

**THE INDONESIA CURRENT ECONOMIC:
PRIORITY BETWEEN EDUCATION AND FINANCIAL KNOWLEDGE
FOR THE INDONESIAN YOUNG GENERATION^{*)}
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Introduction

First of all, I would like to thank Citigroup and INSEAD for hosting this Financial Education Summit 2006 with an excellent arrangement. I am both delighted and honored to be here before distinguished speakers and audiences to discuss important issues of common interest. We are all aware that despite rapid development of the globalized and integrated financial market, there are still many problems that we are facing the issues of financial literacy and economic literacy especially in our youth generation in many countries.

Today, I would like to share with you the current condition of Indonesia economy, the Indonesia Financial System, the importance of education as human investment and some issues on future financial knowledge.

The Economic Crisis and Current Condition

The currency and banking crisis during 1997-1998 caused economic collapse and negated the results of development of more than three decades. The crisis we faced is one of the worst among many of the crises experienced by countries in the world throughout the twenty first century. Its effect, among others, is shown by the negative growth of the GDP. Some factors that triggered the collapse of the Indonesian economy are large foreign debt of private sectors that were affected by drastic changes of the exchange rate, and moral hazard of bankers which led to nationwide public mistrust in the banking industry. The total domestic and foreign debt at that time reached USD137 billion. The already critical condition is further deteriorated by the domestic political condition that was not conducive. The public's dissatisfaction and disappointment toward the economic, social and political condition reached its climax on 14 May 1998 when riots of anarchic nature erupted leading to the destruction of many public and private properties.

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Indonesia was the country most severely affected by the Asian financial crisis, with GDP declining by 13 percent in 1998. The financial system suffered several simultaneous shocks. Those included a significant depreciation of Rupiah between 1997 and 1998 and an increase in the central bank interest rate from 12.75 percent to 70.5 percent in the same period.

As widely known, throughout the last three years, Indonesia's economy has been developed favourably. Mutually supportive monetary and fiscal policies have helped maintaining the momentum of economic recovery. Exports and investment have also started to rebound, in line with increased public confidence, improved stability in social political condition and stability in various macroeconomic fundamentals.

During our stabilization period under the IMF program, Bank Indonesia adopted base money as an anchor. Over the long run, however, we noticed a number of shortcomings in the use of base money as the operating target. In view of those factors, Bank Indonesia adopted a fully-fledged Inflation Targeting Framework (ITF) in July 2005.

Application of the ITF does not mean that the central bank pays attention only to inflation and no longer takes economic growth and overall policy and economic trends into consideration. Furthermore, the ITF is not a rigid rule, but a comprehensive framework for formulating and implementing monetary policy. The focus on inflation does not mean guiding the economy towards a condition of zero inflation. Low and stable inflation in the long-term will in fact provide support for sustainable growth.

One of the primary characteristics of the framework is that monetary policy must be implemented on a forward-looking basis. On the operational level, Bank Indonesia uses the BI Rate as policy rate to respond to the future trend in inflation. BI rate serves as the reference for bill sales and bank rates. Lower rate will in general promote economic growth, initially in the construction, transportation, communications and financial sectors, followed by trade and manufacturing.

On November 7, 2006, Bank Indonesia has again cut its benchmark interest rate by half a percentage point to 10.25%, citing the Country's recently improving macroeconomic conditions on the back of easing inflation and a stable Rupiah. This last rate cut is the fourth in a row, following 25-bps cuts in May and July. The Central Bank had by December last year raised its key BI rate to 12.75 percent following October's fuel price hikes, which pushed up inflation to 17 percent.

The outlook for stability of domestic macro economy show improvements along with decreases of inflation, stability of interest rates and increasing reserves. The development is also supported by the improving country risk as reflected from improved long term debt rating from Standard & Poor, from BB- to B+ for debts in foreign currency and from BB to BB+ for debts in local currency. Improvements of the debt rating is based on better fiscal performance and other external factors with decreasing burden of government debt through acceleration in repayment of IMF debt, and moratorium as well as debt swap from Germany. This progress is projected to be able to increase offshore investments both directly and indirectly. However, increasing occurrence of natural disasters and draught held back the speed of economic growth in 2006.

Indonesian Financial System

Since the 1990s, the Indonesian financial system encompasses fiscal, monetary and banking sectors, each with its own body of authority and supervision. The authority of the fiscal sector is under the Department of Finance, Bank Indonesia authorizes the monetary and banking sector, and the Capital Market is monitored by the Supervising Board of Capital Market.

To date, the banking industry still holds a dominant role in the Indonesian financial system, as opposed to that of the non banking financial institutions. In comparison, in many other countries, institutions such as retirement funds, insurance, capital market, mutual funds, have important roles in providing long term capital needed for the development and economic growth. Based on its contribution to the GDP of the second quarter of 2006, the banking industry contributes 81% or USD2.4 billion, while non-bank financial institutions contribute 19% or USD 568.9 million.

Education as Human Investment

In Indonesia, The 1945 Constitution stipulates that one of the obligations of the state is to provide education to all of Indonesian citizen. Education becomes one of the main media to improve the quality of the human resource. Education in human investment is more precious than any other form of investment. Moreover, education is

an important aspect in raising the dignity of the nation through acceleration of economic growth.

According to the Human Development Report (HDR) 2005 the developed countries have Education Index above 0.95 meaning that 95 percent of its population are able to read and write (adult literacy) and they have received primary, secondary and advanced education. This is in proportion with the Adult Literacy Rate (ALR), where the top ten countries in the report are countries with literacy rate of 99%. Indonesia falls into the Medium Human Development category with HDI ranking at number 110 out of 170 countries due to ALR of 87.9% and Education Index of 0.81.

Education is increasingly becoming more important in today's competitive era that needs qualified Human Resources. Improvement of the human resources quality can be achieved by improving the quality of education. The quality of education is reflected by added values generated by educational institutions, either in the form of products or services or the capability to compete in the work place.

To ensure even distribution of public services, including education, both government and parliament have paid serious attention reflected by the issuance of the Act No.20 of 2003 on National Education System that reserves 20% of the National Budget for education. In the 2003 National Budget, the government provided more than USD 5.9 billion in subsidies for education. Before the crisis, the government subsidies for the higher education reached 95%, but since the crisis, the government fund for the subsidies declined. Therefore, the allocated budget for education in 2006 National Budget was only 10% or USD1,1 billion, still far below the required budget allocation.

The government faces a dilemma concerning education subsidy, where on one hand, continuing the limited subsidies with a consequence that the tertiary educational institutions will not be able to maintain their academic quality and the access becomes more and more unbalanced, whilst on the other hand, discontinuing the subsidies will give universities the freedom to carry out a more rational financing strategies so that they will be able to enhance the quality and maximize access for the less fortunate. Indonesia is not the only country that faces such a dilemma. The United Kingdom, for instance, is also facing the same educational issue, that is declining academic quality and low access of the poor to the tertiary educational institutions.

The indirect relation between the economic crisis and the demand for higher quality education and university enrollment is interceded by two variables, which are the

capability of parents and capability of the government. The economic crisis affected the parents' capability to finance their children's education as well as the government's capability to provide subsidies. At the same time, the 1997/1998 crisis resulted in the decrease of state budget available for routine financing and development fund.

One research results indicated that the impact of economic crisis on the government's capability to provide subsidies for state universities decreases by 26% between 1996/1997 and 1998/1999. It was showed by the UNESCO that government expenditures for education is only 1.3% of GDP as compared to the average of low income countries that is amounting to 3% of GDP. Investment in education against total government expenditures for the public sector is only 10%, very low compared to that of India, Malaysia and Thailand with ratios 13%, 25% and 28% respectively.

A study in 2003 contended that developed countries such as the United Kingdom (UK) also come upon the same condition encountered by Indonesia, in terms of declining academic quality and low access to universities by those from the low economic group. Prof. Nicholas Barr, the professor of public economy of London School of Economics (LSE), present three interesting recommendations. In the White Paper issued in 2003 under the title Financing Higher Education, Barr said that full subsidies and free education do not always increase the access to the higher education. Using income from tax as the source of higher education financing will decrease funding for other programs. In real politics, subsidies for higher education are always defeated by the national health system and by the obligatory education and pre-school programs.

Second, in the implementation, subsidies in the UK are always less beneficial for the poor group. For many years, the access of poor families to higher education is only 15%, compared to 81% of more fortunate families. On the contrary, in the United States of America that follows the market system, access of the poor family reaches 43%.

Third, subsidies from the government are always more beneficial for the group with better economic condition. In the UK, there are quite a number of community members who support the plan for progressive tax system. However, they hope that the income received by the government from taxes are used for pre-school education, decreasing the drop out rate at secondary level, increasing the quality of vocational education, and special programs for children from the less fortunate families.

Like in the UK, the higher education in Indonesia today is facing three difficult challenges, improvement of the quality, fair and evenly distributed access for all

community groups, and low internal efficiency. The fund needed to overcome the three challenges is extremely expensive. The simulation conducted by one of the universities in Indonesia projected that to increase the access of the poor family from the current condition of 3.3% to 10% with participation rate in the higher education of 15% needs fund in the amount of USD213 million. If the increased access is accompanied by improvement of quality, funds required rises USD898 million, assuming the cost of education for each individual student is approximately USD2,126 per year as planned by the Directorate General of Higher Education. In order to improve the quality and increase access to higher education, the amount of fund that must be provided is USD1.1 billion. If the standard quality to be reached is high, such as the standard set by Malaysian universities, it needs budgets of USD3.5 billion per year.

Based on such condition, it seems that costs is the main factor causing hindrance in improving the quality of education in Indonesia, and accordingly parents and banking industry are expected to play a greater role and participate in financing higher education as well as the primary and secondary level, such as education financing in the form of Student Loan by banking industry. In the past, Bank Indonesia, had assumed the position as the biggest fund provider in economic development by granting Indonesian Students Loan and involving commercial banks as Executing Banks.

The role of the community needs to be elevated through family planning programs, for instance through savings. By saving, families are able to plan the financing for their children's future education. Early preparation for the children's future and family finance planning is therefore imperative, which includes management of children's education. In other words, through family finance planning, family needs are better managed and subsequently leads to a better outcome.

Future Financial Knowledge

Financial Education program becomes relevant with conditions in Indonesia, when providing financial knowledge is in line with educational problem as a result of limited funding sources for formal education for the young generation. As the general case in Indonesia, every parent hopes their children will be financially independent as adults. The parents try to prepare their child with various skills as soon as the child is old enough to receive formal education. Unfortunately, the parents sometimes neglect to provide

financial education. Children are only demanded to study sciences and aesthetics. As a result, no matter how high the level of education they reached, and the position they hold at work, many people are incapable of managing their personal finances well. Even though they receive high income, they are unable to enjoy it after they are retired because of their incapability to manage their wealth.

Not many parents educate their children to work hard to earn money. Parents also seldom teach the concept of saving when their children want something. The most important lessons are actually received from the behavior of parents. Most children see their parents as the *role model*. The children tend to follow the behavior of the parents. Therefore, the parents should be careful in making financial related actions because it will be followed by their children.

Financial knowledge is among the lessons that can be given to children from an early age, which will develop into skill, and finally become a habit in managing money. The first lesson to be given to the children is trust. Start by giving daily pocket. By giving pocket money, parents have trusted their children with the responsibility to manage their own money. Secondly, teaching children to save so that it becomes a habit. Saving will teach the children to appreciate the value of money, not to be extravagant, and teaches patience that not everything they want can become instantly available. In Indonesia, saving habits have long been sounded, but the realization is still at a minimum. Next, lessons in financial planning and budgeting can be given. As children become older, they have a better understanding of their needs and can be taught to manage their expenses. The purpose is for children to know how much of their needs. When children have reached adulthood, they can be taught to calculate their future needs. Children should also be taught to share. It means that in addition to manage money for their own needs, children should also be taught how to share. If such matters have been taught, they will be wiser in using their money for their future, as well as to fund for their education.

In facing educational problems for the Indonesian young generation, Financial Education becomes important for many concerned parties; the Government, Bank Indonesia, Financial Institution, Communities, and their respective parents. The Government as the governing executive along with the house of representative should formulate the legal basis of implementing Financial Education Programs by improving the school curriculum, keeping in mind that in the current curriculum issued by the Department of National Education, Economic Science is started to be given in Senior

High School, both in public and religious schools. In addition, the government is expected to fulfill its role by allocating 20% of the national budget for education. Bank Indonesia as central bank that has authority in supervising and regulation can encourage the banking industries to revitalize the “Gerakan Cinta Menabung” (Fond Of Saving Movement)”, as conducted in the 1970s through the issuance of various saving products by banks both for students and the public in general.

It is important to mention that several banks have been actively providing saving programs for educational purposes. Such programs are hoped to be an alternative solution for the public in overcoming the problem of rising costs of education and at the same time become the means of financial education for the young generation.

In addition, one of our commercial banks will provide loans for university students (EduPlan) which is secured by the family of the concerned students. It will launch financing facilities for Indonesian students jointly funded by the International Finance Corporation (IFC) of the World Bank Group and Sampoerna Foundation. The Program is expected to be able to provide a greater financial opportunity to achieve a higher education through commercial mean.

Financial aids for students have also been granted by several social organizations in the form of scholarships to support education for Indonesian young generation in achieving higher education. The role of parents in teaching financial education to their children is also equally important, so as they grow up, they posses sufficient Financial Literacy. In other words, efforts to encourage community participation in educational issues, and financial literacy can be taken by the respective parties or in collaboration with other concerned parties.

Closing

Finally, the recovery of the Indonesian economic condition after 1998 gradually is expected to bring significant changes in improving the quality of education as well as to improve the quality of the Indonesian young generation in the years to come. The role of many concerned parties, either government, Bank Indonesia, including the involvement of financial institutions through education financing, and communities in general, becomes absolutely important for the successful idea of educating the nation life.

The increase in number of participant from community in education is expected to raise the public awareness to have financial literacy for future financial planning for their

children. Accordingly, the banking will also be able to take the economic benefit from such condition.

Much work remains to be done, but we must do so systematically with clear design. The years ahead will not be without challenge, in fact we will face many more challenges than today.

Thank you.