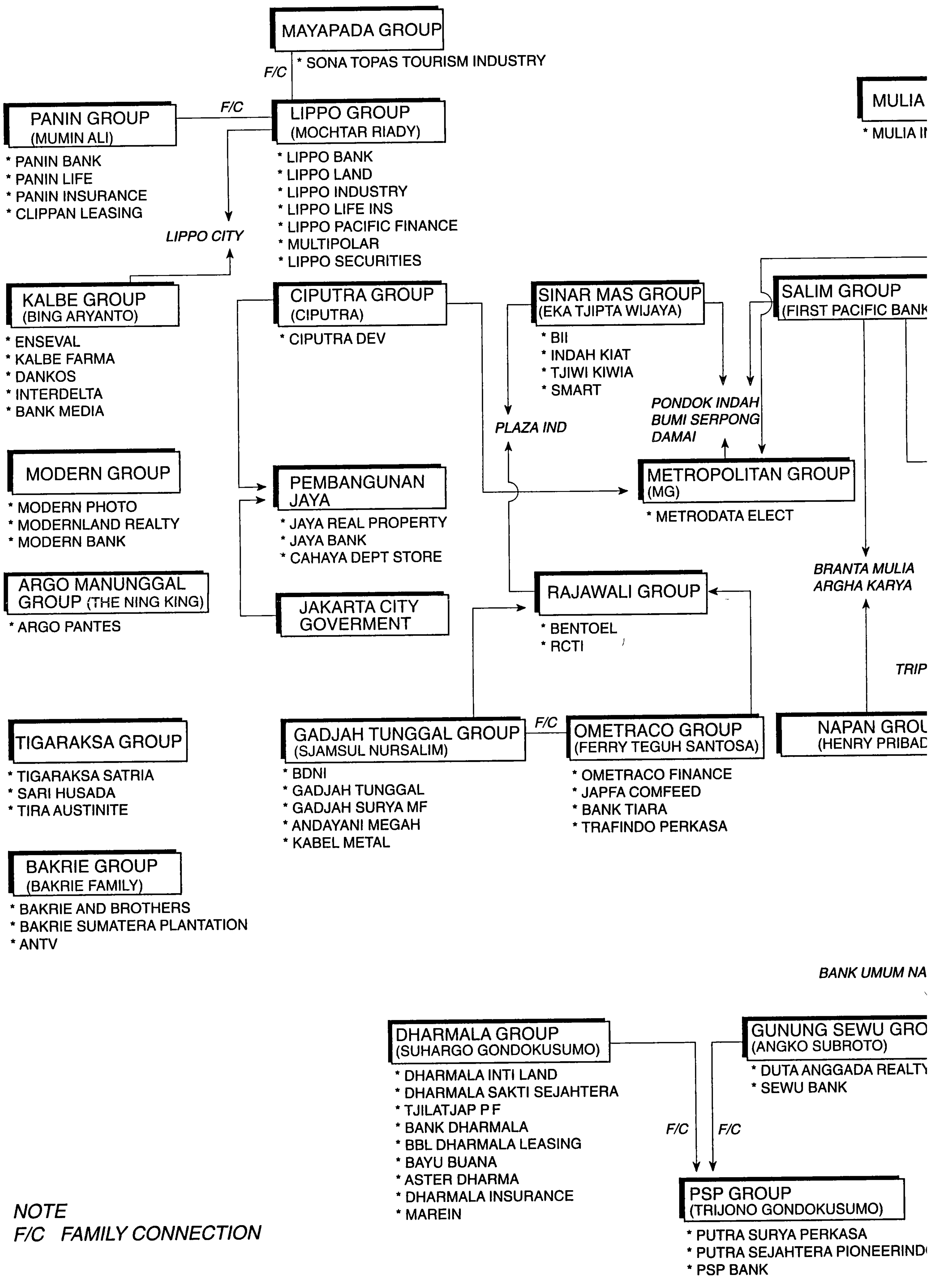

NECTIONS

W.I.CARR
Banque Indosuez Group

PT W I Carr Indonesia
Niaga Tower
20th Floor, Jl Jend Sudirman Kav 58
Jakarta Selatan 12190, Indonesia
TEL (021) 250 5515
FAX (021) 250 5527