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Indonesia
Foundations for Sustained Growth

May 4, 1990

Country Department V
Asia Regional Office

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CURRENCY EQUIVALENTS

Before November 15, 1978 US$1.00 = Rp.415

Annual Average 1979-88

1979	US$1.00 = Rp.623
1980	US$1.00 = Rp.627
1981	US$1.00 = Rp.632
1982	US$1.00 = Rp.661
1983	US$1.00 = Rp.909
1984	US$1.00 = Rp.1,026 /a
1985	US$1.00 = Rp.1,111
1986	US$1.00 = Rp.1,283 /b
1987	US$1.00 = Rp.1,644
1988	US$1.00 = Rp.1,681
1989	US$1.00 = Rp.1,770

May 1, 1990 US$1.00 = Rp.1,830

FISCAL YEAR

Government	-	April 1 to March 31
Bank Indonesia	-	April 1 to March 31
State Banks	-	January 1 to December 31

/a On March 30, 1983 the Rupiah was devalued from US$1.00 = Rp.703 to US$1.00 = Rp.970.

/b On September 12, 1986 the Rupiah was devalued from US$1.00 = Rp.1,134 to US$1.00 = Rp.1,644.

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ABSTRACT : This report describes Indonesia's emergence from a period of adjustment during which significant progress was made in developing a more diversified and competitive economy while achieving substantial reductions in the incidence of poverty. Chapter 1 reviews the Government's adjustment strategy and its impact on economic performance and poverty reduction in the 1980s and outlines the main elements in Indonesia's strategy for sustained growth in the 1990s. These central elements are to continue prudent management of the macroeconomy (Chapter 2), to introduce further reforms in the incentive, regulatory and legal framework to promote efficient private sector development (Chapter 3), and to implement well managed public sector programs to support the growth of the private sector and to meet the needs of the poor (Chapter 4).

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INDONESIA: FOUNDATIONS FOR SUSTAINED GROWTH

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This report was prepared by a team led by Jim Harrison. The principal authors were Donald Hanna, Vladimir Konovalov, Kyle Peters, Nicholas Prescott and Dennis Whittle. Other major contributors were Sadiq Ahmed and Swati Ghosh. Yasmine Hamid prepared the Statistical Annex and, together with Cyrus Talati, provided statistical support. The report also draws on background inputs prepared by Victor Agius, Jean-Charles Crochet, Dipak Dasgupta, Elmo Fernando, Ahmed Galal, Colin Garnon, David Hawes, Andres Liebenthal, Laszlo Lovei, Samuel Paul, Vicente Paqueo, A. Shanmugarajah, Willem Struben, and John Wilton.

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SUMMARY AND CONCLUSIONS

FOUNDATIONS FOR SUSTAINED GROWTH

(i) Indonesia is entering the 1990s following a period of adjustment to severe external shocks. It starts the new decade with an economy that has reduced macroeconomic imbalances and lowered distortions in the incentive system. A strong private sector response is restructuring and diversifying the production base, substantially enhancing the prospects for sustained growth. Moreover, Indonesia's adjustment strategy generated a pace and pattern of growth that led to improved living standards and substantial declines in the incidence of poverty. Continued access to capital markets and strong support from the donor community, in appropriate amounts and forms, helped to ensure the resources needed to implement this strategy.

(ii) These achievements have created new opportunities and challenges. With per capita GNP less than US$500, Indonesia is still a relatively low income country. While poverty has declined, millions of people remain poor and may be difficult to assist, as they are likely to be concentrated in the less productive areas of the country. Indonesia now has the opportunity to enter into a period of sustained and relatively rapid growth, leading to a further significant reduction in poverty and an improvement in the living standards of its people. Establishing the foundations for such sustained growth requires continued skillful macroeconomic management, rapid consolidation of the deregulation process to foster efficient private sector development, and continued improvements in the management of public sector programs to support growth and poverty reduction.

Progress on Economic Adjustment and Poverty Reduction

(iii) Adjustment in the 1980s. After a rapid growth in income, consumption and investment during the 1970s, Indonesia faced a series of severe external shocks in the 1980s. At that point the economy was heavily dependent on oil, which provided more than 80% of export earnings and 70% of budget revenues. Consequently, the large declines in real oil prices between 1982 and 1986 sharply reduced export earnings and budget revenues. Combined with international currency fluctuations that increased the debt service burden, these shocks resulted in a large income loss and called for a strong policy response to stabilize the economy and restore growth. The Government's policy response had two main thrusts: to restore macroeconomic balance, and to restructure the economy in order to reduce dependence on oil and improve economic efficiency.

(iv) Strong stabilization policies were rapidly implemented in response to the external shocks. Two major devaluations of the exchange rate, buttressed by austere monetary and fiscal policies, resulted in a 55% depreciation of the real effective exchange rate over the decade. Current account deficits, which had exceeded 7% of GNP, were reduced to below 2% by 1989. Budget deficits were also reduced to below 2% of GDP, in part through a freeze on civil service salaries, major cuts in spending on large capital- and

import-intensive projects, sharply reduced transfers to public enterprises, and increased non-oil revenues. Inflation was contained below 10% in most years and was reduced to about 6% by 1989.

(v) Public MLT debt rose rapidly over the decade, from about US$20 billion in 1982 to US$44 billion by 1988. This reflected both the need to finance the current account deficits and the depreciation of the US Dollar between 1985 and 1988, which alone accounted for over half of the increase in debt. The quick reduction in the current account deficit slowed the growth in debt. Indonesia continued to meet its external debt obligations on time, retaining its access to commercial borrowing throughout the 1980s. At the same time, the strong support from the donor community enabled Indonesia to limit its commercial borrowing. Thus, the debt structure in terms of interest rates and maturities was better than that of most developing countries. By the end of the decade the debt burden was declining, and is expected to continue declining in the coming years.

(vi) Structural reforms were aimed at establishing a more diverse and efficient economy. Tax reform tapped more buoyant and reliable sources of revenue. Financial sector reforms removed interest rate and credit ceilings, improving the flow of resources to the private sector. Major reforms in the trade regime reduced tariffs and non-tariff barriers, increasing competitive pressures in the economy. Together with exchange rate devaluations and a more realistic management of the exchange rate, these reforms sharply increased the incentives to export. The following table indicates the impact of these reforms on the structure of the economy. Of particular note is the sharp increase in the role of non-oil activities as the major source of export earnings and budget revenues. The rapid rise in the share of non-oil manufacturing in GDP and the share of private investment in total investment are important additional indicators of the increased diversity of the economy, and the growing role of the private sector.

INDONESIA'S ECONOMIC STRUCTURE, 1981/82-1989/90

	1981/82	1985/86	1989/90
	-------	in percent	------
Ratios of:			
Oil/LNG exports to total merchandise exports	81.9	66.6	39.8
Non-oil exports to non-oil imports	28.6	55.2	85.8
Oil/LNG revenues to total revenues	70.6	57.1	38.2
Private fixed investment to total fixed investment	52.1	49.1	62.0
Non-oil manufacturing to GDP	8.4	11.5	14.3

(vii) The swift implementation of stabilization measures, combined with the structural reforms which facilitated the flow of resources to more efficient, often export-oriented activities, supported the rapid return to

higher growth rates by the end of the decade. From the start of the adjustment period in 1983 to the end of the decade, real GDP growth averaged 5.5% p.a., with non-oil GDP rising by 6.2% p.a. in real terms. Non-oil manufacturing and non-oil exports grew particularly rapidly, averaging 12.3% and 13.2% p.a., respectively. By 1988 and 1989, non-oil GDP was growing at 7-8% p.a. Initially the stabilization measures resulted in a sharp reduction in investment in both the public and private sectors, with much of the production growth achieved through higher capacity utilization. After 1985, however, private sector investment resumed growth, rising by nearly 18% in 1989. The surge in private investment will help generate more diversified and stable sources of growth, strengthening prospects for robust growth in the future.

(viii) Progress in poverty reduction. Maintaining solid growth during the 1980s despite the external shocks had important effects on poverty reduction. The analysis presented in the Poverty Assessment and Strategy Report,1/ indicates that poverty continued to decline during the decade, while the distribution of income improved slightly. There was a substantial decline in the percentage of poor from 22% in 1984 to about 17% in 1987. This implies a decline in the absolute number of Indonesians in poverty, from 35 million in 1984 to about 30 million in 1987. Similar conclusions are obtained using a variety of alternative assumptions about the poverty line. Income inequality also declined during 1984-87, as indicated by a rising share of consumption going to the poorest 20% of the population, and declining income concentration ratios.

(ix) The speed and comprehensive nature of the Government's policy response to the external shocks of the 1980s, combined with the supportive response from the donor community and continued access to international capital markets, have been the main factors fostering a decline in poverty during a difficult adjustment period. The pace and pattern of economic growth, and a reorientation of public expenditures were of particular importance in achieving this result. The Government's adjustment strategy supported economic growth strong enough to allow improvements in real earnings for most workers in the poorer income groups, despite the severe external shocks and a rapid increase in the labor force. Using wages for unskilled agricultural workers in Java as a proxy for the wages of lower income groups, real wages for these groups appear to have risen during the 1983-88 period as a whole.

(x) Although large cutbacks in real government spending played a major role in achieving macroeconomic balance, the cuts were made selectively to moderate the effect on the poor. Two basic features of the expenditure strategy were: protecting operations and maintenance (O&M) expenditures and transfers to the provinces; and reallocating development expenditures to programs which benefitted the poor. The continued rise in real O&M expenditures enabled the physical and social infrastructure created in earlier years to be used productively. Similarly, changes in the sectoral composition of development expenditures tended to protect areas with higher employment coefficients, such as programs in agriculture, human resource development and regional development (e.g., INPRES expenditures), which have the greatest

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1/ IBRD Report No.8034-IND, May, 1990.

potential to help the poor. Another important aspect of the adjustment strategy was that most of the required expenditure reduction fell on investment, allowing a continued rise in per capita consumption.

The Tasks Ahead

(xi) Indonesia is emerging from a difficult but successful adjustment period with a more robust, diversified, and competitive economy. The strong surge in private sector growth, investment, imports, and exports, particularly during the past year, indicates that the foundations are being laid for a period of sustained and robust growth. It is important that Indonesia take full advantage of the chance this presents to continue to reduce poverty and widen the economic opportunities for all. Sustained growth -- with non-oil GDP growing at 6-7% p.a. -- is needed to make substantial progress in raising living standards and providing productive employment opportunities for a growing population and labor force. At the same time, growth needs to be carefully managed to reduce the debt burden and broaden the future options for the country. Furthermore, to ensure that growth pressures do not compromise the long term sustainability of development, continuous efforts will be needed to protect the environment.

(xii) The Government's underlying development strategy contains the key elements to achieve these objectives. In the near term, this strategy calls for:

- Continued prudent macroeconomic management to contain inflation, improve the external balance and maintain the competitiveness of exports. Reductions in the major remaining budget subsidies, and full implementation of the recent reforms of the liquidity credit system are of central importance.

- Continued substantial reform of the trade regime. Reductions in non-tariff barriers which protect much of domestic manufacturing, and reform of the tariff system which now allows substantial protection to specific products, would help ensure that the large volume of private investment now underway will be in areas where Indonesia will be competitive, resulting in a more efficient, lower-cost economy in years to come. Reduction in the remaining export restrictions will widen the opportunities for producers of exports.

- Strengthened prudential regulations and supervision for the financial sector. The activities already underway, including technical assistance and the legislation on banking, insurance, and pensions, should be fully supported and accelerated where possible, so that the financial sector retains the confidence of the business community essential for solid growth.

- Further progress in streamlining procedures and reducing remaining restrictions on investment licensing, consolidating the substantial improvements introduced in the past year.

- Steps to identify and reduce potential infrastructure constraints, particularly power supply on Java.

(xiii) The Government's strategy also calls for continued progress on more fundamental and complex areas of reform, where the full benefits will emerge over the medium-term. These include:

- Continued efforts to raise non-oil revenues and increase domestic savings so the economy's investment needs can be financed while reducing the reliance on foreign savings.

- Meeting the needs of the poor by improving the quality and availability of basic services, particularly in education, health, family planning, water supply and other social infrastructure.

- Improving the efficiency of the public enterprise sector through restructuring, including joint ventures, public stock issue, selective divestiture, and liquidation of non-viable firms and through improvements in organization and management of firms remaining under public ownership.

- Development of a strong institutional and regulatory framework for protecting the environment.

- Establishment of a modern framework of corporate legislation.

- Improvements in the design, management and implementation of public sector programs. The evolving role of the public sector towards increased emphasis on quality of services, more effective operations and maintenance, and smaller, often more complex programs carried out in a decentralized fashion, will call for a variety of administrative improvements in procedures, organization, personnel and training.

(xiv) The main features of the Government's development strategy outlined above can be grouped into three interrelated areas: the macroeconomic framework, efficient private sector development, and public sector management for growth and poverty reduction. Each of these areas is discussed in more detail in the following paragraphs and in the main report.

Macroeconomic Framework for Sustained Growth

(xv) Indonesia's adjustment experience during the 1980s demonstrates the critical role of timely implementation of prudent macroeconomic policies. Skillful macroeconomic management will be equally important in the 1990s to ensure that the growth path is consistent with macroeconomic stability, especially given Indonesia's debt burden and the effects of reforms of the trade regime and the financial sector. The main macroeconomic management task ahead is to continue improving the external and internal financial balances in the medium term while maintaining growth. Containing and gradually reducing the current account deficit as a share of GDP will steadily lower the burden of Indonesia's debt and expand the economy's options in the future. Maintaining strong policies to support non-oil export growth is central to this strategy. These policies include maintaining a competitive exchange rate through coordinated fiscal, monetary and exchange rate policies. Further reforms of the trade regime are essential to enhance economic efficiency and

the incentive to export. Public and private savings rates will need to rise to finance the higher investment rate required to sustain growth in output and non-oil exports, while offsetting the decline in foreign savings resulting from the gradual reduction in the current account deficit. Continued implementation of the Government's policies in several important areas would raise public savings and improve the fiscal balance. This would include maintaining the priority given to public resource mobilization, and particularly to raising non-oil tax revenues through continued improvements in tax administration. The rapid implementation of the Government's intentions to reduce the major remaining budget subsidies would release public resources needed for other purposes and improve resource allocation through better price signals. Finally, public expenditure programs will need to be carefully designed and focused on the Government's main priorities as outlined in REPELITA V to be consistent with available resources.

(xvi) Sustaining growth while avoiding pressure on prices and the balance of payments calls for carefully balanced monetary policy. Given Indonesia's open capital account, domestic interest rates are closely tied to international interest rates and exchange rate expectations, thus limiting the ability of monetary policy to influence interest rates. Coordinated monetary and fiscal policies, however, can work to lower inflation and expectations of exchange rate devaluation, thereby reducing the margin between domestic and international interest rates. With the ongoing financial sector reform, the relationships between monetary variables are likely to shift, calling for close monitoring of developments so that timely action can be taken. The phasing out of liquidity credits announced in January 1990 is expected to lead to a tighter monetary stance and increase the effectiveness of Bank Indonesia's monetary instruments. Other components of the financial sector reforms are expected to improve the efficiency of credit allocation and to lower real lending rates by reducing intermediation margins. Continued development of prudential regulations and supervision are of central importance to strengthen the stability of the system.

(xvii) A further increase in reserves to cope with unanticipated fluctuations would be supported by the tighter monetary policy indicated above and would complement the overall macroeconomic strategy. Adequate reserves are particularly important for macroeconomic management given Indonesia's open capital account. Maintaining lines of untied commercial credit (currently about US$1.8 billion) is another cushion against unexpected developments. Another policy option to consider would be using unanticipated gains from higher oil revenues to reduce borrowing or to accumulate fiscal reserves so that the fiscal balance can be improved and such windfalls used in an orderly and efficient fashion. The continued reduction in dependence on oil as a source of foreign exchange and fiscal revenues should add another element of increased stability to the economy as non-oil exports and non-oil fiscal revenues expand.

Efficient Private Sector Development

(xviii) Since the mid-1980s, the Government has encouraged the private sector to play a more important role in the economy, especially in reducing the economy's dependence on oil and improving efficiency and competitiveness. A series of regulatory reforms have complemented the successful macroeconomic stabilization policies and have produced a strong supply response. The

performance of supporting services, especially in the financial and transport sectors, has been improved through extensive deregulatory measures. Private investment has recovered and has laid the foundation for a rapid growth in exports. Much of the investment has been directed towards labor-intensive production which has led to widening employment opportunities. While the increase in private sector activity is encouraging, much can be done to improve the trade regime and investment incentives. Further reforms would ensure that new productive capacity is created in areas where Indonesia can compete in world markets. Now is an opportune time for such reforms, as the strong growth of the economy will quickly absorb labor, capital and managerial resources which might be displaced. The reform process needs to be supported by further efforts to provide infrastructure and develop sound financial sector services. Given the intense pressure on land and water resources, it is also vital that natural resources be managed carefully to protect the environment for sustainable development.

(xix) Trade reforms. Since the mid-1980s, the Government has embarked on a series of trade and deregulation measures to improve the international competitiveness of domestic production. The primary objective of reforms is to move from a trade regime based on import licensing to tariffs. Accordingly, the Government removed many import licenses between 1986 and 1988. The share of domestic production protected by import licenses declined from 41% to 29% over the period. Also, exporters have benefitted from a facility that enables them to obtain imported inputs at world prices.

(xx) Further trade reform would improve consumer welfare and the allocation and use of domestic resources. Such reform would reduce protection to the manufacturing sector relative to agriculture and further improve the incentive for export production. The remaining non-tariff barriers (NTBs) continue to be a major source of protection. These barriers have drawn resources into activities in which Indonesia does not have a comparative advantage, thereby lowering economic growth and employment creation. In the case of manufacturing, almost half of domestic production is still protected by NTBs on competitive imports. While there have been impressive reductions in the incidence of tariff protection, in recent years the proliferation of split tariffs and surcharges have resulted in increased protection for specific items. The increase in export restrictions also runs counter to the reform trend.

(xxi) There is considerable scope to reduce NTBs, particularly in those sectors where NTBs provide high protection to domestic production. Further restructuring of the economy would be facilitated by a tariff reform which included the elimination of split tariffs and surcharges, followed by a gradual reduction of tariff ceilings. In most cases the process of restructuring protected industries is underway and they should be able to compete with tariffs no higher than 20 to 30%. Further reduction in export restrictions would widen opportunities for producers of exports. The rapid reform of the trade regime would ensure that new investment flows into areas where Indonesia has a clear comparative advantage.

(xxii) Domestic incentives and regulatory framework. In order to translate trade reforms into an efficient supply response, the Government has broadened and intensified its efforts to improve domestic incentives and the regulatory environment for the private sector. So far, the reforms focused on

areas that have been the most urgent and implementable in the short run. Reform has progressed significantly in the areas of investment licensing and regulation of foreign direct investment. The investment process has been streamlined and made less restrictive, particularly after May 1989, when the Government replaced a long list of activities open to investment with a short list of activities which were closed. In formulating this negative list, there has been a conscious attempt to keep the number of restricted items to a minimum and to remove the ad hoc conditions that had been introduced over the years. The Government has also undertaken steps to improve the attractiveness of Indonesia to foreign investors, particularly by easing ownership controls on investment in export-oriented activities and other priority areas.

(xxiii) Domestic deregulation has led to a sharp increase in domestic and foreign investment. The bulk of new investment approvals are directed towards export activities. Further measures would help reduce the remaining barriers to the entry and mobility of private investment. The main policy options for further reform are to: maintain a short negative investment list by opening additional areas to domestic and foreign investment; simplify and streamline further the licensing system by eliminating licenses where possible (e.g., capacity expansion licenses) and improving coordination at the local level; and further ease divestiture obligations of foreign investors. At the same time, a start could be made on the more complex and longer run issues of developing a modern corporate legal system and reforming the factor markets, particularly land and labor.

(xxiv) Policy environment for support services. Financial services and transport services both play a vital role in private sector development. An expanding private sector will require a broad array of financial services and intermediaries. Indonesia has already done much to promote the financial system, especially commercial banking and the stock exchange. A series of reforms was introduced over the period 1983-88 to deregulate interest rates, replace credit ceilings with reserve money management and increase competition through easier entry by private domestic and foreign banks. Sources of long term finance were expanded by encouraging the development of the capital market. A start was made to improve the soundness of the system. These reforms led to dramatic changes within the financial system. The number of intermediaries and services expanded rapidly, while assets and deposits soared. Both lending and deposit rates have declined in response to the increased amounts of resources mobilized. Competition has gradually reduced spreads. The capital and bond markets also became more active, with the volume of shares traded expanding eight-fold during 1989.

(xxv) One critical issue not fully addressed in the earlier reforms was the role and extent of subsidized, directed credits (referred to as liquidity credits) within the banking system. Bank Indonesia (BI) had been refinancing loans for a large number of selected activities at interest rates varying from 3% to 14.5%. On January 29, 1990, a major reform of the liquidity credit scheme was announced. The number of areas eligible for liquidity credit was sharply reduced, and even where continued, interest rates for final borrowers were moved much closer to market rates. The reduction in the scope of liquidity credits and the increase in interest rates will greatly enhance BI's ability to manage base money. The changes will improve incentives to assess credit risk and facilitate targeting of priority users. Segmentation in credit markets will be reduced, and new commercial banks will

expand into these sectors more rapidly. For state banks, the reform will lead to a stronger effort to mobilize deposits from the public since a large share of their portfolio has been financed through liquidity credits. The reform will also call for efforts by the state banks to improve their efficiency and ensure the quality of their loan portfolios. The soundness and stability of the financial system calls for the strengthening of financial regulations and institutions. The Government has already introduced several important regulations in this area such as establishing legal lending limits on commercial bank portfolios and restricting their net open position in foreign exchange to 25% of their equity. Four main items remain as priorities: (a) strengthening the prudential regulation of financial markets; (b) enacting updated laws governing financial institutions and commercial relations; (c) bolstering managerial and technical expertise in financial institutions; and (d) strengthening state banks through improving their portfolios. The rapid pace of financial sector growth justifies the urgent attention being given these issues by the Government.

(xxvi) In the transport sector, the Government has made concerted efforts to deregulate and remove impediments which previously caused widespread inefficiencies. These reforms have focused initially on the maritime sector and have resulted in some impressive improvements in performance and quality of service. The rates for international shipping have declined significantly, while services have improved. Important changes are also taking place in domestic shipping as shown by increased reliance on more efficient vessels and services. However, there is still scope for further improvements, particularly for the ports, where efficiency is constrained by structural and management problems. More recently the Government has focused on the land transportation system, in particular road transportation. The costs of road transportation remain significantly higher than they need be, reflecting the poor standard and condition of the road network, inappropriate taxation and user charges, and road traffic and transport regulations that are overly restrictive and unevenly applied. The Government is committed to develop a transport system able to meet the nation's growing and increasingly sophisticated transport needs quickly and efficiently. Consequently, the Government is formulating a series of policies designed to establish a modern and coherent framework of laws, regulations and taxes for road transport; strengthen central and regional transport departments; and improve transport sector policy formulation and planning.

(xxvii) Environmental management. Private sector development depends heavily on the availability of natural resources, particularly water and land. These resources are already scarce in some parts of Indonesia, and rapid growth in both production and population will lead to greater shortages in the years to come. In addition, industrial use of land and water, if unregulated, can have serious health effects. To maintain private sector growth while safeguarding public health, it will be vital to manage the natural resource base carefully. Current efforts to plan land use and water resource management are hindered by weak institutions. There is a reasonable policy framework in place for pollution control, but the current division of responsibilities among many different agencies has meant that standards have not yet been systematically developed and enforced. The main challenge for the year ahead is to put in place institutional arrangements that will ensure that land and water resources are managed efficiently.

Public Sector Management for Growth and Poverty Reduction

(xxviii) Indonesia's successful adjustment performance has set the stage for sustained growth and poverty reduction in the 1990s. If maintained for long, the sharp expenditure cutbacks made to restore financial stability would have constrained growth. Accordingly, the focus of the public sector has shifted from the management of expenditure cutbacks to the efficient management of a growing level of public spending. The policy challenge for the public sector will be to provide sufficient complementary resources to support private sector growth and poverty reduction while continuing to contain the level of public expenditures to preserve macroeconomic stability and ensure adequate resources for the private sector.

(xxix) The realization of the Government's policy objectives for the 1990s calls for a sharper focus of public spending on two broad priorities: (a) ensuring adequate provision of basic infrastructure and services to remove potential constraints on sustained private sector growth (agricultural support services, power, telecommunications, and transport); and (b) meeting the needs of the poor for basic services (primary education, community health, family planning, water supply and sanitation, and other poverty-related infrastructure). To some extent these priorities overlap and reinforce each other. Adequate economic infrastructure will be essential to support economic growth, non-oil exports, private investment, and employment, and such growth will also reduce poverty. Provision of agricultural support services will be necessary both to increase agricultural output and to increase the earnings of poor smallholders and landless labor. Human resource development will play an important dual role in promoting growth and reducing poverty by creating a more skilled and productive labor force.

(xxx) Recent budgetary allocations have been consistent with these broad priorities. Nevertheless, it will be important to monitor the allocation of public spending within individual sectors to ensure that resources are not spread thinly between low and high priority programs. Improved targeting of public expenditures between programs will need to be complemented by better pricing policies designed to raise revenues, induce greater efficiency of resource use, and improve the equity of public spending. These considerations call for a concerted effort to promote administrative reforms designed to overcome institutional problems in planning, budgeting, and implementation capacity which are likely to constrain the effectiveness of an expanded public expenditure program. At the same time it will be important to move ahead with public enterprise reforms aimed at improving the efficiency and financial performance of the large public enterprise sector.

(xxxi) Improving public expenditure priorities. The role of public expenditure in meeting the goals of steady growth and poverty reduction differs from sector to sector. Despite these differences, all sectors face the same fiscal dilemma of controlling total spending and allocating it efficiently to high priority uses. Four points emerge from a cross-sector review: (a) opportunities exist for private sector participation in providing services which will remain largely in the public domain; (b) reallocation to higher priority programs could improve the effectiveness of public spending; (c) higher levels of operations and maintenance (O&M) spending are vital to improve the productivity and strengthen the quality of public infrastructure;

and (d) greater emphasis needs to be placed on attracting and motivating qualified staff and on administrative improvements to strengthen the implementation of public programs.

(xxxii) The most serious potential infrastructure constraint on private sector development is the possible shortfall in the power generating capacity of the power utility (PLN). The rapid growth in demand from the buoyant economy, combined with lags in bringing planned power generating capacity on line, could result in some power shortages in Java in the next few years. This problem could be reduced by making greater use of private sector captive generation capacity. More efficient use also needs to be made of PLN's existing generation capacity through appropriate operations and maintenance, improvements in transmission and distribution, and other efficiency improvements. In addition, the planned generating capacity needs to be installed as rapidly as possible, and appropriate power pricing policies should continue to restrain demand growth. Another priority area for public expenditures will be assisting farmers to sustain agricultural output growth. This calls for increasing O&M funding to improve the productivity of irrigation infrastructure, together with selective expansion emphasizing completion of existing command areas instead of new construction. At the same time, tree crop development could be spread to a larger number of smallholders by switching to approaches that cost less per beneficiary. Expansion of the telecommunications network could be facilitated by greater private sector participation in project management and facility maintenance. Port investment priorities should support containerization of inter-island cargo movements from provincial ports, and efficient capacity expansion in the major international ports in line with demand growth. Priorities for the road transport network emphasize increased O&M, with capacity increases of the main road network limited mainly to congested approaches to major cities and key links within those cities.

(xxxiii) The Government's poverty reduction strategy calls for improving basic services for the poor. These services (particularly in education, health, family planning, and water supply) redress the most severe consequences of being poor. But they also attack some of the most important causes of poverty, thus providing the basis for long-term poverty reduction. In education, the priority is to improve the quality of primary education for the poor by increasing O&M funding for textbooks and other essential teaching materials. This would require additional resources for O&M in primary education, together with new criteria for allocating more funding to schools in poor communities. In health, there is a need to increase access by the poor through improving both the quality and quantity of available services. This would also strengthen the delivery of better family planning services for the poor who account for most of the unmet demand for contraception. A related priority is to expand the very low coverage of clean water supply in both rural and urban areas. Important priorities are to provide adequate O&M funding for new water supply facilities, and, in urban areas, to increase the numbers and operating efficiency of public standpipes.

(xxxiv) Pricing policies. Against a background of clear spending priorities, appropriate pricing policies can help to improve investment decisions, raise operational efficiency, and improve equity in public service provision, while raising needed resources. For example, removing the cross-subsidy for diesel oil as part of an effort to rationalize domestic

energy prices would lower the incentive for excessive use of heavy goods vehicles for commercial freight transport. Many public services are provided free or at low cost for equity reasons so that poor people have access to them. But in practice budget constraints tend to ration such subsidized services, with the result that the better-off often get most of the benefit. Thus, charging efficient prices to better-off users while targeting subsidies to poor beneficiaries can help to alleviate poverty and improve efficiency at the same time. For example, raising the subsidized water tariffs charged to high-volume residential consumers would release resources to increase the availability of water to the poor, through such measures as an expansion of the Government's program to increase the numbers of community standpipes for the urban poor. Even when revenue is not transferred directly to the budget, higher prices reduce the need for borrowing or budgetary payments for subsidized expenditures. Reducing the large remaining budget subsidies is of particular importance as this would release resources for higher priority uses and would substantially improve resource allocation through better price signals.

(xxxv) Program management and implementation. The projected expansion in public expenditures on infrastructure and human resources will pose a major challenge for the design, selection and implementation of programs and projects in the 1990s. Ensuring the efficiency and effectiveness of higher levels of public spending will require continued improvements in program management and implementation by the Government departments. This calls for a variety of administrative improvements. An important step would be to improve information on individual sectoral expenditures which are now carried out through a variety of budgetary channels. This would make resource allocations more transparent and improve budgetary decisions. Underlying these areas for improvement is the continuing need to attract and motivate higher quality staff both in the central and regional governments through better training and compensation systems. Finally, an emerging challenge is the new requirement for environmental impact analysis, which will be phased in over 1990-92. This is a potentially enormous task for which strong measures are needed to ensure prompt and effective review of projects.

(xxxvi) Public enterprise management. Indonesia has a large and diversified public enterprise (PE) sector. Over the past year several steps have been taken to improve the efficiency of these enterprises and to support an expanded role for the private sector. The Government reforms aim at restructuring enterprises to increase their efficiency and reduce their fiscal burden. Financial data on PEs indicate an improvement in their financial performance, and the Government now plans restructuring involving stock sales, management contracts, mergers, and liquidations to make more thorough-going changes for a large number of PEs. Implementation of these objectives could be facilitated by a clear articulation of the Government's intention to focus the role of PEs increasingly on the provision of goods and services that cannot be efficiently produced by the private sector. Within this overall strategy, the subsequent stages would concentrate on (a) preparing viable PEs that will not remain in the public sector for divestiture; (b) defining a core of enterprises that will stay public and initiating the reforms needed to further improve their performance; and (c) liquidating unviable commercial PEs. A more efficient set of core public enterprises would improve the availability and lower the cost of essential inputs and services (such as power and telecommunications) for the private sector.

Growth Prospects and Resource Needs

(xxxvii) Medium term outlook. Continued strong implementation of the Government's development strategy outlined in the paragraphs above, would help achieve a 6-7% annual growth in non-oil GDP. Such growth would permit continued reductions in poverty and in the debt burden. To sustain a 6-7% p.a. growth in the non-oil economy while maintaining external balance, non-oil exports will need to grow in real terms by about 11% p.a. over the next three years, and by about 7% p.a. over the remainder of the decade. This compares with an average growth in non-oil exports of over 13% p.a. since 1983. As noted, sustaining this progress in non-oil exports will require that the real exchange rate be maintained at a competitive level. Furthermore, complementary policies will be needed to improve the incentive framework through further trade and industrial policy reforms, to strengthen financial and transportation services, and to supply the necessary infrastructure, particularly in power and telecommunications. The outlook for the world economy in the 1990s suggests a relatively supportive external environment. With sustained progress in non-oil exports, the current account deficit would gradually decline from about 2% of GNP currently to about 1% by the end of the decade, with the non-interest current account remaining in surplus throughout the period. On the domestic front, a higher investment rate will be needed both for expanding private sector capacity, particularly in non-oil export production, and for providing adequate public investment to deal with emerging constraints in power and telecommunications. To finance this investment, at a time when foreign savings are falling, national savings will need to rise from about 21% of GDP currently to 27% by the end of the decade. Continued progress in raising non-oil tax revenues, improving returns on public enterprises, and reducing subsidies will be of critical importance in generating public savings, thereby contributing to the required increase in national savings.

(xxxviii) Implications for employment and poverty reduction. The projected pace and pattern of economic growth would allow Indonesia to employ its growing labor force at higher levels of productivity and income. The manufacturing sector is expected to absorb a much larger share of employment than in the past, reflecting a rapid rate of growth, particularly in relatively labor-intensive activities. The bulk of new employment will still come in agriculture and services as both sectors become more diversified and productive. Such a pace of growth would also lead to further substantial reductions in poverty, though it should be recognized that the remaining poor are becoming concentrated in more remote areas, with more limited resources, and so will be more difficult to assist. Continued large reductions in the incidence of poverty will also require specific measures to improve labor absorption in the services sector, boost employment prospects in the Outer Islands (particularly the eastern areas), and target public expenditures, especially in social and basic services, into those areas of greatest potential benefit to the poor.

(xxxix) External borrowing strategy. While the current account deficit as a percentage of GDP is projected to fall in the medium term, its absolute size will increase slightly, reflecting a faster rate of GDP growth. This, combined with higher debt service payments and the need to build up reserves, causes the total annual financing requirement to rise. An increasing share of the needed financing can be obtained from private sources: direct foreign

investment, private non-guaranteed capital flows and commercial borrowing by the Government. In the near term, however, use of import-related credits should be restrained, and applied only to well-selected projects with sound financial arrangements. Untied commercial credits can be used more flexibly, but since they are more expensive than official assistance, their use should also be moderated to help ease the debt burden. Consequently, it is essential that IGGI continue to provide a major share of Indonesia's financing needs in the years ahead. It is recommended that the level of IGGI assistance to Indonesia in 1990/91 be US$4.5 billion, slightly higher than pledged last year.

(xl) Following the sharp drop in oil prices and adverse international exchange rate movements in 1986, a special effort was made to provide Indonesia with assistance in the form of fast-disbursing program aid and local cost financing to offset losses in foreign exchange and budget revenues. A strong and encouraging response from donors led to disbursements of about US$5.4 billion in special assistance over the past three years. These funds have enabled Indonesia to pursue its structural reforms while sustaining growth and reducing poverty. Special assistance has also contributed to a more favorable structure for Indonesia's debt, improving the confidence of investors and the international financial market in the adjustment program. Indonesia's situation continues to justify special assistance. Balance of payments projections indicate that the special assistance need in 1990/91 will be US$1.2 billion. This is a substantial reduction from the US$1.8 billion pledged last year, reflecting the Government's commitment to reduce its reliance on special assistance as non-oil exports and fiscal revenues rise. While our current projections indicate that special assistance could be phased out after 1990/91, a more gradual phasing out of special assistance may be required if actual developments are less favorable than projected. In such a case the donor community should be prepared to respond flexibly. This will provide Indonesia with the confidence to pursue trade and other reforms vigorously. As special assistance declines, there will be a need to increase the level of project assistance and shift its composition towards relatively quick disbursing operations such as sector loans which can provide a flexible form of financing well-suited to Indonesia's needs.

(xli) With appropriate macroeconomic policies and a prudent borrowing strategy, the growth in Indonesia's debt will continue to slow in the next few years. Medium and long-term (MLT) public and private debt outstanding and disbursed (DOD) is projected to rise less than 2%, from US$48.3 billion at end-1989 to US$49.2 billion at the end of 1990. With most of the increase in official borrowing in the form of concessional loans, there has been an improvement in the maturity and term structure of the public debt. This, combined with the projected solid economic performance, results in steady improvement in the main debt indicators. The ratio of total DOD to GNP has fallen from a peak of 66.7% in 1987 to 54.7% in 1989. Debt service on total debt has declined from a peak of 38% of exports of goods and services in 1986 to about 32.1% in 1989. It is projected to decline further to about 22% by 1995.

CHAPTER 1

PROGRESS IN ADJUSTMENT AND POVERTY REDUCTION

A. Introduction and Overview of the Report

1.01 Indonesia is entering the 1990s following a period of sustained, successful adjustment to severe external shocks. It enters the new decade with an economy which has reduced macroeconomic imbalances and lowered distortions in the incentive system. A strong private sector response to the Government's deregulation program is restructuring and diversifying the production base, substantially enhancing the prospects for sustained growth. Moreover, the adjustment strategy adopted generated a pace and pattern of growth which led to substantial declines in the incidence of poverty and sustained growth in the living standards of the people. Access to capital markets and strong support from the donor community, in appropriate amounts and forms, augmented the resources needed to implement this strategy.

1.02 The progress achieved creates new opportunities and challenges. With per capita GNP at less than US$500, Indonesia is still a relatively low income country. While the number and proportion of the people living below the poverty line have fallen, millions of people remain below the line and may be more difficult to assist. Indonesia now has the opportunity to enter into a period of sustained and relatively rapid growth, leading to a further significant reduction in poverty and an improvement in the living standards of its people. Chapter 1 deals with Indonesia's progress in adjustment and poverty reduction and identifies the tasks ahead to lay the foundations for sustained growth. Those tasks--skillful macroeconomic management, rapid consolidation of the deregulation process to foster efficient private sector development, and continued improvements in the focus and efficiency of public sector operations to sustain growth and poverty reduction--form the core of the rest of the report.

1.03 Chapter 2 deals with the macroeconomic outlook and policy framework for sustained growth. A key theme is the need for continued careful macroeconomic management to mobilize the resources needed for growth and to anticipate and avoid potential sources of instability. Policies to reinforce and sustain the growth of diversified non-oil exports and non-oil fiscal revenues and to mobilize and allocate private savings efficiently will be essential to achieve the growth potential of the economy. Continued progress in reducing poverty and raising living standards depends critically on sustained growth. This Chapter also assesses the implications of the macroeconomic scenario for continued improvements in Indonesia's creditworthiness.

1.04 Chapter 3 focuses on the recent measures to deregulate the economy and improve the structure of incentives, and how these reforms have stimulated a strong private sector response, generating growth in output, non-oil exports, and employment. The strong surge in investment which developed in the past few years underscores the importance of consolidating and implementing the structural reforms to remove remaining distortions and improve the functioning of the regulatory and legal framework. The effects of

the recent reforms of the financial sector and of the transport sector in supporting efficient private sector development are discussed. Finally, to ensure that the growth process is sustainable, it will be essential to manage the natural resource base carefully and protect the environment. Therefore, the Chapter concludes with an assessment of the main challenges ahead in developing appropriate institutional arrangements for land and water resource management.

1.05 Chapter 4 discusses public sector management for growth and poverty reduction. Four areas are reviewed: (i) focussing public expenditure programs to remove growth constraints and to provide better services and opportunities to the poor; (ii) appropriate public sector pricing policies to help improve investment decisions, raise operational efficiency and reduce inequalities in public service provision; (iii) overcoming institutional problems in planning, budgeting and implementation through administrative improvements in the effectiveness of public expenditure programs; and (iv) reform of public enterprises to improve their efficiency and enhance their overall contribution to the economy.

B. Adjustment Response and Macroeconomic Performance

1.06 The rest of Chapter 1 assesses progress in adjustment and poverty reduction. First, the main elements of the Government's adjustment program and its effect on economic performance are analyzed, concluding with a preliminary assessment of policy changes and economic developments in 1989/90 (Section B). Next, progress in reducing poverty and the links to policies followed during the adjustment period are discussed. Here two factors appear to have been critical. First, the Government undertook measures which fostered efficient growth in output and consumption, while shifting resources from inward-oriented, capital-intensive activities towards labor-intensive export activities. Second, while reducing public expenditures in real terms to restore fiscal balance, the Government protected poverty-related expenditures relative to other expenditures. The support of the donor community helped provide the resources to support this effort. These issues are discussed in Section C. Finally, Section D outlines the tasks ahead in preparing for sustained growth.

External Shocks and Adjustment, 1983-88 1/

1.07 After experiencing a rapid growth of income, consumption and investment during the 1970s, Indonesia faced a much worse external environment beginning in 1983. The real price of oil declined by about 60%;2/ the effect of this decline on the Indonesian economy was massive since oil earnings accounted for 82% of export receipts and 71% of Government revenues in

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1/ This discussion is based on the analysis contained in last year's economic report. See, Indonesia: Strategy for Growth and Structural Change, Report No. 7758-IND, May 3, 1980.

2/ The real price of oil (in 1985 US Dollar terms) was US$11.8 in 1989, compared to US$29.2 in 1983.

1981/82. Moreover, the deep, world-wide recession of the early 1980s also hurt Indonesia's balance of payments. During 1985-88, the depreciation of the US Dollar was another source of external shocks, as a large proportion of Indonesia's debt is in currencies which have appreciated against the US Dollar. The combination of lower oil prices and adverse currency fluctuations led to a rapid increase in Indonesia's debt service burden, over this period.

1.08 Indonesia responded effectively to the challenge posed by those external shocks by implementing a broad range of macroeconomic stabilization and structural adjustment measures starting in 1983. In broad terms, two types of policy adjustments were made. First, the Government adopted more austere macroeconomic policies to restore financial stability. Second, to sustain the development momentum over the medium to longer term, it embarked on a major program to restructure the economy, aimed both at reducing Indonesia's heavy dependence on oil as a source of foreign exchange and budgetary revenues, and at improving economic efficiency. The specific policy responses can be grouped in the following four categories:

(a) To restore balance of payments stability and sustain growth over the medium term, the Government adopted an active exchange rate policy. Major devaluations were implemented in March 1983 and September 1986 and the flexibility of the exchange rate was increased through a more actively managed float. In conjunction with prudent fiscal and monetary policies, these measures supported a real effective exchange rate depreciation of about 55% between December 1981 and December 1988. This played a key role in boosting non-oil exports and reducing the current account deficit.

(b) The objectives of demand restraint and structural change were served by the implementation of a number of strong fiscal measures, designed to restrain public expenditure, mobilize public revenues and reduce the overall fiscal deficit. Budget austerity and more careful selection of projects reduced public investment by over 30% in real terms between 1983/84 and 1988/89. In addition, a sweeping tax reform implemented over 1984-86 boosted non-oil tax revenues and improved the efficiency of the tax system.

(c) Supportive monetary and financial policies were maintained to contain inflationary pressures, prevent capital flight, mobilize financial resources and improve the efficiency of the use of financial resources. A major financial sector reform was introduced in June 1983, which deregulated domestic interest rates and increased the flexibility of monetary management. A second round of financial measures initiated in October-December 1988, aimed at enhancing financial sector efficiency and boosting capital markets.

(d) The Government also initiated a series of trade and other structural reforms to support demand management policies in reducing macroeconomic imbalances and to enable a recovery of economic growth over the medium term. A number of measures were undertaken: a comprehensive reform of the tariff system (1985); a reorganization of customs, ports and shipping operations (1985); the creation of a duty exemption and drawback facility (1986); the elimination of a significant number of non-tariff barriers (1986-88); a reduction in

investment and capacity licensing restrictions (1986-89); a relaxation of the rules governing foreign investment (1986-89); and, a deregulation of maritime activities (1988). These reforms have led to the development of a more efficient and dynamic private sector.

1.09 As a result of the Government's balanced adjustment program, good progress was made towards restoring financial stability and stimulating the recovery of economic growth (see Table 1.1). Prudent macroeconomic management helped to reduce current account and fiscal deficits, as well as lower inflation. Along with structural reforms, it also supported the recovery of economic growth by boosting non-oil exports, stimulating private investment and enabling a noticeable gain in economic efficiency. As a result of these factors, growth of the non-oil economy was much better than expected, averaging 5.9% p.a. during 1983-88; the non-oil manufacturing sector provided the primary impetus for this growth, expanding by 12.4% p.a. Another notable feature of Indonesia's adjustment performance was that private consumption per capita grew throughout this period.

1.10 The magnitude of Indonesia's internal adjustment is also illustrated by Table 1.2. The collapse in oil prices and the surge in external interest payments caused gross national savings to decline by 4.1% of GDP in 1986, with most of the decline (3.4% of GDP) concentrated in public savings. A large reduction in public investment enabled the Government to contain the public sector savings-investment gap at only 4.0% of GDP in 1986. Through a combination of the Government's public resource mobilization effort and restraints on public investment, this gap had been reduced by 1988, despite higher external interest payments.

1.11 Trends in the balance of payments. The Government's adjustment program helped to bring down the current account deficit from 7.8% of GNP in 1982/83 to 2.2% of GNP in 1988/89. The balance of payments adjustment was achieved through a combination of demand management and expenditure switching policies. The specific measures that helped restore balance of payments stability included: (a) depreciation of the real exchange rate, which boosted non-oil exports and reduced the demand for imports; (b) the rephasing of large capital projects in May 1983 and cutbacks in real capital spending in subsequent years, which sharply reduced imports of capital goods by the public sector; (c) the redefinition of public expenditure priorities, which focused expenditures on less import-intensive sectors; (d) strict limits on non-concessional external borrowing; (e) austere budgets and supportive monetary and financial policies, which reduced demand for imports and discouraged capital flight; and (f) trade and other regulatory reforms, which stimulated non-oil exports.

1.12 A reduction in the level of imports was initially the most important part of the improvement in the balance of payments (see Figure 1.1). This objective was achieved primarily through general macroeconomic instruments. Large real exchange rate depreciations served to raise the price of tradeables relative to non-tradeables, thereby causing private sector demand to switch from imports towards domestic substitutes. By rephasing large projects in May 1983 and by cutting real capital expenditures in subsequent years, imports of capital goods were reduced sharply. These measures were complemented by a redefinition of public expenditure priorities; expenditures were diverted away

Table 1.1: RECENT ECONOMIC DEVELOPMENTS, 1975-1989 /a

	Actual /b					Estimate /b
	1975-83	1984-85	1986	1987	1988	1989
Real growth rates (% p.a.)						
GDP	6.5	4.6	5.9	5.0	5.6	7.4
Non-oil GDP	7.0	5.2	6.2	5.8	7.3	8.1
- Agriculture	3.5	4.2	2.5	2.2	4.3	4.4
- Mining	6.8	-1.8	10.7	7.0	4.8	11.0
- Manufacturing	10.6	12.7	11.1	11.4	13.5	12.2
- Construction	10.8	-1.0	2.2	4.2	8.9	10.0
- Other services	8.6	4.9	7.4	6.3	6.7	8.4
National income	8.5	3.8	0.1	5.7	6.0	7.8
Consumption	8.9	3.7	4.9	3.5	4.0	6.5
Fixed investment	10.7 /c	-5.8	-5.5	2.6	10.3	13.0
- Public	12.6 /c	-2.9	-19.1	-4.5	10.2	6.2
- Private	9.1 /c	-8.6	8.7	8.1	10.4	17.7
Non-oil exports	10.5 /c	10.4	4.1	25.3	14.5	15.9
Non-oil imports	13.8 /c	-11.8	-13.6	5.0	7.8	18.2
Ratios (%) /d						
Overall public sector balance/GDP	-4.8 /e	-3.0	-4.1	-2.7	-3.4	-2.2
Current account/GNP	-7.8 /e	-2.6	-5.8	-2.3	-2.2	-1.9
Debt service/exports	16.8 /e	25.1	38.0	35.5	36.1	32.1
Fixed investment/GDP	25.1	20.5	20.1	19.2	20.0	21.1
National savings/GDP	21.0	21.6	17.5	19.2	20.0	21.3
Prices						
Oil prices (US$/bbl) /d	28.4	25.0	12.5	17.6	15.1	17.9
Terms of trade (1983/84=100) /d	100.0	93.2	62.4	71.6	69.6	73.0
Domestic inflation (% p.a.) /f	16.2	8.1	5.8	9.6	9.3	6.3

/a Balance of payments and fiscal data are for fiscal years (starting April 1). Other indicators are for calendar years.
/b National accounts data for 1983-89 are based on the preliminary revised national accounts series recently published by BPS (see Annex 2). These data are subject to further revision.
/c For 1978-82 only.
/d For last year of multi-year periods.
/e For 1982/83.
/f As measured by the 17-cities consumer price index, with an adjustment for rice prices during 1987-89.

Source: Central Bureau of Statistics (BPS) and World Bank staff estimates.

from relatively high import-intensive sectors (mining and industry) to less import-intensive sectors (agriculture, education and regional development). As a result of these policies, public sector imports declined by about 53% in real terms during 1983/84-88/89, reflecting the direct and multiplier effects of cutbacks in the public investment program. Private sector imports also declined by 20% in real terms during 1983/84-86/87. In the early phase of the adjustment period, imports were also compressed by non-tariff barriers (NTBs). However, as part of the adjustment program, the Government began dismantling these NTBs in 1986. Consequently, since 1986/87, private sector imports have risen steadily, as the demand for both intermediate and capital good imports has surged to support the rapid expansion of non-oil exports.

Table 1.2: SAVINGS-INVESTMENT BALANCES, 1981-89 /a
(% of GDP at current prices)

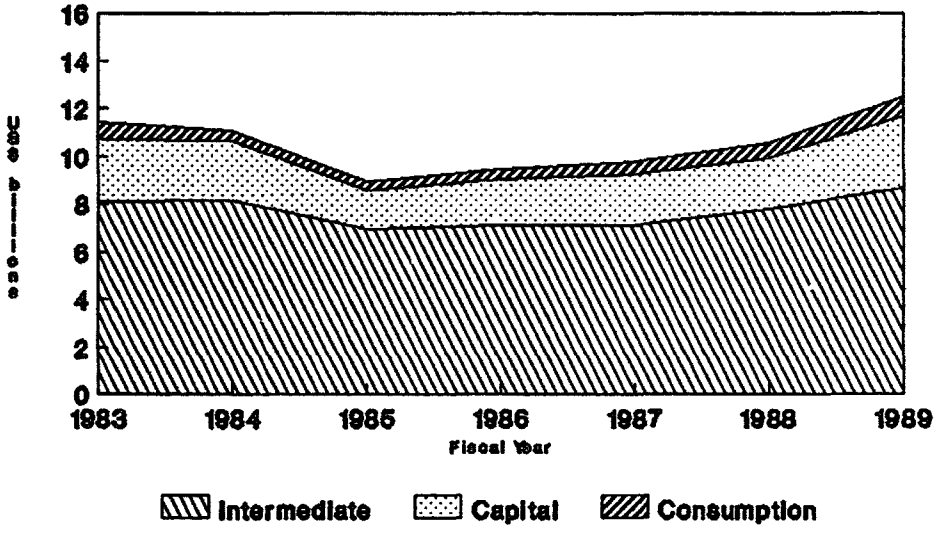
	1981	1982	1983	1984	1985	1986	1987	1988	Estimate 1989
Total domestic investment	29.7	29.2	27.0	25.2	24.0	23.0	22.5	22.2	23.2
- Fixed investment	24.2	25.9	25.1	22.2	20.5	20.1	19.2	20.0	21.1
- Change in stocks	5.5	3.3	1.9	3.0	3.5	2.9	3.3	2.2	2.1
Gross national savings	27.8	22.6	21.0	21.8	21.6	17.5	19.2	20.0	21.3
Savings-investment gap /b	-1.9	-6.6	-6.0	-3.4	-2.4	-5.5	-3.3	-2.2	-1.9
Public sector									
Gross domestic investment /c	10.7	12.7	12.0	10.1	10.4	8.8	8.3	8.8	8.6
Savings	9.2	8.2	8.9	10.0	8.2	4.8	5.4	5.4	6.2
Savings-investment gap	-1.5	-4.5	-3.1	-0.1	-2.2	-4.0	-2.9	-3.4	-2.4
Private sector									
Gross domestic investment	19.0	16.5	15.0	15.1	13.6	14.2	14.2	13.4	14.6
-Fixed investment	13.5	13.2	13.1	12.1	10.1	11.3	10.9	11.2	12.5
-Change in stocks	5.5	3.3	1.9	3.0	3.5	2.9	3.3	2.2	2.1
Savings	18.6	14.4	12.1	11.8	13.4	12.7	13.8	14.7	15.1
Savings-investment gap	-0.4	-2.1	-2.9	-3.3	-0.2	-1.5	-0.4	1.2	0.5

/a All data converted to calendar year basis. As a result, the data on the current account deficit and the public sector differ slightly with other tables.
/b The inverse of the current account deficit expressed in calendar years.
/c Fixed investment only. Investment in stock changes is assumed to be financed by the private sector.

Source: Central Bureau of Statistics and World Bank staff estimates.

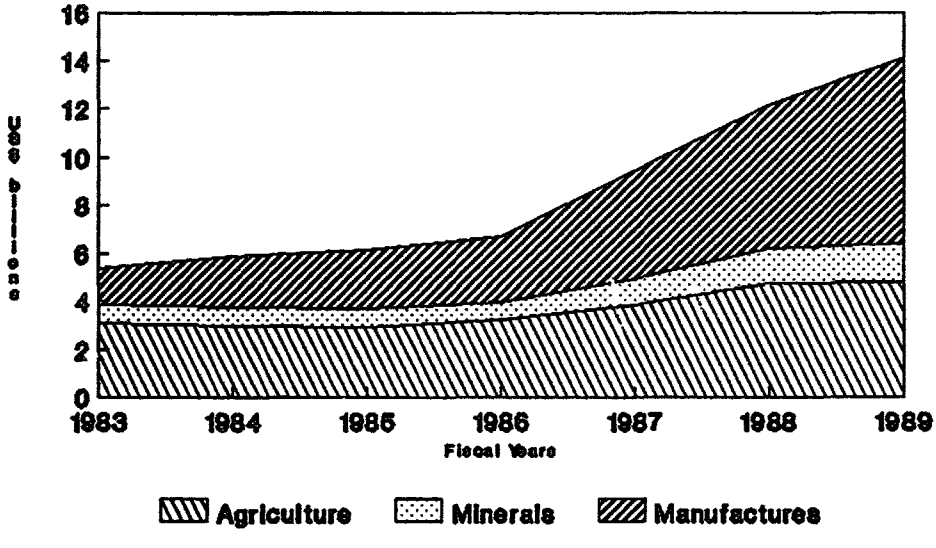
1.13 The most striking feature of the adjustment in the balance of payments has been the dramatic response of non-oil exports which grew by 13% p.a. in real terms during the 1983/84-88/89 period (see Figure 1.2). Non-oil manufactured goods exports, which increased by 26% p.a. during this period, were the principal source of export growth. This performance reflects the competitiveness of the Indonesian economy, that was created and maintained by appropriate exchange rate policies and the series of deregulation reforms started in 1985. Initially, excess capacity in manufacturing caused by weak domestic demand was also an important contributing factor. But as the deregulation process gathered momentum, new export capacity has been created across a wide range of manufacturing items. This illustrates the value of adopting broad policy reforms that reduce costs and enhance efficiency across a spectrum of activities.

Figure 1.1:
Non-oil Import Trends, 1983/84-89/90
(constant 1983 values)



Source: Central Bureau of Statistics

Figure 1.2:
Non-oil Export Performance,1983/84-89/90
(constant 1983 values)



Source: Bank Indonesia

1.14 Trends in the fiscal deficit, inflation, and interest rates. During 1982/83-88/89, the Government's prudent fiscal and monetary management also succeeded in reducing fiscal imbalances and domestic inflation. As a result of the tax reform effort, non-oil taxes grew from 7.4% of non-oil GDP in 1982/83 to 10.1% in 1988/89. The Government's expenditure control measures were also effective, as total expenditures as a share of GDP declined significantly between 1982/83 and 1988/89, despite the large increase in external interest payments. As a result of these revenue mobilization measures and expenditure controls, the budget deficit declined from 4.3% of GDP in 1982/83 to 3.0% in 1988/89. The austere fiscal policy stance during this period (1982/83-88/89) is also illustrated by the large improvement in the primary budget balance from a deficit of 3.1% of GDP to near balance.3/ Budget austerity, combined with appropriate monetary management, in turn contributed to a reduction in the rate of inflation. Inflation decelerated significantly during this period, averaging 8.2% p.a. during 1983-88, compared to the double digit rates of the late 1970s and early 1980s. Furthermore, the deregulation of interest rates in June 1983 helped to mobilize financial resources and restrained capital flight. The close coordination of exchange rate, fiscal and monetary policies has been a distinguishing feature of the Government's macroeconomic policy framework. It strongly reflects a recognition of the linkage between the exchange rate, interest rate and inflation necessitated by Indonesia's open capital account.

1.15 Trends in economic growth and efficiency. The large decline in oil revenues convinced the Government of the need to intensify efforts to improve economic efficiency and stimulate the private sector. The fairly comprehensive and far-reaching deregulation measures initiated since 1985 were in response to this need. Although the benefits of these measures have not yet been fully realized, there is already some evidence of an improvement in economic efficiency in recent years as discussed in last year's economic report. Furthermore, there has been a noticeable improvement in the structure of the economy with a substantial decline in the importance of oil/LNG revenues in the budget and the balance of payments (see Table 1.3). As a result, Indonesia is now reliant on more promising and sustainable sources of growth. These gains in economic efficiency and higher mobilization of non-oil resources have helped to sustain a better-than-expected rate of economic growth, despite the loss of oil revenues.

1.16 The deregulation measures in conjunction with sound macroeconomic policies have also led to an encouraging recovery of private sector investment, which increased by 9.3% p.a. during 1986-88. This was a dramatic reversal of the stagnation experienced during 1983-85. Furthermore, the data available on foreign and domestic investment approvals from the Investment Coordination Board (BKPM) indicate that significant amounts of these investments are planned for export-oriented activities. The rapid growth in private sector investment bodes well for the economy's future growth prospects, but also illustrates the need to consolidate the deregulation process rapidly.

3/ The primary budget balance is defined as the budget balance net of interest payments.

Table 1.3: INDONESIA'S ECONOMIC STRUCTURE, 1981/82-1989/90
(%)

	1981/82	1985/86	1989/90
Ratios of:			
Oil/LNG exports to total merchandise exports /a	81.9	66.6	39.8
Non-oil exports to non-oil imports /a	28.6	55.2	85.8
Oil/LNG revenues to total revenues	70.6	57.1	38.2
Private fixed investment to total fixed investment /b	52.1	49.1	62.0
Non-oil manufacturing to GDP /b	8.4	11.5	14.3

/a Goods only; in current dollars.
/b Calendar year basis; in 1983 prices.

Source: World Bank staff estimates.

1.17 Trends in external debt. Despite considerable success in reducing financial imbalances and the Government's cautious approach to external borrowing, the debt burden rose sharply due to the adverse external environment faced by Indonesia since the early 1980s. Depreciation of the US Dollar after 1985 added US$12.6 billion (31%) to Indonesia's public debt at end-1988 and US$1.9 billion (25%) to its debt servicing during 1988. During 1985-88, oil prices fell by about one half, severely reducing Indonesia's export earnings and capacity to service debt. Even with the high level of debt, and the adverse impact of external shocks, Indonesia did not face a foreign exchange crisis or a cash flow constraint on payment of its external debt obligations. This reflected the Government's cautious approach to external borrowing and responsive economic management, as well as the strong support provided by the donor community. The Government maintained strict limits on import-related and commercial credits, and reduced exposure to private banks. This voluntary restraint limited the total net transfer of resources to Indonesia, but improved the maturity and term structure of external debt. As a result, Indonesia's debt structure is now better than in most developing countries, with a relatively high share of concessional debt and a relatively low share of variable interest debt. Combined with policies to promote efficiency improvements and non-oil export development, this prudent external borrowing has already led to an improvement in Indonesia's debt indicators.

Economic Developments during 1989/90 4/

1.18 During the past year, the Government has continued to pursue prudent macroeconomic policies in order to ensure that economic growth is consistent with macroeconomic stability. The Government sought to maintain the

4/ Economic developments during 1989/90 are analyzed in greater detail in Annex 1.

competitiveness of the exchange rate by depreciating the nominal exchange rate by 2.3% and reducing the rate of inflation. During October 1989, Bank Indonesia also introduced a new procedure for exchange rate management of the Rupiah allowing it more flexibility to reflect market trends. The Government continued to implement fiscal policies designed to strengthen public resource mobilization. In order to increase non-oil revenues during 1989/90, three important measures were introduced: (i) the VAT tax base was extended; (ii) a strengthening of audit efforts for income taxes as well as beginning preparations for the full auditing of VAT returns; and (iii) tax administration was strengthened with a reorganization of the Tax Directorate and the appointment of new higher level staff. Further progress was also made in reducing budgetary subsidies, through the implementation of the elimination of the pesticide subsidy and the raising of the retail prices of fertilizer by a weighted average of 16%.

1.19 The Government has also pushed ahead with important structural reforms in the areas of finance and public enterprises to reduce the Government's direct intervention in the economy and to strengthen the private sector. In the financial sector, several measures were announced, including the phasing out of subsidized, directed credits (liquidity credits), a significant relaxation of the rules governing the foreign exchange activities of commercial banks and the relaxation of rules limiting foreign capital from participating in the stock market.5/ The Government has also made progress towards reforming public enterprises in the past year.6/ Following upon Presidential Decree No. 5 in October of 1988, two ministerial decrees, issued in June 1989, set out the financial performance criteria for public enterprises and outlined a number of options to improve their efficiency and productivity. In trade and industrial policy, efforts have concentrated on ensuring the timely implementation of past reforms. For example, the negative list on investment is being smoothly implemented and foreign investment approvals, in general, are being handled in a timely and efficient manner.

1.20 Economic developments during 1989/90 indicate that the economy is continuing to respond strongly to the structural reforms of the last several years. Economic growth is estimated at about 7.4% in 1989, with non-oil activity increasing by around 8.1%. Economic growth was also more broadly-based than in the past. Within the non-oil economy, there was continued robust growth in the agriculture sector, led by the highest growth in rice production since 1984. Manufacturing continued to grow at a very high rate, driven by the performance of non-oil manufactured exports. Services, particularly trade, construction, and financial, also grew strongly. Increased activity in the banking sector and the stock market as a result of financial sector reforms raised the growth of the finance, insurance and real estate subsector by 13%. Finally, after two years of stagnation the oil/LNG sector grew by over 4%. On the expenditure side, private fixed investment

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5/ These measures are reviewed and analyzed in detail in Chapter 3 of this report.

6/ These measures are reviewed and analyzed in detail in Chapter 4 of this report.

provided a major impetus to this growth. As noted earlier, the increase in private investment has been largely in response to the Government's deregulation policies.

1.21 The strong growth of the economy also influenced developments in the balance of payments during 1989/90 (see Table 1.4). The oil/LNG current account rose by US$1.2 billion, reflecting primarily an 18.5% increase in the price of oil. Moreover, non-oil exports continued to grow rapidly, increasing by 15.6%, reaching an estimated US$14.1 billion. This represented a volume growth of nearly 16%, as non-oil export prices declined slightly during 1989/90. As in previous years, the primary impetus to this growth was from a broad range of manufacturing goods. However, higher export earnings were offset by a rapid rise in non-oil imports, which increased by about 18% in real terms. The surge in non-oil imports demonstrates the strength of the private sector response to deregulation, with private sector capital goods' imports accounting for the largest share of the import growth. Monetary policy appeared to accommodate this strong import growth. Overall, the current account deficit declined slightly to US$1.7 billion (falling to 1.9% of GNP from 2.2% in 1988/89). Net disbursements of public MLT loans fell by about US$1.3 billion in 1989/90, reflecting the decline in new commitments of special assistance, lower disbursements of project assistance from official donors,7/ a reduction in the use of commercial and import-related credits, and a decline in financing for LNG/LPG projects, as well as a small increase in principal repayments. There was also a net outflow of capital, which can be attributed to several factors, including investments abroad by some private companies, a very large unwinding of swaps with Bank Indonesia,8/ and increased foreign borrowings by commercial banks that were channelled into domestic credit in foreign currency.9/ Nevertheless, net official reserves rose by US$0.3 billion.

1.22 The fiscal outturn for 1989/90 indicates a strong non-oil tax revenue performance, with these revenues rising by 29% (see Table 1.5). This resulted from buoyant economic growth, the new non-oil tax measures, and improvements in tax administration. Oil revenues also rose, primarily due to the increase in oil prices. The increase in revenues exceeded the rise in routine expenditures and generated higher Government savings, at 5.6% of GDP compared to 4.4% in 1988/89. In turn, higher savings permitted a rise in

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7/ This partly reflects the shift in the composition of donor's commitments towards special assistance in the past several years, which has reduced the pipeline of project aid.

8/ A reduction in swaps outstanding with Bank Indonesia is a positive development to the extent that it reflects increased confidence in the Rupiah and reduces Bank Indonesia's contingent foreign exchange liabilities.

9/ This was the result of a new regulation that removed the limit on foreign exchange borrowings by commercial banks, but limited their net positions in foreign exchange to 25% of their equity. This is discussed in more detail in Chapter 3.

Table 1.4: BALANCE OF PAYMENTS, 1981/82-1989/90
(US$ billion at current prices)

	Actuals					Estimated
	1982/83	1985/86	1986/87	1987/88	1988/89	1989/90
Merchandise exports (fob)	18.6	18.5	13.7	18.1	19.8	23.4
Oil & LNG	14.7	12.3	7.0	8.6	7.6	9.3
Non-oil	3.9	6.2	6.7	9.5	12.2	14.1
Merchandise imports (cif)	-20.6	-14.4	-12.7	-14.2	-15.7	-19.0
Oil & LNG	-4.8	-3.2	-2.3	-2.4	-2.1	-2.6
Non-oil	-15.8	-11.2	-10.4	-11.8	-13.6	-16.4
Trade balance	-2.0	4.1	1.0	3.9	4.1	4.4
Non-factor services (net)	-1.7	-1.8	-1.5	-1.2	-1.2	-0.9
Interest payments (MLT)	-1.5	-2.2	-2.5	-2.8	-3.0	-3.1
Other factor services and transfers (net)	-2.1	-2.2	-1.2	-1.6	-1.7	-2.1
Current account balance	-7.3	-2.1	-4.2	-1.7	-1.8	-1.7
Public MLT loans (net)	4.0	1.3	2.7	1.9	2.9	1.6
- Disbursements	5.1	3.8	5.2	6.1	7.3	6.1
- Principal repayments /a	-1.1	-2.5	-2.5	-4.2	-4.4	-4.5
Other capital (net)	0.0	1.7	-1.5	1.0	-1.3	-1.0
U e of net foreign assets	3.3	-0.9	3.0	-1.2	0.2	1.1
Memo items:						
Net official reserves /b	3.0	5.8	5.0	6.0	5.4	5.7
- Months of imports /c	(2.0)	(5.5)	(4.3)	(4.6)	(3.4)	(3.2)
Total net foreign assets	7.5	12.6	9.6	10.8/d	10.6	9.5
Current account/GNP (%)	-7.8	-2.6	-5.8	-2.3	-2.2	-1.9
Non-interest current account balance (% of GDP)	-6.0	0.7	-1.7	2.4	2.3	2.4
MLT debt service/ exports (%) /e	16.8	25.1	38.0	35.5	36.1	32.1

/a Includes prepayments of US$420 million in 1985/86, US$626 million in 1987/88, US$341 million in 1988/89 and US$300 million in 1989/90.

/b Net official reserves are defined as gross official reserves minus outstanding liabilities to the IMF and other short term liabilities.

/c Net official reserves in months of next year's expected imports (oil/LNG and non-oil) of goods.

/d Excludes US$326 million of prepayments, committed during the year but not completed until June 1988.

/e Debt service on public and private debt, excluding prepayments; denominator is gross exports of goods and services.

Source: Bank Indonesia and World Bank staff estimates.

Central Government capital expenditures (about 5% in real terms), reflecting Government initiatives to support poverty reduction and to eliminate infrastructure bottlenecks. Despite higher capital spending, the budget deficit declined from 3.0% of GDP in 1988/89 to 1.4% in 1989/90. In anticipation of a weakening of oil prices in 1990/91, the Government intends to continue its efforts to raise non-oil revenues and reduce budgetary

Table 1.5: CENTRAL GOVERNMENT BUDGET, 1982/83-1988/89
(Rp. trillion at current prices)

	Actuals				Estimated
	1982/83	1985/86	1987/88	1988/89	1989/90
Revenues and grants	12.0	18.8	21.8	23.2	29.5
Oil and LNG taxes	7.6	10.7	10.4	9.2	11.3
Non-oil taxes	3.8	6.4	9.0	11.9	15.4
Non-tax revenues /a	0.5	1.5	2.0	1.6	2.1
Grants	0.1	0.2	0.4	0.5	0.7
Current expenditures	8.2	12.7	15.5	16.8	19.9
External interest	0.7	1.8	3.8	4.3	4.5
Subsidies	1.4	1.4	1.4	1.0	1.5
Other	6.1	9.5	10.3	11.5	13.9
Government savings	3.8	6.1	6.3	6.4	9.6
Capital expenditures	6.6	8.7	8.9	10.8	12.0
Budget balance	-2.9	-2.7	-2.6	-4.4	-2.4
Financed by:					
External loans (net)	2.0	1.8	2.5	4.5	2.7
Disbursements	2.7	4.3	8.9	11.6	10.2
Principal repayments	0.7	2.5	6.4	7.1	7.5
Asset drawdown	0.9	0.9	0.1	-0.1	-0.3
Memo items (% of GDP):					
Non-oil taxes (% of non-oil GDP)	7.4	8.2	8.8	10.1	11.3
Government savings	5.7	6.2	4.9	4.4	5.6
Budget balance	-4.3	-2.7	-2.0	-3.0	-1.4
Total expenditure	22.4	21.8	19.0	18.7	18.7
Net domestic expenditure /b	11.3	8.2	3.5	2.8	2.4
Primary balance /c	-3.1	-0.8	1.1	0.0	1.3

/a Includes domestic oil surplus in 1986/87.
/b Defined as the domestic content of expenditure less non-oil revenues.
/c Budget balance net of external interest payments.

Source: Ministry of Finance and World Bank staff estimates.

subsidies. Furthermore, cautious fiscal management will be needed to ensure that public expenditures do not put undue pressure on the balance of payments, rekindle inflationary forces or reduce the efficiency of expenditure allocation and program implementation. These priorities are recognized in the 1990/91 budget announced in January, as the Government intends to lower the budget deficit and focus public expenditures on infrastructure and poverty-related programs.

1.23 During 1989, monetary policy was more expansionary than in the past several years. Monetary and credit aggregates grew strongly throughout the year: reserve money increased by 23% from December 1988 to December 1989; broad money rose by 38%; and domestic credit to the private sector rose by 50%. This rapid growth in credit was supported by a large increase in liquidity credits. Despite this, inflation was further reduced in 1989, with the CPI growing by about 6% compared with about 9% in 1988.10/ In response to concerns about pressures on the balance of payments, the Government is monitoring trends in the monetary aggregates closely. In 1990, the phasing out of liquidity credits will help to slow the growth of domestic credit and improve the effectiveness of monetary policy instruments. This, combined with the continued cautious stance indicated by the 1990/91 budget, indicates a continuation of prudent macroeconomic management in the future.

C. Progress in Poverty Reduction

1.24 During the 1970s and early 1980s, Indonesia experienced a rapid rate of economic growth and a sustained reduction in the incidence of poverty. A major concern has been the effect of the economic adjustment during the 1980s on the living standards of the poor. The analysis presented in the Poverty Assessment and Strategy Report, indicates that poverty continued to decline during this period and that the distribution of income may have improved slightly.11/

1.25 Using the official poverty line, there was a substantial decline in the percentage of poor in both urban and rural areas during 1984-1987 (see Table 1.6). The incidence of poverty was 22.0% in Indonesia in 1984. By 1987, this percentage had declined to about 17%. There was also an absolute

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10/ In this report, annual inflation rates are calculated as the percentage change between the simple average of the monthly 17-cities CPI in year t and the average in year t-1.

11/ For a detailed analysis, see, Indonesia: Poverty Assessment and Strategy Report, World Bank Report No. 8034-IND, April 1990. The Central Bureau of Statistics (BPS) has estimated an official poverty line based on 2,100 calories and necessary non-food expenditures. In this report, we use this line as a benchmark for measuring the incidence of poverty and its trend. However, other sources have also estimated poverty lines for Indonesia using slightly different methods. While these other methods yield different estimates of the percentage of the population and the number of people that are poor, the basic conclusions regarding trends in poverty reduction remain unchanged.

decline in the number of Indonesians in poverty, from 35 million in 1984 to about 30 million in 1987. This decline reflected a substantial reduction in rural poverty. Income inequality, as measured by household income and expenditure data, also declined during 1984-87.12/ This is indicated by the increase in the consumption share of the poorest 20% of the population during 1984-87 and a slight decline in the Gini coefficient.

Table 1.6: OFFICIAL ESTIMATES OF POVERTY, 1976-87

	1976	1978	1980	1984	1987
	Percentage of Poor in Total Population				
Urban	38.8	30.8	29.0	23.1	20.1
Rural	40.4	33.4	28.4	21.2	16.4
Total	40.1	33.3	28.6	21.6	17.4
	Number of Poor (millions)				
Urban	10.0	8.3	9.5	9.3	9.7
Rural	44.2	38.9	32.8	25.7	20.3
Total	54.2	47.2	42.3	35.0	30.0
Memo items:					
Gini coefficient	0.34	0.38	0.34	0.33	0.32
Consumption share of the bottom 20% of the population (%)	8.0	7.3	7.7	8.0	9.2
Average per capita caloric intake	-	-	2,489	2,516	2,660 /a

/a For 1986.

Source: Kemiskinan Distribusi Pendapatan dan Kebutuhan Pokok, and Statistik Indonesia 1988, Biro Pusat Statistik, August 1989.

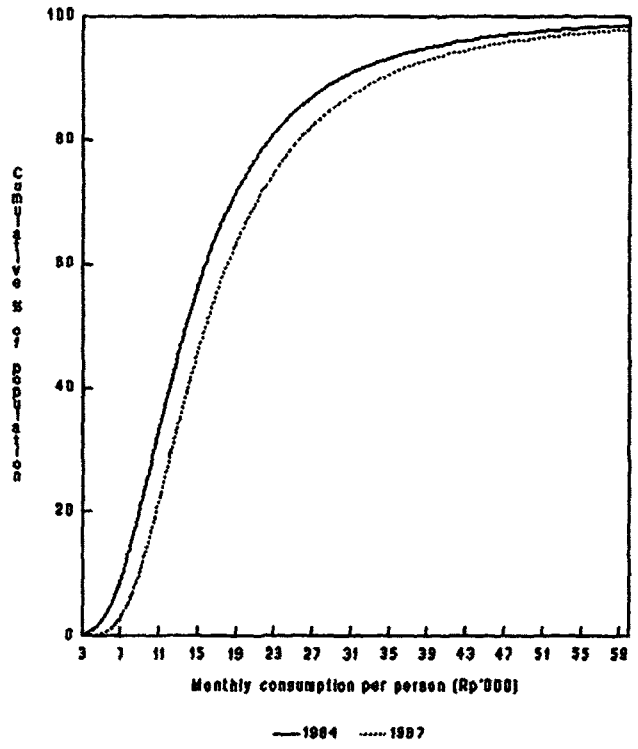
1.26 An alternative approach to measuring the trend in poverty is to compare the cumulative distribution of real expenditures per capita (in 1984 prices) between the two years.13/ This analysis indicates that the 1984

12/ This analysis uses data from the 1984 and 1987 National Socioeconomic Survey (SUSENAS) conducted periodically by the Central Bureau of Statistics.

13/ This analysis adjusts household consumption expenditures per capita from the SUSENAS to 1984 prices using the consumer price index (CPI), reweighted to reflect more accurately the consumption pattern of the poor.

distribution lies entirely above the 1987 distribution (see Figure 1.3). This implies that, at any particular level of real expenditures per capita (or any "designated" poverty line), there was a lower percentage of the population at or below that level in 1987 than in 1984. Thus, it can be concluded that all possible poverty lines will show an unambiguous decrease in aggregate poverty between 1984 and 1987. This result is also robust to any plausible adjustment to the rate of inflation during this period.

Figure 1.3:
Consumption Distributions



Source: Ravallion and Huppi (1989).

Factors Contributing to Poverty Reduction during the Adjustment Period

1.27 As noted above, there is strong evidence that poverty has continued to decline despite the macroeconomic adjustments necessitated by external shocks. The success in reducing poverty is attributable partly to the development programs and policies pursued during the 1970s, but chiefly to the comprehensive nature and the speed of the Government's policy response to these external shocks. The supportive response to the Government's adjustment program from the donor community and Indonesia's access to international capital markets, facilitated the implementation of these policies. In

particular, two aspects of the adjustment program--the pace and pattern of economic growth, and public expenditure policies--were important in sustaining the reduction of poverty during this period.

1.28 The pace and pattern of economic growth. Because of the flexibility of Indonesia's labor markets, the policies for growth, employment and poverty alleviation are largely complementary. The rapid pace of economic activity during the 1970s supported a large expansion of employment at higher real wages. During the early 1980s, Indonesia's growth rate did decline relative to the 1970s because of external shocks. Nevertheless, the Government's growth-oriented adjustment effort supported a pace of economic activity sufficiently robust to allow improvements in real earnings for most workers belonging to poorer income groups. Increases in employment and real wages both contributed to a rise in real earnings.

1.29 Overall, employment grew faster relative to output in 1982-87 than in 1976-82, as evidenced by the rise in the elasticity of employment with respect to output from 0.44 in 1976-82 to 0.65 in 1982-87.14/ An important factor contributing to this was the change in the composition of output during the adjustment program. Although rice output growth slowed somewhat, which pulled down the agriculture sector's growth rate, a diversification of production towards non-rice food crops and non-food farm activities supported a faster growth of agricultural employment. In manufacturing, slower expansion of domestic-oriented, capital-intensive production was partially offset by a rapid growth of labor-intensive, export-oriented activities, especially during 1985-88.15/ This changing pattern of output and employment in agriculture and manufacturing was supported by: the depreciation of the real exchange rate which improved the incentives for non-oil exports in both agriculture and manufacturing;16/ decontrol of interest rates which helped to reduce the bias towards capital-intensive production; and trade deregulation which increased the efficiency of production while also significantly reducing the bias against exports.

1.30 Using wages for unskilled agricultural workers in Java as a proxy for the wages of lower income groups, real wages for these groups appear to have risen from 1983 until 1987 (see Table 1.7).17/ Real wages did, however,

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14/ This analysis is based on data from the 1976 and 1987 Labor Force surveys (SAKERNAS) and labor force data collected as part of the 1982 SUSENAS survey.

15/ The available evidence suggests that manufacturing employment in enterprises with more than 15 employees increased by 9.9% p.a. during 1985-88, compared to only 5.1% p.a. during 1982-85.

16/ For econometric evidence on the role of exchange rate in the expansion of Indonesia's non-oil exports, see, Ahmed and Chhibber, How Can Indonesia Maintain Creditworthiness and Non-Inflationary Growth?, PPR Working paper, Washington, D.C. (1989).

17/ This analysis uses nominal wages for weeding, hoeing and planting in Java collected as part of the Farmer's Terms of Trade Index by the Central Bureau of Statistics. These wage data are deflated by the Household consumption component of that index (base 1983=100).

decline in 1988, reflecting the increase in rice prices which occurred due to the 1987 drought. Real wages appear to have recovered in 1989, as inflation declined significantly. For the period 1983-89 as a whole, agricultural wages rose by about 1% p.a., with the largest increase in Yogyakarta. These results are consistent with the available evidence from village surveys, and also are closely correlated with changes in the incidence of poverty during the adjustment period. In industry, the available evidence shows that industrial wages rose significantly, although at a much slower pace than average labor productivity. Real wages, however, did decline for civil servants, resulting from the Government's decision to institute a wage freeze in 1985-88. This was an important adjustment response to reduce fiscal deficits. The real wages of rural construction workers also stagnated, reflecting the large cutbacks in public capital spending. However, real wages in rural construction activities would have declined further without active policies to protect labor intensive construction activities (through INPRES program).

Table 1.7: TRENDS IN REAL WAGES, 1983-89
(index numbers, 1983=100)

	1983	1984	1985	1986	1987	1988	1989	Average Growth Rate (% p.a.) 1983-89
AGRICULTURE								
West Java	100.0	101.4	112.8	110.3	111.0	105.7	105.6	0.9
Central Java	100.0	97.9	103.2	105.2	102.9	100.0	103.9	0.6
Yogyakarta	100.0	97.1	115.1	136.1	132.1	131.8	138.1	5.5
East Java	100.0	102.2	105.5	98.6	98.1	99.1	100.9	0.1
INDUSTRY								
Average	100.0	105.2	115.2	120.4	120.3	118.7	n.a.	3.5 /a

/a For 1983-88 only.

Source: Central Bureau of Statistics and World Bank staff estimates.

1.31 What are the implication of these trends in employment and real wages for the poor? Since the bulk of Indonesia's poor reside in rural areas, labor earnings in agriculture are an important determinant of progress in alleviating poverty. The evidence presented here suggests that real earnings of workers in agriculture continued to grow, as both the level of employment and real wages increased. Outside agriculture, employment expanded in rural non-farm activities. Workers employed in small-scale rural manufacturing enterprises benefitted from the surge in non-oil exports. The returns to some

non-farm rural activities (trade and transport) may have declined initially (1982-85) but are also likely to have grown during 1986-88. Therefore, total labor income for the rural poor continued to grow during the adjustment period. In the urban areas, both employment and real wages grew in the manufacturing sector; however, wages grew more slowly than productivity. In the urban informal sector, incomes may have stagnated or fallen in 1982-85 but are likely to have risen during 1986-88. In summary, the ability to sustain a reasonable pace of economic growth, based on higher economic efficiency and a more labor-intensive pattern of production, was a key factor in Indonesia's ability to reduce poverty even as major adjustments were implemented to restore financial stability. This has important implications for Indonesia's development strategy in the 1990s.

1.32 Public expenditure policy. As noted earlier, public expenditure policy played a major role in achieving internal balance. While raising non-oil revenues the Government made large cutbacks in real public investment. These cutbacks were done selectively to moderate the effect on the poor. Two basic features of the expenditure strategy were:

(a) protecting operations and maintenance (O&M) expenditures, and transfers to the provinces, relative to other expenditures; and

(b) reallocating capital expenditures to programs which yielded more benefit to the poor.

1.33 Although real capital spending was cut by about 30% between 1983/84 and 1988/89, expenditures on O&M continued to grow in real terms. This made it possible for the Government to maintain many of its ongoing programs, including those in agriculture and the social sectors, allowing the productive use of much of the physical and social infrastructure created in the late 1970s and early 1980s. The overall level of O&M, however, continues to be a problem, reflecting a lack of balance between current and capital spending during the oil boom period of the late 1970s. Raising O&M funding to a more appropriate level is a priority for public expenditures during the 1990s.18/

1.34 A related factor was the protection of transfers to the local governments. These transfers finance over two-thirds of total public expenditures by local governments and thus, are an important factor in determining local demand. An important component of these transfers is the INPRES program, which is implemented by the provincial governments and is used to finance physical and social infrastructure (including O&M), which contribute significantly to regional development. Selected projects are generally either small-scale construction projects which generate low-wage, unskilled employment or are used to finance social services.

1.35 The Government also made significant changes in the sectoral composition of development outlays. There were several important features of this change:

18/ This issue is discussed in Chapter 4.

(a) the share devoted to industry and mining was reduced sharply. Many large, capital-intensive, industrial projects, begun during 1979-1981, were dropped. Similarly investments in mining projects were scaled back;

(b) the share of development expenditures was also substantially reduced in areas where implementation constraints or environmental concerns were severe. For example, the proportion of expenditures allocated to the transmigration program was reduced substantially;

(c) a larger share was allocated to poverty-related sectors, such as agriculture and human resource development; and

(d) the share of expenditures on physical infrastructure was increased.

This reallocation of development expenditures had two important effects in reducing the social costs of adjustment for the poor. First, the employment coefficients were higher in those sectors into which development expenditures were reallocated. Second, expenditures were switched to sectors (agriculture and human resource development) where they are of greatest potential benefit to lower income groups. These initiatives to protect poverty-related expenditures during 1983-88 played an important role in softening the effect of expenditure cutbacks on the poor. The scope for further improvements in public expenditure management to assist the poor, however, remains significant.

D. The Tasks Ahead

1.36 Indonesia is emerging from a difficult but successful adjustment period with a more robust, diversified and competitive economy. The strong surge in private sector growth, investment and imports, particularly during the past year, indicates that the foundations are being laid for a period of sustained and relatively rapid growth. It is important that Indonesia takes full advantage of the opportunities this presents. While living standards have improved and poverty has declined during the adjustment period, sustained growth is needed to make further progress in raising the living standards and providing productive employment opportunities for a growing population and labor force.

1.37 Sustained growth would enable Indonesia to make continued progress in poverty reduction. Poverty reduction must remain a priority for several reasons: (i) the number of absolute poor is still high at about 30 million people and a large proportion of the population, "the near poor", have incomes only slightly above the poverty line; (ii) despite significant progress in a number of social indicators (e.g., infant, mortality, life expectancy and malnutrition) Indonesia still lags behind other Asian countries; and (iii) population and labor force growth rates are still rapid, with about 2.4 million Indonesians expected to enter the labor force annually in the 1990s.

1.38 The Government's underlying development strategy contains the key elements which would provide the foundations for a period of sustained growth. The main features of this strategy can be grouped into three interrelated areas: macroeconomic management, efficient private sector development, and efficient public sector programs to support private sector development and poverty reduction.

1.39 The continuation of Indonesia's prudent macroeconomic management is an essential part of the development strategy. In recent years macroeconomic policies have provided a stable setting which has helped foster the private sector growth response. Through the balanced application of fiscal, monetary and exchange rate policies, the Government has contained domestic demand growth, provided incentives for strong non-oil export growth, and eased pressure on the balance of payments. Continued improvements in non-oil fiscal revenues and reductions in fiscal subsidies will strengthen fiscal policies and reduce their vulnerability to oil price fluctuations. Keeping the fiscal deficit within sustainable levels, combined with appropriate monetary restraint and the ongoing implementation of financial sector reforms, will encourage a growth in savings sufficient to finance the investment needed for sustained growth while reducing dependence on foreign savings. Effective implementation of such policies will serve Indonesia well in the coming years as growth in private sector investment and imports responds increasingly to deregulation and improved incentives. The main elements of the macroeconomic policy framework for sustained growth are discussed in Chapter 2.

1.40 The promotion of efficient private sector development depends on the rapid consolidation and implementation of the Government's program of reforms to the incentive structure; the reform of the legal and regulatory framework to encourage private initiative while protecting the public interest; and reforms in institutions and services which support private sector activity, notably the financial sector and transport. The acceleration of investment over the past few years underscores the urgency of implementing the Government's agenda to improve the incentive regime by removing non-tariff barriers, reforming the tariff system and reducing export constraints. Such reforms would help ensure that investment takes place in efficient activities, and would reinforce the macroeconomic incentives to export by reducing protection. The need for a more modern, streamlined system of corporate, land, and labor laws and regulations governing private sector activity poses more complex issues which will take considerable analysis and time to resolve, which only emphasizes the importance of the efforts underway in these areas. Supplementing recent reforms of the financial sector by improvements in prudential regulations and supervision, both in the banking system and the capital market, will enhance the stability of the financial system. Further progress is called for in extending the benefits of deregulation in transport to the road transport subsector. Finally, for the pace of private sector development to be sustainable, increasing attention is being given by the Government to resolving environmental issues and constraints, particularly the problems of water supply and quality in Java. These issues are discussed in greater detail in Chapter 3.

1.41 The third element in the strategy is efficient public sector programs to remove constraints on private sector growth while improving basic services to meet the needs of the poor. This also includes improving the efficiency and performance of the public enterprise sector. REPELITA V

sought to allocate development expenditures along these lines and these expenditure priorities were reaffirmed in President Soeharto's presentation of the draft budget:

> "... we must use the development budget as appropriately as possible in order to give maximum stimulus to development activities outside the Government's sector, namely activities conducted by the public, including the private sector. This means that development activities conducted by the state must be carefully selected and directed to strategic areas so as to stimulate and encourage self-reliance and public participation in all development sectors .... through the provision of basic means and infrastructures that cannot be provided by the people themselves."19/

Key areas to support private sector development include agricultural infrastructure and support services for farmers, and expanding capacity in power and telecommunications. The priorities for basic services for the poor include education, health, family planning and water supply and sanitation. Focusing expenditures on these strategic priorities is of crucial importance because the investment needs in these areas are likely to be very large, while expenditures will need to be kept within strict limits to sustain macroeconomic balance. These issues are assessed in Chapter 4.

1.42 Sustained donor support and access to capital markets will continue to be important in providing the resources needed to implement this strategy. An additional year of special assistance support, at a level lower than last year, would provide the Government with the flexibility and confidence to manage the surge in private sector activity and continue the deregulation effort, while maintaining reserves in terms of months of imports. Project assistance would support high priority projects and sector programs, and a modest level of commercial borrowing would round out the financing requirements. Beyond 1990/91, Indonesia will continue to require substantial amounts of official assistance to finance priority public investments in support of higher growth and poverty reduction.

19/ Government Statement on the Draft State Budget for 1990-91 to the House of the People's Representatives, January 4, 1990.

CHAPTER 2

A MACROECONOMIC FRAMEWORK FOR SUSTAINED GROWTH

A. Introduction

2.01 As noted in Chapter 1, Indonesia is emerging from a period of successful adjustment to a series of external shocks. Prudent macroeconomic management helped to reduce current account and fiscal deficits and, together with structural reforms, supported a recovery of economic growth by boosting non-oil exports and stimulating private investment. Moreover, the pace and pattern of economic growth enabled a significant reduction in poverty. The success of Indonesia's adjustment during the 1980s is demonstrated by a GDP growth rate in 1989 similar to rates reached in the oil-boom years of the 1970s. Indonesia's fundamental macroeconomic challenge for the 1990s is to make further progress in improving living standards by sustaining a relatively rapid rate of growth while preserving macroeconomic stability. The favorable environment expected in the 1990s will help in meeting this challenge.

2.02 This Chapter analyzes policy issues relating to the macroeconomic framework, employment and sustained poverty reduction, public resource mobilization and the external debt strategy. The main elements of the macroeconomic policy framework necessary to sustain a relatively rapid rate of economic growth, ensure macroeconomic stability and improve living standards are presented in Section B. The medium-term prospects for growth, employment and poverty reduction based on the macroeconomic framework, are discussed in Section C. This is followed by a more detailed review of policy options for public resource mobilization in Section D. Finally, the financing requirements for the medium term macroeconomic scenario and the key elements of Indonesia's external debt strategy are outlined in Section E.

B. Macroeconomic Strategy and Policy Framework

2.03 Sustained, steady growth in non-oil GDP at around 6-7% p.a. would enable Indonesia to make major progress towards its fundamental objective of reducing poverty and raising the living standards of all its people. It is important that Indonesia continue its present macroeconomic strategy to ensure that this growth path is consistent with financial stability, especially given Indonesia's substantial debt burden. This strategy combines prudent macroeconomic management with structural changes which strengthen and diversify the economy. The adjustment experience during the 1980s described in Chapter 1, demonstrates the Government's ability to take firm, timely action to restore financial stability, employing the full range of macroeconomic policies. Skillful macroeconomic management will be equally important in the 1990s. During the adjustment period, investment was curtailed to restore external and internal stability. Reasonably robust economic growth was achieved through efficiency improvements, the use of excess capacity and postponing public investment whenever possible, particularly in infrastructure. But to sustain a growth of 6-7% p.a. in the non-oil economy during the 1990s will require significant increases in

investment and savings. Macroeconomic policies will need to be geared towards achieving this objective, while structural reforms in the trade regime, in industrial policy, and in the financial sector are implemented. This will call for a careful monitoring of economic trends so timely policy adjustments can be made as needed. Such prompt actions will help avoid costly interruptions in the growth path and will maintain an atmosphere of confidence within the business community conducive to sustained growth.

2.04 Macroeconomic management will continue to focus on improving the external and internal financial balances in the medium term while maintaining growth. Containing and gradually reducing the current account deficit as a share of GDP will steadily lower the burden of Indonesia's debt and expand the economy's options in the future. A continuation of policies to support non-oil export growth is central to this strategy. This includes maintaining a competitive exchange rate through coordinated fiscal, monetary and exchange rate policies. Further reforms of the trade regime will also be necessary to enhance economic efficiency and the incentive to export.

2.05 Appropriate fiscal and monetary policies are needed to support the improvement in the external balance and reduce inflationary pressures. With the fall in foreign savings implied by the projected decline in the current account deficit, and with the rise in the investment rate needed to support sustained growth, public and private savings will need to rise faster than income and consumption. Continued efforts in several important areas will further improve public savings and the fiscal balance while financing a public expenditure program adequate to meet the needs of a growing economy and provide better opportunities for the poor. First, the Government's priorities in public resource mobilization need to be maintained. This includes raising non-oil tax revenues through continued improvements in tax administration, with a primary focus on the VAT, corporate and personal income taxes, and the property tax. Apart from their revenue potential, these taxes are also likely to have a positive effect on income distribution. Other areas for strengthening public resource mobilization include: (i) improving cost recovery from public services; (ii) reducing the financial burden of public enterprises through improvements in their financial and operating performance and selective divestiture; and (iii) strengthening local government finances. Second, continued implementation of the Government's efforts to reduce subsidies for fertilizer and oil will both release needed public resources for other priority purposes and improve resource allocation through better price signals. Finally, as outlined in Chapter 4, public expenditure programs will need to be carefully designed and focused on the main priorities, as set out in REPELITA V, of ensuring adequate infrastructure and services to support private sector growth and improving basic social services for the poor.

2.06 Monetary policy will need to be designed carefully to support growth while avoiding pressure on prices and the balance of payments. Given Indonesia's open capital account, domestic interest rates are closely tied to international interest rates and exchange rate expectations. This limits the ability of monetary policy to influence interest rates except possibly in the short run. An expansionary monetary policy designed to achieve low domestic rates would be self-defeating over the longer term, putting pressure on prices and the balance of payments. Coordinated monetary and fiscal policies, however, could work to lower inflation and expectations of exchange rate depreciation and thereby reduce the margin between domestic and international

interest rates. With the ongoing financial sector reform, the relationships between monetary variables can change rapidly, calling for close monitoring of developments so that timely action can be taken. The phasing out of liquidity credits announced in January 1990 is expected to lead to a tighter monetary stance and increase the effectiveness of Bank Indonesia's monetary instruments. Other components of the financial sector reforms are expected to improve the efficiency of credit allocation and to lower lending rates by reducing intermediation margins. Continued development of prudential regulations and supervision will strengthen the stability of the system.

2.07 A further increase in reserves to cope with unanticipated fluctuations would be supported by the strengthening of monetary policy mentioned above and would complement the overall macroeconomic strategy. Adequate reserves are particularly important for macroeconomic management given Indonesia's open capital account. Maintaining lines of untied commercial credit (currently about US$1.8 billion) is another cushion against unexpected developments. Another policy option to consider is the use of unanticipated gains from higher oil revenues to reduce borrowing and/or to accumulate fiscal reserves for the budget so that the fiscal balance can be improved and such windfalls used in an orderly and efficient fashion. The continued reduction in dependence on oil as a source of foreign exchange and fiscal revenues should add another element of increased stability to the economy as non-oil exports and non-oil fiscal revenues expand.

2.08 The remainder of this Chapter discusses the implications of the macroeconomic strategy for sustained growth and reduction in poverty. Sustaining growth, however, will require that sound macroeconomic management be accompanied by other measures to foster efficient private sector development and improve the efficiency and focus of key public sector programs. Those measures are discussed in Chapters 3 and 4.

C. The Medium-Term Macroeconomic Outlook

The External Environment

2.09 A major objective of the Government's adjustment program has been to improve the economy's capacity to withstand external shocks. As discussed earlier, the economy's dependence on oil has been substantially reduced and the export base has been expanded from a reliance on a small group of resource-based commodities to a broad range of agricultural, mining and manufacturing products. Even so, Indonesia's economic fortunes remain strongly linked to conditions in the world economy, particularly the oil market. Table 2.1 summarizes the key external assumptions underlying Indonesia's medium-term prospects presented in this section.

2.10 Since 1983, economic activity in OECD countries has increased by 3.6% p.a. In the near term, economic activity is expected to slow down in the early 1990s, although the G-5 countries are not expected to go into a recession. By the mid-1990s, however, growth in the industrialized countries is expected to reach and be sustained around 3% p.a., based upon the efficiency improvements embodied in the investment boom of the late 1980s and the gradual reduction of large external and internal balances in the

industrialized countries, particularly the United States. Any financial turbulence caused by the adjustment, is expected to be short-lived, not depressing economic activity over a sustained period. With gradual adjustment, real interest rates are projected to decline during the 1990s, with the real rate on six-month dollar deposits (LIBOR) falling from 4% in 1990 to 3% in 2000. The average for the 1990s would be 3.3%, substantially below the 5.3% average for the 1980s. Exchange rate movements are also expected to abate somewhat.

Table 2.1: SELECTED INDICATORS OF INTERNATIONAL ECONOMIC ACTIVITY: 1989-2000

	Estimated	Projected /a				Growth Rate (% p.a.)		
	1989	1990	1991	1995	2000	1989-1990	1990-1995	1995-2000
Economic activity								
G-5 growth (% p.a.)/b	3.4	2.3	2.6	3.0	3.0	2.8	3.0	3.0
Price indices (1985=100)								
Commodity prices in constant dollars /c	86.7	75.5	n.a.	75.8	76.8	-12.9	0.1	0.3
Manufacturing unit values in current dollars	137.6	144.4	151.5	183.7	220.1	4.9	4.9	3.7
Oil prices (US$/barrel)								
In 1985 dollars /d	11.9	11.3	11.3	12.0	15.3	-5.0	1.2	5.0
In current dollars /e	17.9	16.5	17.5	22.0	33.7	-0.8	6.2	8.9
Interest rates (%)								
LIBOR /f	9.4	9.1	8.7	8.0	7.5			
Real interest rate /g	4.1	4.0	4.7	4.0	3.0			

/a End of period.
/b Weighted average of real growth rates for USA, UK, Japan, France and Germany.
/c Nominal price index for 33 commodities (excluding energy) deflated by the World Bank's G-5 manufacturing unit value (MUV) index.
/d Deflated by MUV index.
/e Prices are for the Indonesian fiscal year (April 1 - March 31).
/f Six-month US$ London Interbank Offered Rate (LIBOR).
/g LIBOR deflated by the changes in the US GNP deflator.

Source: World Bank staff estimates.

2.11 The short-term trend for oil prices is uncertain. After declining at the end of 1988, oil prices steadily recovered throughout 1989 and into the first quarter of 1990. Short-term prospects are for a softening of the oil market in mid-1990, causing prices to fall by US$1-2/bbl. This would result from the expected near-term slowdown in OECD's economic growth, restoration of production and export levels from non-OPEC sources (especially the United Kingdom and the USSR), and OPEC output remaining above the existing quota ceiling of 22.0 million bb/d. The present outlook, therefore, is for oil prices to average about US$16.5/barrel during 1990/91, which is about an 8% decline from the 1989/90 level. Over the medium t. m, the trend is more favorable with real oil prices expected to rise by about 3% p.a. during the 1990s. Even so, the projected oil price in 2000 is only 52% of the level of 1980, in real terms.

2.12 The short-term outlook for non-oil commodity prices is not bright. Prices of palm oil, coffee, rubber and tin are expected to decline in 1990 relative to 1989. This will lead to a slight decline in the terms of trade index (both the non-oil index and the total) for 1990/91. The medium-term outlook for non-oil commodity prices is better, but import prices are also expected to keep pace. As a result, the non-oil terms of trade index is projected to show an improvement of only about 1% p.a. for the 1990s (see Table 2.2). But including oil, the overall terms of trade index will rise by 2.6% p.a.

Table 2.2: INDONESIA'S TERMS OF TRADE, 1988/89-2000/01
(1983/84=100)

	1988/89	1989/90	1990/91	1995/96	2000/01	Rate of Growth (% p.a.) 1990/91-1995/96	1995/96-2000/01	1990/91-2000/01
Export price index								
Total exports	85.3	91.8	93.0	134.3	181.0	7.6	6.2	6.9
Non-oil exports	124.8	124.5	126.2	171.6	206.1	6.3	3.7	5.0
Import price index								
Total imports	123.0	125.7	131.7	165.5	198.7	4.6	3.7	4.2
Non-oil imports	121.9	124.8	130.8	164.2	197.3	[illegible].7	3.7	4.2
Terms of trade index								
Total	69.6	73.0	70.6	81.2	91.1	2.8	2.3	2.6
Non-oil	102.3	99.8	96.5	104.5	104.4	1.6	0.0	0.8

Source: World Bank staff estimates.

2.13 Despite the expected sluggish growth in the non-oil terms of trade, as Indonesia enters the 1990s, the outlook for the external environment appears to be favorable. Oil prices are expected to grow from the depressed level of the 1980s; real interest rates are projected to decline and display a more stable trend; and world economic activity is likely to be sustained at about 3% p.a. These favorable trends should present Indonesia with an opportunity to sustain a higher level of economic growth, than was achieved during the 1980s.

Macroeconomic Projections

2.14 This section provides illustrative macroeconomic projections based on the external environment described above and on the Government implementing its macroeconomic strategy as described in Section B. In the near term, economic activity is expected to slow slightly in comparison to the rapid pace of 1989 (see Table 2.3). This moderation in economic activity will result from: (a) stagnant oil production due to capacity constraints; (b) a leveling off of rice production after a bumper harvest in 1989; and, (c) a gradual decline in the rate of growth of non-oil manufacturing and exports from the extraordinary levels of the last several years. Moreover, infrastructural constraints in supporting services, particularly power, telecommunications and transport, may act to limit growth in the near term.

Table 2.3: BASE CASE - SELECTED ECONOMIC INDICATORS, 1983-2000 /a

	Actual 1983-88	Estimated 1989	Projected 1990	1990-95	1995-200
Average real growth rates (% p.a.) /b					
Gross national income (GNY)	3.8	7.8	6.1	6.4	6.1
Gross domestic product (GDP)	5.1	7.4	6.0	5.6	5.5
Non-oil GDP	5.9	8.1	7.0	6.6	6.4
Non-oil exports /c	12.7	15.9	15.9	8.1	6.9
Non-oil imports /c	-4.9	18.2	10.7	8.6	6.3
Fixed investment	-1.0	13.0	12.0	8.6	6.4
- Public	-4.3	6.2	4.1	8.4	6.4
- Private	1.6	17.7	16.8	9.0	6.4
Consumption	4.0	6.5	5.0	5.5	5.9
Structure of the economy (%) /d					
Non-oil manufacturing/GDP /e	13.7	14.3	15.2	18.4	21.7
Non-oil exports/non-oil imports /f	89.7	85.8	86.9	91.7	94.5
Public savings/GDP	5.5	6.2	6.4	8.7	9.1
National savings/GDP	20.0	21.3	22.2	25.6	26.5
Fixed investment/GDP	20.0	21.1	22.4	25.3	25.8
Private fixed investment/total fixed investment	55.7	59.4	61.0	60.4	60.5
Consumption/GDP	74.4	73.3	72.8	70.4	70.2
Macroeconomic balance (%) /d					
Current account/GNP	-2.2	-1.9	-2.1	-1.4	-1.0
Non-interest current account/GNP	2.3	2.4	2.1	1.6	1.1
Overall public sector balance/GDP	-3.4	-2.2	-2.4	-1.5	-1.0
Public sector primary balance/GDP	-0.4	0.6	0.4	0.5	0.5
MLT debt service/exports	36.1	32.1	33.0	21.8	16.8
MLT debt/exports	218.6	189.0	177.6	130.7	99.7
MLT debt/GNP	61.0	54.7	52.3	43.6	33.2

/a Balance of payments and fiscal data are for fiscal years (starting April 1). Other indicators are for calendar years.
/b Based on revised national accounts.
/c Goods only.
/d End of period; in current prices.
/e In constant 1983 prices.
/f Goods only; in current dollars.

Source: Central Bureau of Statistics and World Bank staff estimates.

2.15 Throughout the 1990s, the rate of growth of non-oil GDP will be sustained at 6-7% p.a. This growth is fuelled by improvements in productivity resulting from structural reforms and a strong investment effort. Non-rice agriculture, non-oil manufacturing and non-oil exports will provide the main stimuli to future growth. Substantial buildups of production capacity in the

agriculture and manufacturing sectors, as well as supporting improvements in economic infrastructure are incorporated in the base scenario projections. As a result, it is estimated that the rate of fixed investment grows quite rapidly (about 7-8% p.a.), reaching about 26% of GDP by 2000, an increase of 5 percentage points of GDP. To finance this increase, the growth of national savings will need to keep pace with investment. This would reflect in part a strong public resource mobilization effort. The economy is also expected to continue the process of structural change, which began in the mid-1980s, with the share of non-oil manufacturing increasing from about 14% of GDP in 1988 to nearly 22% in 2000. This growth path will allow Indonesia to absorb its burgeoning labor force at rising levels of productivity and income and achieve a sustained rise in per capita consumption, while the burden of external debt eases considerably.

2.16 External balance. The performance of non-oil exports since 1986 has allowed Indonesia to make considerable progress towards reducing external imbalances and lowering the debt service ratio, despite larger debt service payments and lower oil prices. The strong non-oil export performance continued in 1989/90, with non-oil exports reaching an estimated US$14.1 billion, which represents about a 16% rise in real terms (see Table 2.4). The strength of the private sector's response to deregulation is also shown by a surge in intermediate and capital goods imports; in aggregate, non-oil imports rose by about 21% in value terms in 1989/90. As a result, the current account deficit declined only slightly to US$1.7 billion (about 1.9% of GNP compared to 2.2% in 1988/89). Over the medium term, these imports of capital goods will lead to a strengthening of the balance of payments position, since private sector investment is increasingly directed towards export-oriented activities. However, the continuation of strong import growth, reflecting high levels of private sector investment and further progress on trade and industrial deregulation, will contribute to a slight widening of the current account deficit to US$2.0 billion, about 2.1% of GNP in 1990/91. A second contributing factor is the expected decline in oil prices from US$17.9 per bbl to US$16.5 per bbl. The widening of the current account deficit in 1990/91 illustrates the need for the Government to monitor trends in the balance of payments closely, especially in the near term, and to exercise prudent fiscal, monetary and exchange rate policies. A recovery in oil prices, rapid growth of non-oil exports and the resumption of more normal import growth are projected to reduce the current account deficit in 1991/92 to US$1.7 billion (1.6% of GNP). An important assumption underlying the projections is that progress is made in reducing the oil subsidy, thereby slowing domestic consumption and raising the volume of oil exports. Without progress in this area, oil exports will decline and the positive effect of higher oil prices over the medium term will be partially lost.

2.17 Over the medium term, management of the balance of payments will require a careful balancing between the growth required to absorb the labor force at increasing levels of productivity and the need to achieve further improvement in Indonesia's debt service burden. Monetary and fiscal policy will have an important role in achieving these objectives. To support the economic growth envisaged under the base case, non-oil imports will have to grow at about 7-8% p.a. in real terms during the 1990s. High investment outlays by both the public and private sector, and the increasing demand for raw materials in exporting sectors will be the principal sources of import growth during this period.

Table 2.4: BALANCE OF PAYMENTS, 1989/90-2000/01
(US$ billion)

	Estimated	Projected			
	1989/90	1990/91	1991/92	1995/96	2000/01
Gross merchandise exports (fob)	23.4	25.1	28.5	44.5	71.0
Oil and LNG	9.3	8.5	9.2	11.3	15.3
Non-oil	14.1	16.6	19.3	33.2	55.7
Gross merchandise imports (cif)	-19.0	-21.4	-24.3	-39.5	-64.4
Oil and LNG	-2.6	-2.3	-2.5	-3.3	-5.4
Non-oil	-16.4	-19.1	-21.8	-36.2	-59.0
Trade balance	4.4	3.7	4.2	5.0	6.6
Net non-factor services	-0.9	-0.8	-0.9	-1.0	-0.9
MLT interest payments	-3.1	-3.3	-3.2	-3.8	-4.5
Other factor services and transfers (net)	-2.1	-1.6	-1.8	-2.3	-3.7
Current account balance	-1.7	-2.0	-1.7	-2.1	-2.5
Public MLT loans (net)	1.6	1.5	1.8	2.1	2.0
- Disbursements	6.1	6.2	6.4	6.8	7.6
- Principal repayments	-4.5 /a	-4.7	-4.6	-4.7	-5.6
Other capital (net)	-1.0	1.4	1.5	1.9	3.3
Use of net foreign assets	1.1	-0.9	-1.6	-1.9	-2.8
Memo items:					
Net official reserves /b	5.7	6.5	7.6	14.5	29.8
Net official reserves (in mons. of imports) /c	3.2	3.2	3.3	4.0	5.0
Total net foreign assets	9.5	10.4	12.0	19.5	31.6
Current account/GNP (%)	-1.9	-2.1	-1.6	-1.4	-1.0
Non-interest CA/GNP	2.4	2.1	2.1	1.6	1.1
MLT debt service/exports (%)	32.1	33.0	28.8	21.8	16.8

/a Includes prepayments of US$300 million.
/b Net official reserves are defined as gross official reserves minus outstanding liabilities to the IMF and other short term liabilities.
/c Net official reserves in months of next years's expected imports (oil/LNG and non-oil) of goods.

Source: Bank Indonesia and World Bank staff estimates.

2.18 To reconcile the growth and external targets, non-oil exports will have to grow at around 8% p.a. throughout the 1990s. This will require maintaining the competitiveness of the exchange rate, and reducing the domestic cost of production through continued deregulation of trade policy,

local level regulations and supporting services. The prospects for Indonesia's non-oil exports remain bright for three reasons. First, import growth in Indonesia's major trading partners is expected to be robust over the medium term. Second, Indonesia's share of the market for most manufacturing products (excluding plywood and textiles) is still small, leaving room for expansion. Finally, in the last several years, there has been a large increase in investment, particularly in export-oriented, manufacturing industries. Capacity in existing export industries has expanded and investments in new, manufacturing export industries by small- and medium-scale entrepreneurs have also grown dramatically. Data obtained from the Investment Coordinating Board (BKPM) on recent investment approvals for foreign and domestic investment also indicate that these investment outlays are being increasingly directed into export-oriented activities, particularly in textiles, agroprocessing and wood processing industries. Accordingly, the base case assumes that non-oil exports will increase rapidly in the next three years (about 11% p.a.), but then are expected to slow to about 7% p.a. over the medium term (see Table 2.5).

Table 2.5: PROJECTIONS OF NON-OIL EXPORT GROWTH
(real growth rates, % p.a.)

	Actual		Projected	
	1983/84-1988/89	Estimated 1989/90	1990/91-1992/93	1992/93-2000/01
Non-oil manufactures	26.0	25.7	16.1	8.2
Textiles	31.6	17.9	14.8	8.4
Plywood	21.8	6.7	7.5	2.6
Other	31.6	51.8	21.1	9.9
Primary commodities	5.1	5.2	2.3	5.2
Metals and minerals	6.7	12.6	7.4	5.0
Total non-oil exports	12.7	15.9	11.3	7.1

Source: Bank Indonesia and World Bank staff estimates.

2.19 The implications of these balance of payments trends for external financing requirements and the external debt situation are discussed in Section E below. In brief, there are several important implications of the base case scenario. First, Indonesia will continue to require substantial amounts of official assistance to finance priority public investments in support of higher economic growth and poverty reduction. Special assistance will be needed, for at least one more year, to manage with confidence the rise in imports resulting from the faster pace of economic growth and trade policy deregulation. Second, there is likely to be a substantial increase in private sector debt associated with the ongoing investment boom. While the effect of this trend is expected to remain manageable, Indonesia needs to monitor

carefully trends in private sector indebtedness as this can affect Indonesia's creditworthiness. Third, given the projected growth in non-oil exports, the debt service ratio for public and private medium- and long-term debt (MLT) declines from 36% in 1988 to 22.3% in 1995 and to 17.1% in the year 2000. Similar declines are also achieved in the Debt/Exports and Debt/GNP ratios, indicating a substantial improvement in Indonesia's creditworthiness. Finally, the projected increase in net official reserves would provide Indonesia with the flexibility to respond to external shocks without unduly disrupting economic growth.

2.20 Internal balance. Reducing the current account deficit to more sustainable levels over the medium-term will require that savings increase faster than investment. Even allowing for gains in economic efficiency, the rate of fixed investment will need to expand from 21% of GDP currently to about 26% of GDP by 2000 to support the projected growth rate. These trends imply that investment and saving will have to grow faster than output and consumption. This expansion in investment is particularly important given the low rates of investment, especially public investment, during the adjustment period. To support economic growth during the 1990s, critical investments are needed in supporting infrastructure (e.g., power, telecommunications, roads and ports). Substantial amounts of private investment will also be required to create the capacity for non-oil exports. To achieve this projected expansion of private investment, further progress with trade and industrial sector reforms, as well as improvements in the financial sector, will be essential to enhance the profitability of private investment. Macroeconomic policy will also be important in maintaining an environment conducive to private sector investment, as it affects expectations regarding exchange rates, interest rates and inflation. In order to finance this higher level of investment activity while reducing the current account deficit, national savings will need to rise from 21% of GDP in 1989 to about 27% in 2000. Part of the increase in national savings will be achieved through an increase in private savings. Household savings are expected to improve with sustained higher economic growth, while business savings will respond positively to higher profitability. However, these factors alone will not be adequate to achieve the required increases in national savings; public savings will need to increase to achieve the savings target.

2.21 The conduct of fiscal policy during the 1990s, therefore, will be crucial to the success of this macroeconomic scenario. Additional public resources will need to be mobilized to offset the expected phasing out of special assistance, as well as finance an increase in the investment rate to support higher economic growth and poverty reduction. Furthermore, budgetary resources also need to be raised to meet Indonesia's substantial debt service obligations. The focus of fiscal policy appears to be moving in the appropriate direction with the Government's intention to reduce budgetary subsidies, increase non-oil tax revenues, and improve the finances of public enterprises. The increase in non-oil tax revenues is expected to be derived primarily from improvements in tax administration and a strengthening of local government finances; these measures are discussed in greater detail in Section D below. Enhancing the contribution of public enterprises to public resource mobilization will need to be achieved through improvements in their financial and operating performance (see Chapter 4 for a detailed discussion of public enterprises). Based on these public resource mobilization measures, the projected economic growth and higher oil prices, the public savings rate is expected to grow from 6.2% of GDP in 1989/90 to 9.1% by 2000/01.

2.22 The likely improvements in public resource mobilization will be adequate to allow a growth of real public investment of about 7% p.a. during the 1990s, which should be sufficient to achieve the Government's expenditure priorities. Given the projected progress in resource mobilization, this rate of expansion of public expenditures, would enable an expanding role for the private sector while maintaining macroeconomic stability. It should also permit the systematic strengthening of implementation capacity. The policy challenge for the public sector will be to provide sufficient complementary resources to support private sector growth and poverty reduction while containing the level of public expenditures to preserve macroeconomic stability and ensure adequate resources for the private sector. This would imply focussing the public sector investment effort on basic infrastructure (power, roads, and telecommunications) and essential social services (health, basic education, water supply and sanitation, and kampung improvement), which are largely complementary rather than competitive with private activities. Expenditure priorities are explored in greater depth in Chapter 4.

2.23 The pace and pattern of economic growth. The expansion of non-oil exports and the substantial production capacity which will be put into place in the early 1990s will allow the non-oil economy to grow by 6-7% p.a. (see Table 2.6). The main factors supporting this growth are: (i) the higher level of private investment in the late 1980s which has created substantial export capacity in existing export industries and significantly broadened the base of the manufacturing sector into a number of new activities; (ii) higher levels of public sector investment which are expected in such critical areas as transport, telecommunications, and energy in order to support the growth of private sector activities; and, (iii) the external environment which will be relatively favorable with strong import growth in the economies of Indonesia's major trading partners. Underlying this projection is the assumption that the remaining reforms in the incentive framework are implemented in the early 1990s in order to ensure that private sector investment reflects an appropriate set of incentives.

Table 2.6: GROWTH AND COMPOSITION OF GDP, 1983-2000 /a

	Growth Rates (% p.a.)				Share in GDP /b	
	1983-88	1988-90	1990-95	1995-2000	Estimate 1989	Projected 2000
Non-oil GDP	5.9	7.6	6.6	6.4	81.2	89.8
Agriculture	3.5	3.9	3.5	3.5	20.5	16.4
Manufacturing	12.4	12.1	9.7	9.0	14.3	21.7
Services, etc.	5.5	7.8	6.8	6.4	46.4	51.7
Oil/LNG	2.0	2.8	0.4	-0.9	18.8	10.2
Total GDP	5.1	6.7	5.6	5.5	100.0	100.0

/a Based on revised National Accounts Statistics.
/b In 1983 prices.

Source: Central Bureau of Statistics and World Bank staff estimates.

2.24 At the sectoral level, the primary impetus to economic growth is provided by the non-oil manufacturing sector. This sector is projected to grow in excess of 9% p.a. during the 1990s, raising manufacturing's share of GDP to almost 22% by the year 2000. Given that the ongoing program of trade and industrial deregulation will enhance profitability in efficient export industries which are relatively labor intensive, manufacturing growth will also make an important contribution to employment growth. Agriculture will continue to increase by 3.5% p.a., the same pace as during the 1980s. The pattern of agricultural growth is likely to change gradually over this period. Increases in rice production, which made a major contribution to growth in both output and employment in the past, are likely to decelerate somewhat in the 1990s. Other activities, such as non-rice food crops, smallholder tree crops, and other non-food farm activities will grow more rapidly (especially on the Outer Islands). However, this pattern of agricultural development needs to be supported by policies that encourage farmers to raise their productivity and diversify their production within an efficient cropping system. This will involve bringing the pattern of input and output prices more closely in line with world prices, improving rural infrastructure, providing more responsive research and extension services, and reducing regulatory restrictions. There also exists substantial untapped potential for the development of agribusiness to increase value added of agricultural sector output. Although agriculture's share of GDP is expected to decline to about 16% by 2000, its role in employment creation will continue to be significant. Finally, the construction and services sectors will increase in line with overall economic activity during the 1990s. Infrastructure-based services, such as telecommunications, electricity and transport, will need to grow rapidly to avoid infrastructural bottlenecks which could slow growth in the industrial and agricultural sectors. Tourism, in response to recent deregulation measures and an intensive Government promotional campaign, will also increase rapidly during the 1990s. The contribution of the oil/LNG sector to the Indonesian economy is projected to gradually decline in the years ahead, although an increased pace of exploration activities, if successful, could lead to higher growth from this subsector, which would push GDP growth above the levels projected in the base scenario.1/

Implications for Employment and Sustained Poverty Reduction

2.25 During the 1990s, meeting the employment challenge and reducing further the incidence of poverty are central concerns of Indonesia's development strategy. There are three important aspects to the employment challenge in Indonesia: (i) the labor force is projected to grow very rapidly with an average of 2.4 million persons entering the labor market annually; (ii) open unemployment, which has traditionally been very low in Indonesia, is high among secondary and university graduates between the ages of 15 and 24, particularly in urban areas;2/ and (iii) the percentage of the labor force

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1/ Oil exploration was very low in 1986 and 1987, and increased only slightly in 1988; however, exploration activities began to rise in 1989. Recently, there have been several major finds.

2/ The rate of unemployment in urban areas for persons between the ages of 15 and 24 was 22.5% and in rural areas, only 4.1%. These data can be compared with an economy-wide unemployment rate of 2.6%.

that is underemployed as measured by those working less than 35 hours per week was estimated at 42% in 1987.3/ Moreover, despite the substantial progress achieved during the 1980s, Indonesia needs to continue to make progress in reducing the incidence of poverty, as about 30 million persons remain below the absolute poverty line and a significant number of Indonesians, the "near poor", have incomes only slightly above the poverty line. The poverty problem is also characterized by considerable regional variation, with the prevalence of poverty relatively high in the eastern areas of Indonesia. The macroeconomic strategy outlined above is designed to enable Indonesia to address these employment and poverty challenges.

2.26 The projected pace and pattern of economic activity, coupled with complementary specific programs and policies, should allow Indonesia to absorb its expanding labor force at higher levels of productivity and income (see Table 2.7). While a strong agricultural sector will be essential to absorb a large proportion of the incremental labor force, the manufacturing sector will need to play a dynamic role in absorbing a much larger proportion of new employment than in the past. Again, this underlines the importance of expanding manufactured exports and maintaining the policies necessary to induce this expansion. The projected rate of growth of output and investment will also spur growth in the services sector. The experience of other countries in East Asia, such as Korea and Thailand, indicate that productivity in the service sector is closely linked to progress in industry and

Table 2.7: PROJECTED EXPANSION OF EMPLOYMENT AND LABOR PRODUCTIVITY

	1990-2000						
	Annual Increment (millions of persons)	Growth Rate (% p.a)		Share in Employment (%)		Average Labor Productivity (Rp. million)	
		Value Added	Employment	1990	2000	1990	2000
Agriculture	0.69	3.5	1.6	53.1	47.2	0.58	0.63
Manufacturing	0.67	9.4	6.5	9.8	13.9	2.44	2.79
Other services	1.08	6.6	3.3	37.1	38.9	1.45	1.66
Total non-oil	2.44	6.5	2.8	100.0	100.0	1.32	1.57

/a The projections of labor force and employment are based on the 1987 Labor Force Survey (SAKERNAS). GDP data are based on the revised national accounts series.
/b At 1983 prices.

Source: World Bank staff estimates.

3/ This figure may considerably overstate the true extent of underemployment, as the 1982 SUSENAS found that only a small proportion of those working less than 35 hours per week in rural areas indicated that they would be available for extra work.

agriculture. The projected level of economic activity is, therefore, likely to lead to improved earnings for workers currently engaged in low-wage activities, as well as generate additional productive employment opportunities in the sector. Continued deregulation in transportation and other services, as well as a strengthening of financial services, will be critical in this regard. Furthermore, the attitude of local governments towards service sector activities will also be important, as regulations and restrictions on informal traders and transportation could inhibit growth in services, which would have an adverse effect upon employment, particularly for the poor.

2.27 Achieving this pace and pattern of economic growth could also have a dramatic effect on the incidence of absolute poverty in Indonesia. Assuming that the elasticity of poverty reduction with respect to economic growth remains unchanged throughout the 1990s from its level during the 1976-87 period, the incidence of poverty would decline from about 17% in 1987 to slightly less than 9% by the year 2000. As a result, the number of absolute poor in Indonesia in the year 2000 would be 20 million (the total population is estimated at 213 million in the year 2000). This would imply an absolute decline of about ten million persons from the 1987 level.

2.28 These projections are, however, illustrative. As the number of poor decline, the poor are becoming more concentrated in remote areas and in areas with less productive resource bases, thus becoming harder to assist. Therefore, sustaining reductions in the incidence of poverty of these magnitudes will also require specific measures to improve labor absorption in the services sector, boost employment prospects in the Outer Islands (particularly the eastern part of Indonesia), and target public expenditures, especially in social and basic services and smallholder agricultural support services, into those areas of greatest potential benefit to the poor. Several principles will need to guide the introduction of these types of measures. First, over the long term, income and employment generating programs should be sustainable and direct income transfers are often not sustainable. Second, targeting is necessary to ensure that the programs actually reach the intended beneficiaries, thereby minimizing the leakage of benefits to the less needy. And finally, these programs are likely to be most effective if they are an integral part of an overall development strategy.

2.29 In this regard, several measures could be considered by the Government.4/ First, providing the poor and underemployed with greater access to Indonesia's available land resources and improved agricultural technology can make an important contribution. In the Outer Islands, there is a substantial amount of underutilized and degraded land that could potentially be made available. Much of this land is suitable only for activities such as tree crops, which require a relatively high degree of infrastructure and inputs, including appropriate financing. Second, Central Government transfers to local governments are another vehicle to stimulate income-generating activities and employment particularly in poorer areas. The INPRES program is a potentially important instrument in this regard, and there may be scope for targeting these expenditures more effectively to poorer areas. In the 1990/91 budget, the Government made important steps in this direction through

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4/ A detailed formulation of a strategy for poverty reduction is contained in Indonesia: Poverty Assessment and Strategy Report, Chapter II, op.cit.

modifications in the allocation criteria for the general INPRES, but further action may be warranted. Finally, specific measures to increase employment and incomes also need to be supplemented by measures to target human resource development towards the poor. This would have both an investment effect, in the form of augmenting the human capital of the poor leading to increased productivity and incomes, and a consumption effect, by improving present welfare. This is true for the social services--health, education and nutrition--as well as other basic services--water supply, sanitation and related infrastructure--which directly affect living conditions and hence health status. Priorities for public expenditures in these areas are discussed in Chapter 4.

Risks and Uncertainties in Prospects

2.30 In general, Indonesia's medium-term prospects described in Table 2.3 could be adversely affected by three types of risks: (a) an undermining of financial stability through excessive expansion of the economy; (b) a slower pace of domestic reforms; and (c) a deterioration in the external environment. The Government's record on economic management, including ongoing reforms and the recognition by policymakers of the need to maintain macroeconomic stability because of Indonesia's high level of indebtedness, indicates that the risks from these sources are relatively low for Indonesia. The most significant risk arises from the external environment. Given its structure and openness, Indonesia is vulnerable to an array of external factors including oil prices, exchange rates, other commodity prices, world trade, and interest rates. The existence of these uncertainties underscores the need to sustain the momentum of policy reform, diversify sources of foreign exchange and fiscal revenues, build up reserves and maintain a prudent external borrowing strategy.

2.31 Policy reforms and financial stability. Indonesia's economic prospects, particularly in the near term, are sensitive to assumptions concerning the performance of non-oil exports and public resource mobilization. The scenario presented above assumed continued policy reforms in trade and industry and further strengthening of the financial sector. An alternative scenario, without adequate policy improvements, would result in slower non-oil export growth. Moreover, without an appropriate incentive framework, private sector investment could be channelled into areas which are not economically viable over the medium term. Similarly, without determined efforts to increase public resource mobilization, the Government will not be able to finance the required investments in infrastructure without a deterioration in the fiscal balance. In the near term, these factors could undermine financial stability, which in turn, could result in slower per capita consumption growth, stagnant labor incomes, and inadequate progress on poverty reduction. Over the longer term, the growth prospects of the economy will be adversely affected, as there would be interruptions in the building of infrastructure and the establishment of non-oil export capacity. However, as long as the existing programs of reform are producing the kinds of positive results in exports and growth seen to date, there is little reason to expect a weakening in the Government's commitment to policy reform. Through continued implementation of structural reforms, a buoyant level of economic growth can be sustained, while financial stability is preserved and further progress is made towards poverty reduction.

2.32 Adverse external environment. A number of uncertainties cloud the outlook for the external environment. Sustained policy changes are required in industrialized countries to reduce existing macroeconomics imbalances and contain growing inflationary pressures. Without these policy actions, the 1990s could be characterized by slower economic growth, higher real interest rates and increased protectionism. Moreover, there are some downside risks in oil price projections, stemming from higher OPEC production. This could lead to a larger decline of oil prices in 1990/91 than envisaged in the base case scenario. To a limited extent, a loss of resources can be offset by drawing on the country's external reserves and pipeline of commercial credits. But, in the event of an unexpected major external shock, it would be important to move quickly to ensure that the current account deficit remains within manageable limits. This would require an acceleration of economic reform, as well as renewed stabilization efforts. A depreciation of the real exchange rate and tightening of monetary and fiscal policies would need to be accompanied by additional measures to improve competitiveness and promote investment in the non-oil tradeable sector. In the short term, economic growth would be lower than projected. However, growth would recover over the medium term supported by accelerated economic reforms. Under such circumstances it would be important that the donor community stand ready to support the Government's efforts with additional fast-disbursing assistance as needed, to smooth out the adjustment process. Indonesia's exposure to external shocks arising from fluctuations in oil prices and the availability of external finance, will diminish over the longer term, as the structure of the economy continues to shift away from dependency on oil. Thus, the nature of country risks will shift towards growth trends in industrial countries and access to export markets. This highlights the need to sustain progress in the reform of trade and industrial sector policies and in the strengthening of the financial sector, in order to diversify Indonesia's exports and import markets.

D. Public Resource Mobilization

2.33 As noted in Section C, the importance of public resource mobilization lies in the need to improve the fiscal balance (in order to maintain macroeconomic stability), and increase expenditures in certain priority areas such as physical infrastructure (to promote private sector development) and basic services (to help reduce the incidence of poverty). While a reallocation of expenditures towards higher priority areas can help, the scope for cutbacks in total expenditure is limited. The Government has generally maintained a cautious approach to public expenditures and the level of government spending in Indonesia remains broadly comparable to other Asian countries (see Table 2.8).

2.34 Despite the substantial progress made in resource mobilization over the past five years, particularly in 1989, Indonesia's tax effort still remains below that of other countries in the region, and there is room for further improvement. Therefore, the goal of raising public savings will need to be achieved largely through additional public resource mobilization. Greater public resource mobilization will primarily involve increasing non-oil tax revenues. In addition, strengthening local government finances, increasing the efficiency of public enterprises, and improving cost recovery

from public services will also be important. The rest of this section reviews issues pertaining to the Central Government's non-oil tax effort and local government finances. Public enterprise finance and cost recovery issues are discussed in Chapter 4.

Table 2.8: GOVERNMENT EXPENDITURE AND TAX EFFORT IN SELECTED ASIAN COUNTRIES, 1983-1988 /a
(% of GDP)

	Expenditure Ratio /b				Tax Ratio /c			
	1983	1985	1987	1988	1983	1985	1987	1988
ASEAN Region								
Korea	17.5	17.7	17.0	n.a.	16.7	16.0	15.3	n.a.
Malaysia	40.3	35.1	35.0	n.a.	19.7	17.0	13.1	n.a.
Thailand	19.3	20.5	18.0	17.1	14.6	14.7	14.9	16.2
Philippines	13.6	13.6	16.1	16.0	10.4	10.0	12.1	11.1
Indonesia /d	21.2	21.8	19.0	18.7	7.1	8.2	8.8	10.1
Other Asia								
Pakistan	19.5	19.6	21.8	26.2	12.9	12.2	13.2	13.6
India	17.8	20.8	21.0	16.1	7.5	8.1	8.4	8.5
Bangladesh	19.1	17.3	19.1	17.7	6.7	7.1	7.0	7.0

/a Central Government only.
/b Excludes amortization payments.
/c Excludes petroleum revenues.
/d Non-oil taxes expressed as a percentage of non-oil GDP.

Source: World Bank Country Economic Reports and International Financial Statistics, IMF.

Central Government's Non-oil Tax Effort

2.35 The Government has recognized the importance of mobilizing non-oil tax revenues, and has already undertaken significant measures to improve performance. Based on a major tax reform in 1984-86, and subsequent improvements in tax administration, non-oil taxes of the Central Government were boosted from 7% of non-oil GDP in 1983/84 to 11% in 1989/90 (see Table 2.9). In raising these revenues, care has been taken to minimize the distortions and disincentives resulting from taxation. For example, the tax reform focussed on income and value added taxes rather than on international trade taxes; the tax system was greatly simplified with relatively low marginal rates; and the reform program removed most special tax incentives. The non-oil tax drive was further intensified in 1989/90, by extending the VAT coverage to the wholesale level and to most services, increasing the number of items in the luxury tax category and their rates, and strengthening audits for income taxes. These changes have led to a significant shift in the composition of non-oil taxes during the 1980s.

Table 2.9: INDONESIA'S TAX NON-OIL STRUCTURE, 1981/82-2000/01
(% of total non-oil taxes)

	Before Reform	After Reform		Projected		
	1981/82	1988/89	1989/90	1990/91	1995/96	2000/01
Income and property taxes	45.3	36.7	39.4	40.7	43.1	46.2
Value-added tax	16.4 /a	37.8	37.8	36.3	35.7	35.1
International trade taxes	20.5	11.3	11.4	11.5	11.6	9.2
Excise Tax	16.8	11.7	9.6	9.9	8.1	7.9
Miscellaneous	1.0	2.5	1.8	1.7	1.6	1.6
Memo item:						
Non-oil taxes (% GDP)	5.5	8.2	9.4	9.7	11.8	12.0
Non-oil taxes (% of non-oil GDP)	7.2	10.1	11.3	11.6	13.4	13.1

/a Refers to sales tax prior to reform.

Source: Ministry of Finance and World Bank staff estimates.

2.36 Given that the current tax rates and structure are broadly in line with the efficiency and equity aims of the tax reform, efforts to increase non-oil taxes in the near term need to be focussed on further improvements in tax administration, particularly in the area of income and property taxes, and the VAT. These improvements will be essential to realize the budget target of increasing the tax ratio by half a percent of non-oil GDP in 1990/91 and to make progress towards the goal of raising non-oil taxes to 13-14% of non-oil GDP by 1995/96.

2.37 Tax administration. The Government has made progress towards improving tax administration in three key areas: (i) an increase in tax registration and compliance; (ii) an improvement in the tax audit effort; and (iii) a reorganization of the Tax Directorate. Several steps have been taken to improve tax registration and compliance. First, a tax registration campaign that aims to disseminate information to the public has been sustained since 1986. Second, the number of taxpayer offices has been raised from 69 in 1983/84 to 120. Third, the Government has implemented measures to improve its information base at the district level in order to increase the number of registered taxpayers. These efforts are being reinforced through a cross-checking system: telephone and electricity bills are required to carry a taxpayer's identification number in order to identify potential taxpayers; trade and industry data are used to identify companies; and for the VAT, a cross-checking system between buyers and sellers to verify claims for refunds is being planned. The Government's enforcement efforts have also been intensified. A payment control system which computerizes all incoming payments and shows individual taxpayer's liabilities at any point in time has been set up in five districts of Jakarta. The system allows precise

monitoring of tax payments due, and facilitates a systematic follow-up in cases of non-compliance. The Government plans to extend this system throughout Jakarta by 1991. In addition, implementation of penalty measures for non-compliance has been strengthened, including the confiscation of corporate property. As a result of these initiatives, there has been some improvement in tax compliance (see Table 2.10).

Table 2.10: TAX COMPLIANCE INDICATORS, 1983-89 /a

	No. of Registered Taxpayers				Filing Ratio /b	
	1983	1987	1988	1989	1987	1988
	-------- (000's) ---------					
Personal Income Tax /c	327.5	674.5	703.1	780.3	64.0	72.8
Corporate Income Tax	83.6	178.1	191.8	210.1	43.8	57.4
Value Added Tax (VAT)	n.a	80.4	86.0	133.1	42.0	43.9

/a End of year figures.
/b Ratio of filed returns to number of registered taxpayers.
/c Excludes personal income taxpayers on whose behalf personal income tax was withheld and the withholding represented the final tax liability.

Source: Ministry of Finance.

2.38 A second area of improvement in tax administration has been the enhancement of the tax audit effort, especially for corporate income taxes. Although direct evidence on the additional revenue from this audit effort is not available, the expected revenue outcome from income taxes in 1989/90, much in excess of the growth of non-oil GDP, suggests that the audit effort is having a noticeable effect.

2.39 Finally in 1989/90, the Tax Directorate was reorganized along functional lines. Under the new organization, audit and enforcement functions have been taken out of the district level offices and centralized in the Tax Directorate. By separating operations, evaluation and enforcement functions, the reorganization aims at clearly defining areas of management responsibility, enhancing the expertise of both staff and management in their trained areas, and simplifying communications. The implementation of the reorganization has proceeded well at the management level, but there is a need to strengthen the delivery of services at the district level.

2.40 These are notable achievements and maintaining this effort will be essential. A key priority is to strengthen the audit effort especially for corporate and personal income taxes, as well as for the VAT. The Government's recent steps to establish audit offices at the district level, introduce a comprehensive audit selection mechanism, and increase the number of trained auditors to 1,000 are important indicators of progress. Nevertheless, a strengthening of the institutional capacity to undertake systematic and comprehensive audits is essential. Since the supply of auditors is still significantly below that required, adequate budgetary support for training, both through the foreign and national training programs, needs to be provided.

Some modification of the job rotation policy, which allows tax auditors to be assigned to non-auditing duties is also required. One possibility is to limit rotations to similar functional duties. The scope of the audit effort, which has focussed on income taxes needs to be extended to the VAT. The Government is planning to address this problem by issuing new directives that will require VAT taxpayers to report their cumulative tax liability along with their monthly obligations. Total VAT paid will then be reflected in the monthly return filed at the end of the fiscal year, providing a basis for yearly audits.

2.41 Despite the progress in increasing personal income tax compliance, the amount of revenue remains below potential mainly because the number of registered taxpayers (including those for whom tax is withheld) is significantly below potential. At present, urban wage earners in the organized sector constitute the bulk of income taxpayers. The recent decision to raise the family level exemption from Rp.2.9 million to Rp.4.3 million will result in a reduction in the number of wage earners who pay withholding tax. Income tax collection will, therefore, fall unless there is a corresponding effort to increase the number of self-employed taxpayers, raise the filing ratio, and strengthen income tax audits. Similarly, tax compliance for corporate and value added taxes needs to be improved. Effective implementation of the registration drive described above will be a major determinant of this progress. Another prerequisite for achieving these improvements in tax compliance is the systematic application of legal sanctions for tax evasion. More extensive use of the confiscation of property and stiffer penalties, along with more vigorous monitoring of tax compliance, could help improve non-oil tax performance.

2.42 Finally, the effectiveness of the reorganization of the Tax Directorate could be improved by streamlining operations at the district level. At present, a key aspect of the work at the district level is to prepare reports for management review. As progress in implementing the payments control system is made, the reporting function is becoming much less useful. Similarly, the guidelines for report preparation are not well defined, resulting in excessive reporting. These examples illustrate the need for setting priorities and presenting clear guidelines for district level offices. At the same time, quality of staff, especially at the district level, remains a major concern. There is a clear need to strengthen the training effort along with progress in streamlining the district level functions.

2.43 While the priority for the next 2-3 years is to continue efforts to improve tax administration, there may be a need to consider some increases in the tax rates or base over the medium term. One option for consideration is extension of the VAT to the retail level. Experience with extension of the VAT to the wholesale level suggests that a strengthening of the administrative capacity would be an important prerequisite for implementing this measure.

Strengthening Local Government Finances

2.44 Local governments are playing an increasingly larger role in the implementation of public expenditure programs, and the Central Government intends to continue to devolve responsibility over the medium term. However, resource mobilization by local governments has not been commensurate with

these trends despite the constraints on the Central Government budget. To support the decentralization policy as well as to increase available resources, there is a need to strengthen the resource mobilization efforts of local governments.

2.45 The major source of revenue available to the local government is the land and building tax (PBB) introduced in 1986 as a replacement for the old land tax (IPEDA) and the net wealth tax (PPK). In line with the tax reform, it aimed to broaden the local government's tax base and simplify tax administration. The property tax is also a potentially important tool for promoting equity through fiscal policy. Under the PBB, a flat rate of 0.5% tax is imposed on the market value of land and buildings. Since the official assessment ratio is 20% of the market value, the present effective tax rate is 0.1%. Additional revenues from the PBB can, therefore, be raised through an increase in the official assessment ratio as well as through an increase in the market valuation of the property. The Government's present focus, appropriately, has been on establishing a valuation standard for properties and on improving staff training in property valuation. Two pilot programs have been initiated: one to revalue urban properties and increase the registration of properties in three pilot cities; and a second to introduce a new payments system in Tangerang. This new payment system is expected to be extended to 12 other cities over the next two years. The Government is also working to strengthen its enforcement efforts, and penalties for non-compliance are now being applied, including the confiscation of properties.

2.46 Although revenues from property taxes have grown significantly from Rp.190 billion in 1985/86 to Rp.590 billion in 1989/90, revenue yields in relation to the potential, remain very low. The Government intends to step up its effort in this area, by extending the pilot schemes to other parts of the country. Over the medium term, however, the full potential of the property tax will be realized if, in conjunction with measures to improve tax administration, the effective tax rate on property is increased.

2.47 Other existing local taxes have smaller revenue potentials and administrative efficiency can be improved by eliminating those taxes that result in higher collection costs than revenue. At the same time, some broadening of the tax base may also be required. The Government is currently preparing draft legislation to improve local taxes. The speedy finalization and implementation of this legislation will be an important step in improving the finances of local governments.

Local Government Borrowing

2.48 So far, local borrowing has been confined to small loan schemes that are sponsored by the Central Government for specific projects. Recognizing the potential of the borrowing option as a means to ease the dependence of local governments on central government resources, a special fund, known as Regional Development Account (RDA), is being established under the management of the Ministry of Finance. This revolving fund would consolidate the existing channels of loans for urban infrastructure investments. The objectives of the RDA are to help: (i) rationalize the existing complex and fragmented pattern of regional government loan financing through a uniform set of audit and financial policies with independent analysis and monitoring; (ii) provide access to credit on market or near-market terms to local

governments with a capacity to service debt, and thereby strengthen the financial and economic viability of projects at the local level; and (iii) encourage local governments and enterprises to establish service charges on an increasingly cost-recovery basis, and thereby enable available grants to be targeted at the poorest regions. To realize the potential benefits of the RDA, care will need to be exercised to ensure that it starts on a sound basis along the lines of the objectives stated above. Thus, the long-term viability of this fund would depend on the consistent application of realistic market-based interest rates, project appraisal based on standard criteria, appropriate cost recovery measures, and appropriate procedures to enforce repayment. The ability of the RDA to provide technical assistance aimed at strengthening the capacities and responsibilities of the local governments would also be important in ensuring its effectiveness.

E. External Borrowing and Debt Management

2.49 Projections of Indonesia's external capital requirements and sources are based on the macroeconomic scenario presented in Section C (see Table 2.11). Although the current account deficit (as a percentage of GDP)

Table 2.11: EXTERNAL CAPITAL REQUIREMENTS AND SOURCES
(annual averages in US$ billion)

	Actual	Projected		
	1987/88-1989/90	1990/91-1991/92	1992/93-1995/96	1996/97-2000/01
Requirements	6.8	9.0	10.5	12.6
Current account deficit	1.7	1.9	2.0	2.3
(of which interest payments)	3.0	3.3	3.5	4.3
Principal repayments	5.2	5.9	6.6	7.8
Increase in net foreign assets	-0.1	1.2	1.9	2.5
Sources	6.8	9.0	10.5	12.6
Direct foreign investment	0.4	0.9	1.3	2.0
Disbursement of private MLT loans	1.0	1.9	2.5	3.5
Short-term and other capital (net) /a	-1.0	0.0	0.0	0.0
Disbursements of public MLT loans	6.4	6.3	6.7	7.1
of which:				
Project aid	2.6	3.1	4.2	4.4
Special assistance /b	1.6	0.7	0.0	0.0
Others /c	2.2	2.5	2.5	2.7

/a Includes errors and omissions, and valuation adjustments.
/b Fast-disbursing program aid and local-cost financing.
/c Import-related credits, untied commercial credits, and credits for LNG expansion, LPG and paraxylene projects.

Source: World Bank staff estimates.

declines steadily after 1990/91, the current account deficit is projected to rise slightly in absolute terms during the 1990s, reflecting higher growth than projected last year. Moreover, once allowance is made for rising debt service requirements (both interest and principal repayments) and the need to build up adequate reserves (in relation to the growing import requirements), the annual financing requirement is projected to continue rising, averaging US$9.0 billion in 1990/91 and 1991/92, about 32% higher than in the 1987/88-89/90 period.

2.50 An important change in the source of this financing is likely to occur during the 1990s, as an increasing share of this financing requirement is expected to be provided through private non-guaranteed capital flows--in the form of direct foreign investment and disbursements of private MLT loans. This change reflects the growing importance of the private sector in Indonesia's economy as a result of the ongoing regulatory reform and the non-oil export response. The potential strength of private capital inflows is reflected in the recent surge in private sector investment and in particular, foreign investment. Based upon this trend, the macroeconomic projections assume that private capital flows total about US$6.0 billion during 1988/89-91/92, with US$2 billion in direct foreign investment and US$4 billion in private non-guaranteed debt.5/ This is a significant increase over the levels realized during the 1980s. Over the medium term, private non-guaranteed debt and direct foreign investment are assumed to grow rapidly in line with expectations regarding future investment trends.

2.51 These levels of private capital flows have two important implications for Indonesia's macroeconomic situation in the 1990s. First, rapid progress on removing the remaining distortions in the policy environment is critical, in order to ensure that these capital flows are being used to finance economically viable and export-oriented projects. This is important because if some projects encounter debt servicing difficulties, the access to foreign loans of other private sector borrowers could be adversely affected. Second, the investment activities of state enterprises in joint ventures with the private sector need to be closely supervised, as foreign borrowing under these arrangements could develop into public sector liabilities. The existing guidelines that apply to the external borrowings of state enterprises need to be applied rigorously to all joint ventures with the private sector, regardless of the Government's equity position.

2.52 Despite the increasing importance of private capital flows, the lion's share of Indonesia's external financing requirements will have to be met by disbursements of public MLT loans over the next two years. About half of these disbursements are expected to come from existing commitments. The outstanding balance of undisbursed commitments has declined relative to previous years, because of lower project aid commitments and higher

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5/ These flows are estimated from data collected by Bank Indonesia on the planned financing of foreign investment which indicate that about 22% is in the form of foreign equity, 67% in foreign debt and the remainder from domestic sources.

commitments of special assistance. With some improvements in project implementation performance, pipeline disbursements are projected to average about US$2.1 billion p.a. over the next two years. In aggregate, the financing requirement could be met with annual commitments of public loans and grants averaging US$6.5 billion during 1990/91-1991/92. About 70% of these commitments are projected to be official assistance, primarily from the IGGI. Over the longer term, the composition of public borrowing shifts gradually toward import-related and untied commercial credits.6/

2.53 The case for special assistance, in the form of fast-disbursing program aid and local-cost financing, was presented in the last three Economic Reports and endorsed at the subsequent IGGI meetings. Special assistance has been intended to provide temporary support to Indonesia while it implemented policies to adjust the balance of payments and the budget to external shocks, such as lower oil prices and adverse exchange rate movements, while removing trade and investment restrictions. The response from IGGI members has been substantial, with disbursements of special assistance totalling US$5.4 billion over the past three years. This assistance has played a valuable role in helping the Government push ahead with its deregulation measures, in facilitating the recovery of economic activity and in sustaining the momentum of poverty reduction. It has also enabled Indonesia to restructure its external debt, improving the average maturity and term structure, while maintaining financial market and investor confidence in its adjustment program. The balance of payments projections presented in Section C indicate that the requirement for new commitments of special assistance will total US$1.2 billion for 1990/91, a significant decline from the level pledged for 1989/90. There are two important elements of the justification for this level of special assistance. First, there is a need to support the Government's ongoing program of reforms of trade, industry and financial policies, especially in the context of the rapid growth of imports associated with the non-oil export and investment boom resulting from these reforms. Second, there is a strong case for the need to maintain the level of official reserves in the near term in order to provide Indonesia with the flexibility required to respond to external shocks, especially given Indonesia's open capital account. In line with the anticipated improvement in Indonesia's balance of payments position and the favorable external outlook, particularly in the oil market, our current projections assume that commitments of special assistance could be phased out by the end of 1990/91; however, in the event that macroeconomic developments, and especially the external environment, are less favorable than assumed in the projections, the phasing out would need to be more gradual. The donor community should be prepared to respond flexibly in this event. This will be important for enabling Indonesia to move ahead with confidence in trade and other regulatory reforms.

2.54 The level of project aid commitments recovered in 1989/90 from the levelling off in previous years. An important shift in the composition of project aid towards faster disbursing, sector-based operations often including local-cost financing is also occurring. As special assistance declines there

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6/ Also as a result of the changing composition of public commitments; and the increasing role of private capital flows, the share of IGGI assistance in total sources of external capital falls from 47% in 1989 to 35% in 2000.

will be a need for this shift to continue as the level of project assistance rises. This type of assistance will continue to have a high priority for a number of years due to the need for financial support of structural reforms in some sectors and major sector investment needs. Moreover, as economic activity and investment levels pick up, there will also be increased scope for specific projects to expand capacity. Total commitments of project aid are therefore projected to rise rapidly in the next year, from US$3.4 billion in 1989/90 to US$3.8 billion in 1990/91. As discussed in Chapter 4, public investments need to be focussed on two areas: investments in infrastructure and human resource development to support higher economic growth; and, investments in social and basic services to reduce further the incidence of poverty. Donors need to work closely with BAPPENAS to develop a pipeline of projects in these areas. In addition, given the increasing role projected for private investment, it will be important to strengthen mechanisms to channel aid-financed funds to the private sector, such as two-step loans and financial sector operations.

2.55 As in the past, a portion of the projected requirements for special assistance and project aid is expected to be provided outside the IGGI. However, these amounts are declining rapidly, as the extraordinary financing provided by some donors is phased out. Allowing for this trend, it is recommended that the level of IGGI assistance to Indonesia in 1990/91 be US$4.5 billion, slightly higher than pledged for last year. While this represents a modest increase in total assistance, it implies a significant rise in project and sector assistance because of the US$600 million decline in special assistance. Through the mid-1990s, the requirement for new commitments from the IGGI is projected to remain high, but decline in relative importance as private capital flows increase.

2.56 Indonesia has reduced its reliance on import-related credits in recent years. This trend reflects the Government's decision to reduce public investment in large capital-intensive projects and to place strict limits on the use of non-concessional credit under Presidential Instruction No. 8 of 1984. The projections presented in Section C assume that new commitments of import-related credits rise over the medium term, reflecting the emergence of opportunities for new investments. However, as in the past, it will be important to review these proposals carefully, to ensure that the projects warrant priority in the public investment program and that the financing arrangements are appropriate. Disbursements of untied commercial credits, which declined during the adjustment period, were about US$900 million (excluding disbursements for prepayments) during 1989/90.7/ During 1990/91, new commitments are assumed to total only about US$700 million, implying a further decline in Indonesia's exposure to commercial banks. Over the medium term as Indonesia's external debt burden eases, greater use of commercial credits is anticipated, especially since these credits are untied and therefore, can be used more flexibly than import-related credits.

7/ Indonesia's pipeline of undisbursed syndicated loans totalled about US$1.8 billion at end 1989/90, a US$0.2 billion decline from the previous year.

Implications for External Debt Management

2.57 With the borrowing strategy outlined above, the growth of Indonesia's external debt will slow over the next few years. Medium- and long-term (MLT) public and private external debt disbursed and outstanding (DOD) is projected to rise from US$48.3 billion at end-1989 to US$49.2 billion at end-1990, an increase of about 2%. Reflecting the increasing levels of foreign investment activity in Indonesia, private non-guaranteed debt continues to rise, with the private debt/GNP ratio rising from 5.3% in 1987 to about 6.3% in 1995. The private debt/export ratio also rises until 1994, but then declines through 2000, due to the growth in non-oil exports generated by these investments. Since most of the increase in borrowing over the past several years has been in the form of official assistance, there has been a significant improvement in the overall maturity and term structure of external public debt. Combined with the projected improvement in economic performance, these trends lead to a substantial improvement in all of the key debt indicators. The ratios of DOD to GNP and exports have been falling since 1987, and these trends are projected to continue throughout the 1990s (see Table 2.12). Similarly, the total MLT debt service ratio is expected to decline from a peak of 38.0% in 1986 to 33.0% in 1990 and to 21.8% by 1995.

Table 2.12: MEDIUM- AND LONG-TERM DEBT INDICATORS, 1987-2000
(%)

	Actual			Projected /a		
	1987	1988	1989	1990	1995	2000
DOD/GNP	66.7	61.0	54.7	52.3	43.6	33.2
Public	60.9	55.7	49.4	48.0	37.3	27.6
Private	5.8	5.3	5.3	4.3	6.3	5.6
DOD/exports /b	239.6	218.6	189.0	177.6	130.7	99.7
Public	218.8	199.5	170.9	163.0	111.9	82.6
Private	20.8	19.1	18.1	14.6	18.8	17.1
Debt service/exports /b /c	35.5	36.1	32.1	33.0	21.8	16.8
Public	30.3	30.7	26.9	27.1	15.7	11.5
Private	5.2	5.4	5.2	5.9	6.1	5.3
Interest/exports /b	14.4	13.9	12.2	11.8	7.8	5.8
Public	12.6	12.1	10.5	10.0	6.2	4.4
Private	1.8	1.8	1.7	1.8	1.6	1.4

/a Based on exchange rates of December 31, 1989.
/b Denominator is gross exports of goods and services.
/c Debt service excludes prepayments.

Source: Bank Indonesia and World Bank staff estimates.

2.58 The Government continues to handle the administration of its external debt payments in an efficient manner, with no significant errors or delays. However, two areas of debt management require attention. The first priority is to establish a unified debt reporting and analysis system, which can provide up-to-date and comprehensive information to policymakers on the status of Indonesia's public external debt. This information could help to guide the Government's overall borrowing strategy. Second, as our estimates indicated that private sector debt is increasing rapidly, there is a need to develop an information base on private non-guaranteed debt in a way which does not impede individual transactions. Timely information on private debt flows can make a positive contribution to debt management.

CHAPTER 3

EFFICIENT PRIVATE SECTOR DEVELOPMENT

A. Introduction

3.01 Since the mid-1980s, the Government has encouraged the private sector to play a more important role in the economy. The need to reduce the economy's dependence on oil and to tap the dynamic potential of the private sector, provided the impetus for regulatory reform in Indonesia. This reform has complemented the successful stabilization of the economy through macroeconomic policies and has provided a policy framework that has facilitated a strong supply response. It has sought to re-orient the economy to a more outward-looking growth strategy and lower barriers to entry and competition in the domestic market. The Government has also adopted major financial sector reforms to promote the efficiency of financial intermediation and the development of capital markets. In support of the reform strategy, public expenditure has become focussed on the provision of physical infrastructure and improving human resource development. Extensive deregulatory measures have been undertaken to improve port and customs operations and the efficiency of shipping services, which were earlier a major impediment to trade.

3.02 The private sector has responded to the challenge. Private investment has recovered in response to the improved incentive and regulatory environment. Approvals for both domestic and foreign investment issued by the Investment Coordinating Board (BKPM) have surged. Much of the new investment has been directed towards labor-intensive manufacturing for exports and average rates of return on investment and total factor productivity have increased. The pattern of investment has facilitated the striking growth of non-oil exports, which have increased almost threefold over the past six years to reach about US$14 billion in 1989/90. As a result, the share of non-oil exports in total exports rose from 21% in 1982/83 to 61% in 1988/89. It is encouraging that the strongest growth in non-oil exports has been across a wide range of products in the 'other' manufactured goods category. The response of a broad range of firms exporting a wide variety of products is suggestive of expanding opportunities for smaller entrepreneurs.

3.03 So far the manufacturing sector has been the primary target of trade and regulatory reforms. Consequently, the effects of reform are most evident in this sector. The manufacturing sector has grown strongly at over 11% during 1989 and now accounts for 14.3% of GDP. Growth has facilitated structural adjustment within industry as a broad range of export activities have expanded at a much faster pace than production of import competing goods. Employment opportunities have expanded as resources have shifted towards those labor intensive activities in which Indonesia is internationally competitive. Growth in manufacturing employment has been associated with increased real wages and absorption of large numbers of women and unskilled labor into the industrial work force. This has been an important factor in ensuring the success of Indonesia's adjustment program and has also played a part in the

reduction of poverty in the 1980s. One impressive example of the widening opportunities for indigenous entrepreneurs is shown by the 'Bali experience' as described in Box 3.1.

3.04 The agriculture sector, by contrast, has seen little reform of trade and domestic regulation. Nevertheless, the sector profited from the maintenance of a competitive exchange rate and the introduction of improved technology, and was thus able to grow steadily at about 4% p.a. in the 1980s. This growth led to an expansion in agricultural employment of 2.3% p.a. and helped reduce considerably the incidence of poverty in the sector. Although the food crop subsector will continue to be the main source of agricultural output and employment in the 1990s, non-food activities will need to provide the bulk of incremental output and employment in the future. In addition, there appears to be potential for agro-industry to increase value added of agricultural sector output. Trade and regulatory reforms in agriculture and agro-industry will help these sectors maintain solid growth in the 1990s.

3.05 While the increase in private sector activity is encouraging, the barriers remaining in the trade regime need to be lowered quickly to ensure that new investment is channelled into areas where Indonesia has a clear comparative advantage and to accelerate the implementation of investment plans. This argues for a rapid pace of reform. Continued strong growth will facilitate adjustment to further changes in incentives by quickly absorbing displaced labor, capital and managerial resources. Policy options for improvements in trade policy, domestic incentives and regulations, the financial sector and transport will be discussed in the subsequent sections. This is followed by a section on the environment, which covers important issues of land and water use and pollution. To maintain private sector growth while safeguarding public health it will be vital to manage carefully the natural resource base. This section discusses the main challenges for the year ahead in developing institutional arrangements that will ensure that land and water resources are managed efficiently.

B. Trade Policy

The Changing Pattern of Price Incentives

3.06 Since the mid-1980s, the Government has embarked on a series of trade and deregulation measures to improve the international competitiveness of domestic production. These measures supported demand management policies in reducing macroeconomic imbalances and enabled a recovery of economic growth. To restore balance of payments stability and sustain growth over the medium term the Government adopted an active exchange rate policy. Significant real exchange rate depreciations between 1981 and 1988 played a key role in boosting non-oil exports and reducing the current account deficit. A central component of economic strategy has been trade reform. Between 1985-89, four major policy packages were introduced, addressing three principal areas: (a) non-tariff barriers (NTBs); (b) tariffs; and (c) duty free inputs for exporters.

Box 3.1: Garments from Bali: Export Success

Garment producers in Bali have established a marketing niche in sales to high fashion stores in Europe and the United States. This market niche has developed from a modest start involving sales of simple clothing to tourists in the 1970s, to an $80 million export business employing 45,000 workers in 1989. Exporters in Bali are successfully competing in a market characterized by small orders made to exacting fashion designs with rapid turnaround times. The industry that has evolved in Bali has provided decentralized employment based on labor-intensive production techniques. It has provided opportunities for indigenous entrepreneurs and much of the production has been sub-contracted to workers in rural villages. Moreover, women form most of the workforce. Most of the raw materials used are produced in Indonesia. The industry has developed within a relatively open regulatory framework as there have been few restrictions on entry and exit. Also most of the training of workers has been undertaken 'in house'.

The origins and growth of the garment industry can be traced to the interaction between local retailers/tailors and individual foreign entrepreneurs. Thus, one impetus for development came from the availability of information about overseas markets, production techniques and marketing skills from foreign visitors. Because Bali was targeted for tourism, immigration controls were, for the most part, flexibly administered which facilitated the operation of foreign buyer-consultants. However, the industry has by no means become dominated by foreigners. In fact through a process of learning-by-doing, local firms have become increasingly adept at solving their own production problems. Thus, foreign entrepreneurs have played the role of catalysts for development.

From the viewpoint of this report, the Bali experience shows how the private sector can achieve desirable social objectives if it is allowed to operate in a relatively open regulatory framework. In this case foreign buyer-consultants were afforded an opportunity to work with local entrepreneurs and entry into and out of the industry was unconstrained. The result has been an impressive development of the garment industry with linkages extending to the textiles and other sectors and worthwhile employment for rural labor.

3.07 Non-tariff barriers. By 1986 NTBs were the most important distortion in the trade regime, contributing not only to the high level and variability of protection but also fostering unproductive 'rent-seeking' behavior. At that time, there were more than 1,700 tariff items under NTBs, covering over 40% of total import value and about the same proportion of domestic production.

3.08 Since then the incidence of NTBs has been reduced through a series of trade reform packages. The cumulative impact of the trade reform packages is shown in Table 3.1. In brief, these measures resulted in the removal of 839 items from license control, which halved the total import value previously restricted. More importantly, the share of total domestic production protected by import licensing restrictions declined by about a third, from 41% to 29%. The reduction in NTBs has been concentrated in the manufacturing sector, where both nominal and effective rates of protection are highest. The share of domestic manufacturing production covered by NTBs declined from 68% in 1986 to 45% in 1988. Nevertheless, substantial scope remains to reduce further the protective impact of these NTBs.

Table 3.1: IMPACT OF REFORM PACKAGES ON IMPORT LICENSING COVERAGE SINCE 1986

	Mid-1986	End-1987	End-1988
% of CCCN items	31.5	21.7	16.3
% of import value	42.9	25.2	20.8
% of total domestic production	41.4	37.6	28.9
Memo item:			
% of domestic production in: /a			
Manufacturing	67.7	58.1	44.5
Agriculture	53.8	52.9	40.9
Mining and minerals	0.2	0.2	0.2

/a The estimates of domestic production under import license protection for manufacturing and agriculture differ from earlier Bank staff estimates due to the reclassification of the food and beverages industry into the manufacturing sector and out of the agricultural sector.

Source: World Bank staff estimates.

3.09 The removal of NTBs has had three beneficial effects on the pattern of incentives. First, the move towards tariff-only protection has greatly increased the transparency of the trade regime. Second, the price of imports relative to the price of exports has fallen since 1986. At least part of this decline reflects the removal of restrictive import licensing requirements. Third, domestic users of the deregulated imports have benefited not only from lower prices but also from more certain delivery times and improved quality. Such 'non-price' factors are crucial for export production and encourage domestic producers of inputs to become more cost and quality conscious.

3.10 Tariffs. The various reforms of the Indonesian tariff schedule have resulted in a marked decline in the average weighted tariff from 22% to 12% by import value or from 29% to 19% by domestic production value (see Table 3.2). However, the introduction of surcharges and splits has eroded some of the gains. Surcharges have been imposed both as additional protection to products moved off NTBs and as a de facto anti-dumping measure. Surcharges have created an easy mechanism by which additional protection can be granted

domestic producers and does not constitute an appropriate anti-dumping mechanism. The introduction of split-tariff positions has involved the sub-division of the tariff schedule into ever finer product descriptions. These have been used to tailor protection for specific products.

Table 3.2: CHANGES IN THE IMPORT TARIFF SCHEDULE FOR THE WHOLE ECONOMY SINCE 1985 /a

	Pre-1985	1985	1988	1989
Average Tariff Rates (%)				
Unweighted	37.3	27.0	24.0	27.0
Weighted				
- by import value	22.0	13.0	14.5	12.0
- by domestic production /b	29.0	19.0	18.0	19.0
Index of Dispersion /c	61.5	107.8	90.0	92.7

/a "Pre-1985" refers to the 1983 Tariff Law in effect from 1983 to 1985; 1985 reflects rates in effect after the 1985 reform; 1988 refers to rates in effect after the November 1988 package; and 1989 refers to the Harmonized System as provided by the Department of Finance in mid-1989. Tariffs are inclusive of surcharges. Specific duties have been converted to ad valorem equivalents.
/b Based on a sample of 1,200 tariff positions.
/c Measured by the coefficient of variation.

Source: Ministry of Finance, Central Bureau of Statistics and World Bank staff estimates.

3.11 In January 1989, Indonesia converted to the new Harmonized System of classifying traded goods. In the process the number of items with specific tariffs was reduced significantly which improved the transparency of the tariff schedule. However, surcharges and split-tariff positions were extended which has led to a slight increase in the unweighted and production-weighted average tariffs for 1989. Dispersion of the tariffs has also increased.

3.12 Export incentives. The most important change in export incentives was the creation of a duty exemption and drawback facility on May 6, 1986. The facility partially protects exporters from the 'high-cost' local economy by allowing them to import their inputs free of duties and, just as important, allowing them to by-pass import license restrictions.1/ The duty exemption

1/ Import duty and VAT exemptions can be given for either a firm's total imported inputs (if the firm exports 65% or more of total production) or on a consignment basis (where a particular import order is directly linked to an export order). A duty-drawback facility also exists to assist "indirect" exporters but this has not been used extensively.

scheme has been administered by a unit within the Ministry of Finance (BAPEKSTA) and has worked extremely well. BAPEKSTA has administered the scheme with an 'arms length' policy which minimizes direct contact with potential applicants and has made continuous efforts to simplify and standardize application and processing procedures. As shown in Table 3.3, the number of firms using the scheme has increased rapidly with processing time for applications significantly falling.2/ The total value of imports approved under the scheme has more than doubled over the past two years, to a level which accounts for 38% of total non-oil imports. The total value of exports which have benefitted from using the facility has also expanded rapidly to a level of 24% of total manufactured non-oil exports in 1989. Access to the scheme has broadened to include more of the 'emerging' sectors that have recently shown strong export growth. BAPEKSTA approval to import has ensured better services and more competitive prices from domestic suppliers.

Table 3.3: IMPLEMENTATION OF DUTY EXEMPTION AND DRAWBACK SCHEME

	No. of Firms	Value of Imports (US$ million)		Value of Taxes/a (US$ million)		Processing Time (No. of days)	
		Approved	Realized	Duty Exempt	Duty Drawback	For Exempt	For Drawback
1986 (July-Dec.)	247	201	65	64	0	12	24
1987 (Jan.-Dec.)	501	849	297	203	6	7	17
1988 (Jan.-Dec.)	1,102	2,206	626	767	20	7	16
1989 (Jan.-Dec.)	1,950	6,312	n.a.	2,601	45	9	10

/a On approval basis.

Source: BAPEKSTA.

3.13 Another important policy component of the export incentives regime has been the provision of pre-shipment export finance guarantee (PEFG) and export credit insurance/guarantee (ECI/G). These measures are available to all firms that contribute to non-oil export value added. However, they appear to be utilized most by larger, well-established exporters and the PEFG and ECI have not been effective in encouraging banks to provide small or new firms access to credit. Until recently exporters were also afforded subsidized

2/ In addition to the underlying growth in the scheme, this rapid growth reflects two changes in coverage: (a) the scheme was expanded to incorporate foreign aided public sector projects; and (b) the definition of producer-exporters was changed in December 1987, when the ceiling for qualifying for duty/tax exemption was lowered from 85% to 65% of total production (except for textiles producers).

short-term export financing. However, in early 1990 the interest rate subsidies were eliminated in line with financial sector reforms (discussed in Section D).

3.14 One policy development that runs counter to the reform trend is the increased coverage of export regulations. During 1988, the existing export ban on raw rattan was extended to cover semi-processed rattan and a new export ban was introduced for certain rubber products. Most recently the Government has introduced a prohibitive export tax on sawn timber. Many export restrictions are designed to encourage domestic processing or 'value-added' by lowering the domestic price of the restricted item. This has, for example, reduced the income of raw rattan growers/collectors (most of whom are relatively poor and live in rural areas) and increased the revenue to rattan product manufacturers. The negative effects of these restrictions are discussed below.

Directions for Continued Reform

3.15 Despite major improvements in the past several years, the trade regime still taxes domestic consumers and hampers the efficient allocation and use of domestic resources. The import regime provides high protection to manufacturing relative to agriculture and favors production for the domestic market over exports. The remaining NTBs continue to be the primary cause of price distortions in manufacturing and agriculture. These price distortions have drawn resources into activities in which Indonesia does not have a comparative advantage, thereby lowering economic growth and employment creation. Export assistance measures partially reduce the overall anti-export bias of the trade regime but they leave many potential economic activities and the losses incurred by consumers untouched. The main directions for future reform are discussed in the following sections.

3.16 Non-tariff barriers to imports. The Government intends over time to eliminate most non-tariff barriers on imports. Exceptions would be limited to a small group of products that are harmful to health or involve strategic or national defense needs or involve special economic and social considerations. The reduction of the coverage of NTBs may involve: the removal of the NTBs remaining in industries that have already been subject to deregulation (e.g., steel, textiles, chemicals, paper and pharmaceuticals); reducing the trading monopolies on agricultural commodities and processed food and beverages; and dismantling the current mix of import license restrictions, import bans and domestic regulations protecting durable goods industries. Further trade reform will assist the restructuring of the economy. In most cases the process of restructuring these industries is already underway, and the move to an import tariff of, say, 20% or 30% would not cause major dislocations.

3.17 The NTBs on the agricultural commodities (primarily rice, wheat, wheat flour, sugar, soybeans and soybean meal) cover a large share of agricultural value added and trade. For some products (such as rice), import licensing has been used to achieve domestic distribution and food security objectives, and not necessarily to protect domestic producers. For other products such as sugar and soybean meal, the distortions resulting from import restrictions and directed area/production controls have encouraged agricultural resources to be used in activities which yield low economic rates

of return and have taxed Indonesian consumers. Given the important role that these crops play in the agricultural sector, changes in trade policy will have to be assessed in the context of the Government's overall agricultural strategy. Nevertheless, these crops are also important to consumers. The reduction in import license protection on agricultural products would be a logical part of a broader trade reform effort. This would pave the way for more uniform and lower assistance across the agriculture sector and encourage farmers to respond to changing market signals. Where continued protection is desirable, this could be provided through import tariffs.

3.18 Tariff reform. It has been five years since the last major reform of Indonesia's tariff schedule. Since that time, the substantial progress made in reducing NTBs has increased the relative importance of tariffs in the incentive regime. At the same time ad hoc changes have been introduced in the tariff structure which have increased the level and dispersion of tariffs, particularly in the manufacturing sector. Given the anticipated removal of most NTBs and the recent increase in private investment, it is opportune to consider a systematic reform of the current tariff schedule.

3.19 A reform of the tariff schedule would seek to reduce the absolute level and the variance between rates. Such a reform would reduce the range of protection provided to different economic activities, lower the tax on domestic consumers, and remove the pressures to provide special treatment to powerful lobby groups.3/ A tariff reform would involve 'tidying up' the current schedule through the removal of split-tariff positions and the gradual elimination of surcharges. The removal of splits will result in a reduction of the dispersion of tariff rates, both overall and within commodity groups. Also all surcharges could be removed in a phased, systematic manner. Surcharges do not constitute an appropriate anti-dumping device. They apply to particular commodities over a period of time whereas anti-dumping procedures constitute essentially legal actions by one party (for example, a firm) against another with respect to a particular shipment. Thus, the appropriate response to dumping is the imposition of specific penalties related to a particular supplier rather than measures which apply to a broad commodity group. If dumping is indeed a significant problem within certain industries, then the appropriate response is to establish anti-dumping procedure aligned with GATT rules.4/

3/ For empirical support for this strategy see "Trade Liberalization: The Lessons of Experience", by Michaely, Choksi and Papageorgiou; and "Strengthening Trade Policy Reform", World Bank; and "Issues in the Design of Tariff Reform" by A.C. Harberger. See also Thomas, Martin and Nash: "Lessons in Trade Policy Reform", Policy and Research Series Paper No. 10, World Bank.

4/ GATT principles require that duties be imposed only to the extent of any dumping margin and that they be imposed only after it has been established that: (a) dumping has occurred; (b) injury has been caused or threatened to a domestic industry; and (c) there is a causal link between dumping and injury.

3.20 In addition, a further reform of tariff rates would reduce both average tariff rates and the degree of tariff dispersion. This would be best achieved by tariff reductions across the whole tariff structure as opposed to reductions in tariffs for particular industries. A desirable strategy would be to reduce the highest allowed tariff rates to a common ceiling, and then lower the ceiling tariff over time, for example ultimately reducing the ceiling rate to 20-30%. This approach would result in a reduction in the level and variance of protection at each step. The business community should be advised in advance of the direction of future policy change in order to reduce investor uncertainty and to enable more informed investment decisions to be made.

3.21 The effects of a broad based tariff reform on average import duty rates across the main categories of industrial activities can be illustrated in Table 3.4. As can be seen from the table, the tariff schedule would become much more uniform through the phased reduction of the tariff ceiling over a period of several years to, say, 20% (the index of dispersion is almost halved). The tariff structure could be rationalized further by the imposition of more uniform rates within commodity groups. This would result in some low rates (zero or 5% import duties) being raised. Finally, the Government could consider eliminating some of the exemptions to import duty, replacing them, where appropriate, with less distortionary corporate or investment tax credits.

Table 3.4: ILLUSTRATIVE EFFECTS OF A TARIFF REFORM ON UNWEIGHTED AVERAGE TARIFFS AND DISPERSION /a

	Current		Tariff Ceiling 20%	
	Average Tariff %	Dispersion	Average Tariff %	Dispersion
Economy-wide	27	92	14	53
Agriculture	16	74	16	57
Mining	5	80	5	80
Manufacturing	28	91	14	52
Manufacturing sector				
Food, Beverages and Tobacco	30	56	17	31
Textiles, leather and footwear	46	43	19	23
Wood, cork, and products	30	58	18	19
Paper and printing	22	62	14	55
Chemical, petrol and coal	15	140	9	14
Non-metallic industries	36	64	16	44
Basic metal products	15	121	8	83
Metal products and machinery	23	124	13	60
Other manufacturing	36	42	18	28

/a Dispersion is measured by the co-efficient of variation. A lower number means tariffs are more uniform.

Source: World Bank staff estimates.

3.22 It is important that the Government be informed as to how the reform program is proceeding and monitor its effects. This is a data-intensive and complex task, which would be best undertaken by a unit specifically equipped (both in terms of hardware and expertise) to analyze and examine changes in the trade regime in an economy-wide context. Such a unit would provide

quantitative information and analysis to the government concerning the effects of reform and to represent the public interest in dealing with the inevitable lobbying for exceptions. Further, trade reform needs to be implemented within a balanced macroeconomic framework which takes into account adjustments in the trade regime.

3.23 The export regime. Indonesia's export regime is comprised of export regulations (bans, quotas, taxes and approved exporter arrangements), and export assistance measures (the import duty exemption scheme and the subsidized export credit program). As far as export regulations are concerned, while the effort to increase domestic processing is understandable, care needs to be taken in deciding on the appropriate policy instruments for achieving this objective. In general, export restrictions are beneficial to a country only under very specific (and rather uncommon) conditions. Factors such as the share of the world market, the price elasticity of demand, the availability of substitute products and the supply conditions in the export country, all need to be taken into account. Experience in other countries which have imposed export barriers, provides strong evidence that such restrictions can be counterproductive. The products which are subject to export regulations in Indonesia can usefully be divided into three categories:

- those products which are subject to externally imposed trade barriers (i.e., textiles and tapioca);
- those products where Indonesia has a large enough market share to influence world prices (i.e., logs, plywood, rattan, nutmeg and rubber); and
- those products where Indonesia is largely a price taker.

3.24 Where external barriers exist, the key requirement is to create an efficient and equitable mechanism for allocating the externally determined quotas. First, the Government could improve the current system by publishing information on quota holders, the export performance of quota holders and production capacity. A second option would be to move to an open auction system. This would have several benefits including: quick and relatively straightforward administration of the quota allocations; ensuring that quotas are allocated to exporters who have an incentive to maximize returns by exporting high value export items; discouraging 'rent-seeking'; and ensuring that the quota rents are appropriated by the Government and can be monitored. Whether the first or second option is adopted, it will be important to create an open secondary market where quotas can be freely traded.

3.25 Where Indonesia can influence the world market price, a case for an optimal export tax exists. In practice, determining such an export tax is difficult. While part of the costs of the tax will be passed on to foreign consumers via higher prices, part of the benefits are also passed on to foreign producers. As a result, the benefits derived by the country imposing the tax may be short-lived - except where the costs of entry are high. In addition, world demand will decline as a result of the more efficient use of the taxed commodity and a switch in consumption to substitute goods. If it is decided to impose an export restriction, there are strong reasons for choosing

an export tax rather than a quota or ban.5/ Quotas and bans can create incentives to engage in wasteful 'rent-seeking' behavior and can be used to restrict domestic competition.

3.26 Where Indonesia cannot influence the world price, the case for any type of export restriction is weak. Export restrictions on commodities in which Indonesia is a 'price taker' are unlikely to be in the country's own best interest. The result is to lower returns in activities in which Indonesia is competitive (e.g., crude palm oil, crude coconut oil and copra) in order to provide a subsidy to downstream processors (e.g., edible oil producers). This lowers investment/technical change, and hence growth, in the taxed activity, as well as fostering the development of an uncompetitive downstream industry. All export restrictions on commodities in the tree crops category (with possible exception of rubber) could be removed.

3.27 As far as export assistance measures are concerned, the duty exemption facility operated by BAPEKSTA works efficiently and has provided essential support to Indonesia's expanding non-oil exports. Over the medium term an important component of improving BAPEKSTA's operations will be to simplify application procedures in an effort to encourage more small-scale or new exporters to apply. BAPEKSTA's operations could also be improved by modifying the system for granting duty drawback to encourage greater participation by indirect exporters. One option would be to use the domestic L/C system introduced by Bank Indonesia in October 1988 as an administrative mechanism. Likewise there are elements of the export finance guarantee and insurance schemes that could be improved in order to extend their benefits to small or new exporting firms. For example, the resolution of claims on the finance guarantee scheme, both in terms of administration and time taken to settle claims, is considered a major problem by banks.

C. Domestic Incentives and Regulatory Framework

3.28 As discussed in the previous sections, there has been substantial progress made in reducing the anti-export bias of the trade regime and exposing domestic industry to import competition. In order to translate these reforms into an efficient supply response the Government has broadened and intensified its efforts to improve domestic incentives and the regulatory environment for the private sector. These reforms stem from a clear recognition of the constraints to the private sector that need to be addressed. So far, they have focussed on areas of reform that have been the most urgent and implementable in the short run.

3.29 Reform has progressed significantly in the areas of investment licensing and regulation of foreign direct investment. The investment process has been made streamlined and less restrictive. Importantly, the policy

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5/ An example of the type of economic analysis required to determine if an export tax is appropriate is provided in the World Bank's recent report on the Indonesian Tree Crops Sector - No. 7697-IND.

stance has shifted from control to encouragement of investment. In this regard a fundamental change occurred in May 1989, when the Government replaced a long list of activities open to both domestic and foreign investment with a short list of activities which were closed. In formulating this negative list, there has been a conscious attempt to keep the number of restricted sectors to a minimum and to remove the ad hoc conditions that had been introduced over the years. The reforms to investment licensing have opened up more activities to competition and enhanced the transparency of licensing procedures. The changes also lessened the distinction between investment by various types of domestic companies and between domestic and foreign companies for the purposes of licensing.

3.30 The Government has also undertaken steps to improve the attractiveness of Indonesia to foreign investors. Various packages of reforms since 1986 have addressed concerns of foreign investors on several fronts and, in particular, eased ownership controls on investment in export-oriented activities and other priority areas. Moreover, the conversion period for domestic majority ownership has been extended. Further easing of restrictions have also taken place for foreign investors in access to export credit and marketing. Foreign companies are now permitted to take over local firms if investment is in a priority area and provided 20% of equity remains under domestic ownership. In addition to these measures the Government responded to growing concerns of the foreign investment community by implementing copyright laws and submitting a draft law on patents for legislation by 1991.

3.31 The initial response to domestic deregulation of investment has been a sharp increase in domestic and foreign investment. Domestic investment approvals, which had sagged in the mid 1980s, doubled in 1987 and increased by a further 40% (in dollar terms) in 1988. The rate of increase was about 31% in 1989. Similarly, after recording a sharp and steady decline since 1983, foreign investment approvals increased by 78% in 1987 and a remarkable 300% in 1988 to reach US$4.4 billion. The rate of increase of approvals of foreign investment slowed to about 7% in 1989. Moreover, unlike the 1970s and early 1980s when much of the private investment was oriented towards the domestic market, the bulk of new investment approvals are directed towards export activities.

3.32 In order to ensure that Indonesia can build upon this progress in mobilizing domestic and foreign investment efficiently, it will be important to continue reviewing and improving the regulatory framework. While the increase in private sector activity is encouraging, it should be noted that realization of investments is lagging behind approvals due partly to the remaining complexities and weaknesses in the domestic regulatory framework. Further measures would help reduce the remaining barriers to the entry and improve the mobility of private investment. Broadly the priorities are to: maintain a short negative investment list by opening additional areas to domestic and foreign investment; simplify and streamline further the licensing system - by eliminating licenses where possible (such as capacity licensing) and improving co-ordination at the local level; and further ease divestiture obligations of foreign investors. At the same time a start could be made on the more complex and longer run issues of developing a modern legal system and reforming the factor markets, particularly access to land and labor.

The Investment Licensing System

3.33 The adoption of the negative investment list has made the investment regime much more transparent, and there is a clear perception among investors that bona fide investment in areas that are designated as open are being approved speedily. Although most fields of investment have been declared as open to domestic and foreign private investment, there are still 165 sectors where entry is restricted in the negative investment list. These restricted sectors are concentrated in the metal products subsector (71 items); food, beverages and tobacco subsector (44); wood products subsector (13); the chemicals subsectors (13); and the paper subsector (6). The policy objective and criteria for selecting goods to be included on the negative list could be re-examined and the list shortened. In general, there are likely to be few grounds apart from say national security, for maintaining a negative list. Also, with the adoption of the negative list, the capacity expansion license has become redundant. Existing enterprises have to meet the test of bona fide businesses, and capacity expansion is only an issue in restricted sectors. Accordingly, consideration could be given to eliminating the capacity expansion license for non-restricted activities and replacing it with a reporting requirement.

3.34 In addition, there are a large number of production activities where entry is limited to the small-scale domestic investors. Although these restrictions are not applied rigidly, they are a source of uncertainty and a potential barrier to new investment. These restrictions are particularly important in the food and textiles sectors and could prevent small firms growing into an efficient scale of operations. An investment is considered small-scale under the investment licensing system if it involves an investment covering buildings, machinery and equipment of more than Rp.50 million 6/ and less than Rp.200 million (or about US$100,000). These are extremely low limits in the context of the large number of products covered by the small-scale restrictions on entry.

3.35 In view of the social importance placed by the Government on encouraging small industrial investment, steps to reduce entry barriers that would also be more consistent with efficient investment could be to: reduce the number of products restricted to the small-scale sector significantly; raise the limits of the definition of a small industry and permit foreign investment in the small-scale sector by reducing the minimum foreign investment requirement. This would make available the benefits of technology, design and marketing contacts of smaller foreign firms.

3.36 Foreign and domestic firms obtaining BKPM approvals are eligible for limited fiscal incentives (duty exemptions on approved capital imports and raw materials for the equivalent of two years). Given that the main motivating element for investment is the overall investment climate, and in view of the improvements made to the investment licensing system, these fiscal incentives could be reexamined for future projects. The rates of duty to be applied to imports of capital machinery and raw materials could be assessed within the ambit of the tariff reform.

6/ Investments less than this amount do not need a business license and can function with a registration certificate.

Foreign Direct Investment

3.37 As mentioned earlier various packages of reform since 1986 have improved the attractiveness of Indonesia to new foreign investors. Nevertheless, some negative perceptions about foreign investment regulations still persist especially the need to divest ownership over time. The Government could further relax its restrictions on foreign investment consistent with its opening up of the investment licensing system. Consideration could be given to reducing the local ownership and divestiture requirements to say 49% of equity and allowing majority (up to 51%) foreign ownership in most sectors open to foreign direct investment under the negative investment list. The present 51% divestiture requirement could be retained for only a small number of sectors such as extractive and strategic industries. The floor at which export-oriented firms are allowed majority foreign ownership could be lowered to bring it more into line with divestiture requirements in Thailand or Malaysia. For example, firms in Thailand or Malaysia that export at least 50% of their output are allowed to retain majority foreign ownership. Consideration also could be given to providing investors with greater flexibility as to the terms and length of leases relating to investment in plantations and agriculture.

3.38 In addition, BKPM could improve further the investment climate through enhanced investor services. Some restructuring of BKPM's functions and operations may be necessary as it continues to turn to investment promotion rather than regulation. Particular attention could be given to improving the links between regional and national BKPM efforts at investment promotion.

Local Level Laws and Regulations

3.39 In addition to the investment and business operacion license there are three principal steps involved in establishing an enterprise: obtaining local approval, which in turn requires land reservation and location permits; land rights acquisition, which involves registering and titling land; and construction approval, which involves obtaining a 'nuisance' license (including compliance with environmental regulations) and the construction permit. Although the objectives of these various licenses are similar to those in other countries, the procedures for obtaining them involve several layers of local government and a multiplicity of central and local government agencies. These licensing procedures could be examined with a view to streamlining procedures. Also the rules governing the decision making process could be clarified and made public.

3.40 Private enterprises face particularly difficult problems in acquiring land because the laws governing land ownership are restrictive, and the procedures for acquiring, registering and obtaining a title to land are complex. Indonesian corporations (domestic or foreign) are not allowed ownership of land but are granted varying tenure rights, usually 20 to 30 years. This short tenure right discourages long-term investment. These difficulties are heightened by a number of deficiencies in land use classification. For example, about 75% of total land area in Indonesia is classified as public lands falling under the Forestry Department boundaries, although a large part of such lands is already deforested and under alternative uses. Also, private land markets do not work efficiently because

of: limited land registration; the absence of adequate legal framework or ownership/lease rights; and cumbersome procedures for land transfer, registration, and titling.

3.41 The problems of land use seem to be most acute in: the extensive and fast growing urban and industrial areas and urban fringes in the inner islands (especially in Java); agricultural lands and areas of rapid agricultural encroachment on forest lands in the outer islands; and finally, a separate approach to forestry sector management in the outer islands to conserve forest resources in the longer term. In these areas reforms could encompass: increasing the availability of land by improved land classification; policies establishing appropriate use of these lands; and improving the enforcement of land use policies. A complete cadastral survey and registration of land and titles to improve the functioning of private markets in land could be started upon although it is achievable only in the long run.

Local Content Programs

3.42 In Indonesia, certain products in the automotive, metal and engineering sub-sectors are subject to local content (or deletion) programs. In recent times, these programs have been flexibly administered and have avoided overly rigid schedules of deletion. In most cases, final goods producers can opt to import any component subject to the payment of import duty (usually 60% or less). Also with trade reform it is now possible to import many of the final goods which are subject to local content plans both for final and component goods producers. Thus import duties provide an upper bound on the protective effect of the plans. Also the Government has been responsive to industry concerns about quality and availability of locally made components in choosing items to be deleted.

3.43 Many of the programs are close to the end of their timetables and it is an appropriate time to review them. Although as mentioned above the plans have been flexibly administered, they are still underpinned by high import duties and in some cases NTBs. Many of the plans could now be phased out and replaced with a rationalized and lower system of tariff protection. This would greatly facilitate the operational flexibility of producers, reduce disincentives to new investment and encourage efficient development of industries.

Labor Regulations

3.44 An important consideration for foreign investment in Indonesia is the attraction of its large labor force and low wage rates. Indonesia's labor market is relatively undistorted and there is little distinction between informal and formal labor markets and wage rates. Labor regulations are guided by the Basic Law of 1969, which covers among other matters: hiring and retrenchment of workers; protection and supervision of workers; and employment of expatriate workers. As employment in the industrial sector expands, there is a possibility that these restrictions could become increasingly binding. This is already evident, in the form of increasing constraints faced by firms in hiring labor on a permanent basis, employment of women, overtime work, and legal actions under criminal law against some employers for failing to meet rigid labor laws on dismissals and lay-offs.

3.45 The regulations on firing permanent staff are rigid. Layoffs can be undertaken only if it is proven that all possible steps have been taken to avoid retrenchment. Complex arbitration procedures need to be followed. If satisfactory mutual consent and conditions cannot be established, a firm has to approach a committee at the central government level, with the final decision lying with the Minister for Manpower. The result is that companies minimize the hiring of permanent labor and rely on temporary workers. The regulations on protection and supervision of workers provide extensive controls on firms' with regard to: the number of hours and overtime work allowed per employee; the employment of women; and wages and social welfare that employers must provide.

3.46 Firms are allowed to hire expatriate workers only in a few sectors and restrictions are enforced through requirements for work permits. Since 1987, a significant relaxation has occurred in the case of export-oriented foreign investment firms. In particular, a work permit is no longer required for temporary expatriate employees who provide consultation, training, and technology services. This has been the most widely used route to employ foreign technical workers. The easing of restrictions has facilitated improved performance and productivity at the firm level in these sectors and has speeded technology transfer. However, for other sectors the restrictions are at times inflexible and obtaining work permits involves complicated and lengthy procedures. An example of the positive effects of easing restrictions on foreigners is shown by the experience of the Bali garment industry (see Box 3.1).

3.47 Labor regulations need to be re-examined and reforms initiated. Some specific steps in this direction could include: reliance on published industry-wide guidelines or norms for hours of work, minimum wages and overtime; simplification of the procedures for termination of employees, since the rules now discourage employment and training of permanent workers; and expanding opportunities for firms to hire expatriate skilled labor, since the benefits of on-the-job training and effective technology transfer that such expatriate labor provide may far outweigh the potential risks of temporary displacement of local skilled labor.

The Commercial Law Framework

3.48 In many important areas the existing commercial laws are outdated, and do not meet the requirements of a modern economy. The gaps in the commercial law framework will need to be addressed as an urgent priority in the next few years. Perhaps most importantly, the system of enforcement and interpretation of laws by courts, and generally the efficiency of the legal process needs to be improved. Currently, there are long delays, cumbersome procedures, legal uncertainty (since legal decisions are rarely published), and high costs of the legal process. Alternative dispute settlement mechanisms, such as the functioning of Arbitration Boards could be developed. Legal reforms and the development of institutions involve difficult and complex issues and will take time to be completed. Legislated changes are needed to lend greater legal certainty and codify recent changes made through deregulation measures in a few key areas (such as banking, foreign and domestic investment, companies and securities laws). Changes in the commercial legal framework are also essential if these broader reforms are to have their desired effects.

D. Financial Sector Development

3.49 An expanding role for the private sector will also require development of a broad array of financial services and intermediaries: commercial banks providing working capital and long-term debt finance; venture capitalists and the stock exchange contributing equity; insurance and pension funds supplying long-term funds; and leasing companies and securities houses offering alternative financing options. An increasingly diverse financial system should contribute to savings, investment and growth by: (a) mobilizing greater amounts of savings through offering instruments better suited to the needs of the public; (b) transforming the maturity and size of savings to fit the needs of investment projects; and (c) allocating funds to the highest return projects at lower costs. A sound financial system can contribute to overall financial stability by accurately pricing and disbursing risks throughout the economy, increasing the flow of information available to savers and investors and pressuring for the productive investment of funds.

Recent Policy Developments

3.50 Indonesia has already done much to promote the financial system. A key reform was the Government's June 1983 announcement directed to: (a) stimulating private financial savings; (b) improving the allocation of financial resources; and (c) allowing for more agile management of monetary policy. Accordingly the Government deregulated commercial bank interest rates, replaced credit ceilings with a system of reserve money management and adjusted interest rates on a simplified structure of directed, subsidized credits. In 1984 and 1985, money market instruments were introduced along with a rediscount window at Bank Indonesia (BI) to improve further the control of monetary policy. The financial system responded to this first set of reforms with a rapid expansion of assets--over 23% p.a. between 1982 and 1988, (see Table 3.5). As a share of GDP, financial assets held by the banking system rose from 18% in 1982 to 30% in 1988. At the same time, the number of non-bank financial intermediaries expanded sharply. Prior to 1988, however, the equity and bond markets were inactive.

3.51 While the mobilization of higher levels of financial assets was welcome, the following problems remained:

- regulatory barriers to entry that protected existing commercial banks from competition and led to high intermediation costs;

- the domination of the financial system by state banks because of regulatory advantages in branching, capital adequacy, provisioning, and because of their monopoly on public enterprise deposits;

- the large and growing shares of subsidized liquidity credits received from BI--these credits reduced incentives to raise long-term funds from the public, weakened state banks' portfolios, fragmented credit markets unnecessarily and complicated the implementation of monetary policy; and

Table 3.5: INDONESIA: STRUCTURE AND GROWTH OF THE FINANCIAL SECTOR, 1978-89 /a

	Number in			Assets			Assets		
	1982	1988	1989*	1982	1988	1989*	1978-82	1982-88	1989*
				(In billions of rupiah)			(Annual rate of change) /b		
Bank Indonesia	1	1	1	13,707	42,445	39,388	26.4	25.4	(9.5)
Deposit money banks	114	107	128	15,952	63,284	86,542	31.8	31.7	37.2
National foreign exchange banks /c	15	17	21	12,724	50,051	68,807	32.6	31.5	37.4
Foreign banks	11	11	18	1,172	3,215	4,803	23.4	22.4	49.4
Other commercial banks /d	60	51	81	720	4,972	6,427	29.5	47.2	29.3
Development banks	28	28	28	1,336	5,046	6,505	33.1	30.4	34.9
Nonbank financial institutions /e	14	14	14	805	3,063	3,564**	42.6	30.7	16.4**
Saving banks /f	3	3	3	452	2,409	2,900	86.5	39.7	20.4
Insurance companies	83	106	117	528	1,883.6	n.a.	35.0	23.6	n.a.
Leasing companies	17	83	83	114	1,735	n.a.	44.0	57.4	n.a.
Other credit institutions /g	5,808	5,771	7,448	86	637	579	14.6	49.2	(9.1)
All institutions	6,040	6,085	7,794	31,644	111,838	131,925	30.0	23.4	18.0

Source: Bank Indonesia: Indonesian Financial Statistics, data provided by the Indonesia authorities, and staff estimates.

/a Organized financial sector; end of period.
/b Annual compound rates.
/c Includes five state banks. The remainder are national private banks.
/d National private banks undertaking only domestic currency business.
/e Nine investment finance, three development finance, and two other finance companies.
/f Ones state savings bank and two private savings banks.
/g Village banks, rural paddy banks, and government-owned pawnshops, October 1989.

* October, 1989
** September, 1989

- an inadequate legal and accounting and supervisory framework which hindered sound growth.

3.52 1988-89 policy reforms. The first two of these problems were addressed in a major package of reforms announced on October 27, 1988. Besides strengthening competition, the reforms were designed to enhance stability within the financial system and improve the implementation of monetary policy. Competition was fostered by: (a) lessening restrictions on entry and branching for foreign and domestic banks; (b) allowing public enterprises to place up to 50% of their deposits outside the state banks; (c) allowing non-bank financial institutions (NBFIs) to issue certificates of deposit (CDs); (d) permitting banks and NBFIs to raise capital in the stock markets; and (e) lowering barriers to entry in leasing, insurance, consumer finance, venture capital and securities activities. The soundness of the system was buttressed by reforms (a) defining loan portfolio concentration ratios for banks and NBFIs, (b) setting minimum capital standards for banks and solvency ratios for insurance companies, and (c) establishing rules prohibiting insider trading on stock exchanges. The conduct of monetary policy was improved by: (a) unifying reserve requirements for all bank liabilities at 2%; and (b) lengthening the maturity of BI certificates (SBIs) and initiating a secondary market.

3.53 This impressive list of reforms was followed in March 1989 with a smaller series of decrees clarifying, among other matters, the development and control of NBFIs, lending limits, joint venture bank capital ownership and bank mergers, the definition of bank capital, reserve requirements and bank investment in stocks. An important new regulation was introduced which limited commercial bank net positions in foreign exchange to 25% of their own capital, while at the same time eliminating the ceiling on commercial bank foreign gross indebtedness.7/ This regulation limits banks' exposure to exchange rate fluctuation. However, the elimination of the borrowing ceiling could create a fiscal burden in the unlikely event of payments difficulties, arguing for continued careful monitoring of private borrowing by commercial banks.

Impact of the Reforms

3.54 Enhanced competition and the increased focus on equity have led to dramatic changes within the financial system. New financial intermediaries have flourished in the last year. There are thirty-six new domestic banks and fourteen new joint venture banks. Branches of existing banks have also grown significantly from 5,887 in July 1988 to 6,285 in June 1989. The overall number of financial intermediaries has risen from 6,085 in 1988 to 7,794 in October 1989, a 28% increase (see Table 3.5). Fiercer competition among banks fostered by the reforms is reflected in the falling share of deposits held with state banks as new banks aggressively bid for customers using new or better priced services. These developments have been accompanied by strong

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7/ The net open position is the difference between foreign exchange assets and liabilities both on and off the balance sheet. Own capital is the sum of paid-up capital; capital, general and specific reserves; retained earnings; undistributed profits and subordinated loans.

growth in assets (18% in 1989). Deposit money bank assets have soared 37% after rising by a similar amount in 1988. As with the growth in the number of intermediaries, however, the pace of growth may call into question the quality of some assets. More generally the growth of the financial system has led to shortages of capable financial managers and heightened concerns about the soundness of the system.

3.55 For the year through September 1989, deposits of all kinds at deposit money banks have increased by 32%. The composition of M1 (see Annex 1, Table 8) shows the growing importance of demand deposits for holding transactions balances. Maturities have lengthened, with the highest growth in 6 and 12 month time deposits. This has been matched with a lengthening of the loan maturities. Between December 1988 and September 1989, Rupiah loans with tenor of six months or less have actually fallen. Loans of 6 months to one year rose 34% to Rp.25.3 trillion.

3.56 Both lending and deposit rates have declined over the year in response to the increased amounts of resources mobilized (see Annex 1, Table 9). Six month time deposit at private national banks have declined about three points through February. State banks time deposit rates fell even more. After discussions with the Government, they announced at the end of January 1990 a three point drop in their prime lending rate from 19% to 16%, accompanied by a lowering of their time deposit rate from 16% to 15.25%. Maintaining profitabilities at these low spreads will be difficult, particularly given the planned reduction in liquidity credits (see below).

3.57 The response of the capital market has been even more impressive. For the first 12 years of its existence, there were only 24 companies listed (trading averaging 210,000 shares a month in 1987). Over half of the shares were held by Danareksa, the state underwriter which acted as a market maker. In contrast, in 1989 39 companies offered new issues, raising over Rp.3.75 trillion in capital. The volume of shares traded increased eight-fold. The composite Stock Price Index rose precipitously to over 500 points in September 1989 from just below 300 at the start of the year. Subsequently it declined to about 400, but by March 1990 had recovered to over 600 points. The over-the-counter (OTC), established at the end of 1987, and the corporate bond markets were also more active.

The January 1990 Reforms

3.58 One critical issue not addressed in the 1988 and 1989 reforms was the role and extent of subsidized, directed credits (referred to as liquidity credits) within the banking system. Bank Indonesia (BI) had been refinancing loans to various activities--small-scale industries, exporters, tree crops, and housing--at interest rates varying from 3% to 14.5%. These loans originated as a mechanism for channeling windfall oil revenues to the public in the mid-seventies. By end 1989 the stock of outstanding credits had reached Rp.16.2 trillion. Most of these loans were eligible for insurance coverage (through the state-owned insurance company ASKRINDO) at premia that did not cover company losses. The system had a number of drawbacks. It complicated the control of monetary policy because of a lack of overall refinancing limits. Incentives for participating banks, chiefly the five state banks, to do adequate credit analysis were eroded by the cheap insurance and ability to rediscount up to three quarters of a loan to BI. Repayment

performance was poor. Lax credit policies allowed the subsidized credit to be misdirected, reducing the benefits to the targeted sectors. Liquidity credits also limited the expansion of market based lending.

3.59 On January 29, 1990, a significant reform of the liquidity credit scheme was announced. The number of sectors eligible for liquidity credit were reduced to: farmers, for working capital; cooperatives, for financing food purchases or productive activities; BULOG, for financing stockpiling of food; and development banks, NBFIs and estates for investment credit. Interest rates were moved much closer to market rates. All insurance is now voluntary, with market-based premia. A regulation was also introduced requiring all but foreign or joint venture8/ banks to lend 20% of their portfolio to small scale firms and cooperatives.9/ Banks are given one year to comply with this regulation. No formal sanction was specified for not meeting the target, beyond noting the BI would consider compliance in determining the overall rating of a bank.

3.60 The reduction in the scope of liquidity credits and the increase in interest rates will greatly enhance BI's management of base money. During last year, liquidity credits expanded by Rp.2.7 trillion, more than 50% of the expansion in base money. The changes in interest rates and in insurance will improve incentives to assess credit risk and reduce incentives to divert credits away from priority users. Segmentation in credit markets will be reduced and new commercial banks will expand into these sectors more rapidly. For the state banks the reforms will require a stronger effort to mobilize deposits directly since a large share of their portfolio had been funded with liquidity credits. The reform will also call for efforts by state banks to improve their efficiency and ensure the quality of their loan portfolios.

3.61 Two areas of follow up on the recent reform of liquidity credits merit careful attention. First, there is no timetable or target for the reduction in the stock of credits. However, BI estimates that over the course of the next fiscal year these credits will decline by about Rp.5.2 trillion, leaving a stock of Rp.12 trillion. Second, the imposition of the 20% requirement for lending to small business could distort credit allocation even though at present it is not much different from the amount of credit already reaching cooperatives and small businesses. It would be far preferable to design programs to eliminate barriers holding banks back from lending to these sectors rather than mandating a quota.

The Remaining Agenda

3.62 The comprehensive reforms undertaken by the Government and the rapid growth they have engendered present two challenges. First, financial markets need to continue to grow to fulfill their role of supporting real investment

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8/ Foreign banks have to lend 50% of their portfolio for exports.

9/ Small-scale is defined as firms whose capital, excluding fixed assets, is less than Rp.600 million. Loan sizes are limited to Rp.200 million.

and growth.10/ Second, the stability of the financial system and the overall economy require that this growth be based on sound institutions operating competitively under a transparent legal and regulatory structure. The mushrooming of financial assets and institutions is straining the capacity of the authorities to supervise and regulate markets. Meanwhile, the capacity of private institutions to continue to grow is hampered by the scarcity of qualified staff and management. The imperatives of sound and stable growth leave three principal items on the agenda:

- strengthening the prudential regulation of financial markets;
- enacting updated laws governing financial institutions and commercial relations; and
- bolstering managerial and technical expertise in financial institutions.

While the Government is actively pursuing various efforts on these fronts, their urgency is compounded by the rapid pace of financial sector growth.

3.63 Prudential supervision. BI has already begun to improve its banking supervision with technical assistance from the IMF. A prototype questionnaire for early detection of potentially unsound banks has been designed and tested on a limited basis, but still needs to be refined and used on a broad scale. Efforts are underway to improve general examinations by including: a greater emphasis on management and management systems rather than accounting values and compliance with regulations; off-balance-sheet items; evaluation of liquidity based on an appraisal of asset and liability management rather than simply adherence to minimum reserve requirements; and assessments of portfolio quality based on the financial condition of borrowers rather than simply the state of interest payments. The huge expansion of banks and branches requires greater concentration on off-site examinations, with detailed examinations targeted at apparently risky banks. Finally, a graduated set of responses by BI to mismanagement in financial intermediaries needs to be developed so that shortcomings can be remedied quickly and efficiently.

3.64 Transparency and confidence in financial markets will be greatly enhanced by improving the quality and availability of information to BI and the public. Sound prudential regulation will be advanced by more stringent accounting practices for accruing income and capitalizing interest, accompanied by timely reporting of data updated to fit the requirements of the new deregulated market place. Greater disclosure of information to the public will allow potential investors/depositors to enforce market discipline on financial intermediaries, aiding BI in its supervisory efforts. Of course, the quality of the accounting information also needs to be improved. In this regard, a credit rating company could be established. The creation of a

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10/ Comparisons of the depth of financial intermediation with neighboring countries such as Thailand and Malaysia, indicate that financial markets in Indonesia need to develop further. Indonesia has a current estimated ratio of broad money to GDP of 35%, while that of its neighbors is over 60%.

company registry which listed major shareholders would increase the amount of information available to potential investors in the stock market as well as help BI enforce lending limits.

3.65 State banks need close attention, particularly in light of the sharp reduction of liquidity credits that will occur over the coming years. They require a detailed portfolio audit to determine their soundness. It would be then be possible to assess their need for, and amount, of recapitalization. Any recapitalization would also provide an opportunity to disperse ownership in state banks more widely, perhaps through share issues.11/

3.66 Stricter regulation of the capital markets is also critical to maintain the confidence of small investors and eliminate opportunities for manipulation. In particular, more disclosure requirements for issuing companies and intermediaries, strengthened minority rights, and a more up-to-date transfer, payment and settlement system are needed. As with banks, greater and more reliable accounting information available to the public will facilitate control. Some steps on along this road have already been taken. The relationship between underwriters and companies floating new issues has been revamped after criticism that ownership ties between the two caused underwriters to misrepresent the value of stocks. Plans for restructuring BAPEPAM, the government agency dealing with stock markets, along the lines of the US Securities and Exchange Commission are also well advanced. The implementation of both the restructuring and the privatization of the stock market are important for its further sound growth.

3.67 Legal framework. An integrated legal framework spelling out the scope and activities of various financial intermediaries and the supervisory role of BI, MOF and BAPEPAM is important for creating a stable financial system. Draft laws on the role of BI, commercial banks, insurance companies, investment (mutual) funds, pension funds are already well advanced. These laws should provide ground rules for the operation of these entities. It is also crucial that BI's authority and ability to set and carry out monetary policy be clearly delineated. Establishing and maintaining a sound capital base in financial institutions requires particular attention. Regulations need to be harmonized to eliminate unnecessary barriers or advantages for some group of institutions. Another element of legal reform concerns the commercial code. Modernizing this body of law is critical for advancing not only the stable growth of the financial system, but the growth of the private sector overall.

3.68 Technical and managerial expertise in financial intermediaries. The rapid surge in the numbers of financial institutions has put severe pressure on the market for skilled employees. While the private sector can be expected to provide and finance training for staff, adequate oversight by the BI, BAPEPAM and MOF will require that their staff training keep pace. Not only training, but also levels of staffing and salaries will need to be increased

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11/ State banks are included in the series of actions proposed in Chapter 4 for improving the soundness and efficiency of public enterprises generally.

to cope with the demands of the burgeoning financial sector. Consideration could be given to allowing a larger number of foreigners to enter the financial sector to help increase the supply of qualified personnel.

E. Transport Services

3.69 In the transport sector, the Government has made concerted efforts to deregulate and remove impediments which previously were the cause of widespread inefficiencies. These reforms have focussed initially on the maritime sector and have resulted in some impressive improvements in performance and quality of service. However, there still remains some scope for further deregulation and streamlining of institutional arrangements, particularly for the ports. Improvements in these areas would facilitate further growth of the private sector in Indonesia. More recently the Government has turned its attention to the land transportation system, in particular road transportation. The issues in both sub-sectors are discussed below.

3.70 Maritime sub-sector. Before 1985, regulation in the maritime sector was especially restrictive, with shipping, ports, stevedoring and forwarding governed by layers of complex rules, regulations and administrative interventions. By 1985, it had become evident that inadequate performance and lack of responsiveness within the maritime sector would retard non-oil export growth. Accordingly, the Government dismantled many of the unnecessary regulations and restrictions within the sector. The major deregulation measures were introduced in two packages - Presidential Instruction No. 4 of April 1985 (Inpres 4/1985) and Paknov 21, issued November 21, 1988. The more important elements of the Inpres 4/1985 package removed or relaxed restrictions on port access for foreign shipping, domestic cargo tariffs, entry to freight forwarding and general agency. In addition the package provided for major improvements in customs procedures. The measures comprising Paknov 21 were similarly sweeping and included: greater freedom of entry into different types of shipping activity; removal of restrictions on routing; and the ability to charter foreign vessels of any size or type. More recently the ban on importing vessels below 10,000 DWT has been reduced to 5,000 DWT. By March 1990, it is reported that orders for 17 vessels between 5,000 and 10,000 DWT have been placed.

3.71 With these reforms, Indonesia has moved toward an efficient, responsive and user-oriented shipping industry. The Government has now set up a regulatory framework conducive to the development of an efficient maritime transport industry. The benefits of deregulation have been compounded by those stemming from technological innovation, in particular, containerization. Deregulation has resulted in improved services and has better integrated Indonesia into the international shipping network particularly through feeder services into Singapore. In domestic shipping, important changes are also taking place, including increased use of tug/barge combinations and special purpose vessels. Equally important have been changes to freight forwarding and the promotion of door-to-door transportation. The rates for international shipping have declined significantly, both in absolute terms and relative to rates from other regional ports which feed Singapore. For example, on the main feeder line between Jakarta and Singapore, freight-all-kind (FAK) rates

(per 20 ft container), which have reportedly been as high as US$450, had fallen to US$200 by mid-1989. Although improvements have been observed in the quality of service on domestic routes, it is still too early to discern significant changes in prices.

3.72 Easing entry restrictions to different sections of the shipping industry fostered competition and stimulated restructuring to adapt to the changing market requirements imposed by rapid containerization. Deregulation has allowed national-flag shipping companies to make their own routing decisions, charter in tonnage from overseas and choose whether to dock their ships within Indonesia or overseas. These factors have introduced flexibility into the evolution of the shipping networks (liner and tramp) and into the choice of type, size and docking of vessels. Concerns that deregulation would lead to a reduction in actual service to outports do not appear to have been realized. To date, actual service frequencies to such ports appear in general to have increased. A major benefit of deregulation is the freedom for a tramp market to develop according to the needs of shippers.

3.73 Despite the substantial improvements in performance, a number of significant constraints remain that preclude the realization of the full benefits of deregulation. The efficiency of port operations is limited by structural problems especially in stevedoring, port charges and port management. Stevedoring activities are subject to restrictive labor practices and limitations on innovations in management and reorganization. The loading/destination port charge is still regulated and applies per ton of cargo handled (not handling time). These constraints have led to lower productivity levels in Indonesian ports relative to other ports in the region.

3.74 Road transport. Despite significant progress in recent years the overall costs of road transportation remain significantly higher than they need be. The poor standard and condition of much of the road network raises vehicle operating costs, while comparatively few arterial links have been designed and constructed to the standards needed to permit the use of the most efficient multi-axled truck-trailer combinations. Overly restrictive and unevenly applied road traffic and transport regulations have militated against the introduction of new technologies; for example, the present vehicle height limit means that standard containers may be transported on public roads only by special dispensation. In some instances, regulations have also served to protect inefficient and unresponsive public transport operators from competition.

3.75 The present structure and level of road user taxes also serves to promote inefficiency. While total receipts from road users are now at a level comparable with total public spending on the road network, operators of large trucks are required to pay little if any of the infrastructure costs attributable to them. Consequently the pattern of demand between modes tends to be distorted, with roads carrying some traffic for which other modes - such as rail - are inherently better suited. Equally importantly, the structure of road user taxes provides no incentive for truck operators to invest in the types of multi-axled vehicles which would reduce road pavement damage.

3.76 The Government is committed to the adoption of policies which will permit and promote the development of a transport system capable of responding quickly and efficiently to the nation's growing and increasingly sophisticated

transport needs. In the land transport subsector, the Government has adopted policies which provide for a neutral and well administered regulatory regime under which operators will be able - subject to compliance with appropriate safety and environmental standards - to tailor their facilities and services to users' requirements without the distortions imposed by subsidies and unnecessary quantitative restrictions on entry, routes, fleet sizes, and service frequencies.

3.77 To this end the Government has adopted a series of policies designed to: implement a modern and coherent legal and regulatory framework for road traffic and transport; strengthen the capabilities and improve the efficiency and effectiveness of central and regional transport departments; and improve coordination and integration of transport sector policy formulation and planning. In the process the Government intends to revise the structure and level of road user taxes progressively and to amend and simplify limits on vehicle weight and size and the load-bearing classification of roads.

F. Environmental Management for Private Sector Development

3.78 Private sector development depends heavily on the availability of water, land, and forests. These resources are already very scarce in many parts of Indonesia, and rapid growth will lead to wider shortages in the years to come. In addition, industrial use of land and water, if unregulated, can have serious environmental side-effects that affect people's health. To maintain private sector growth while safeguarding public health, it will therefore be vital to manage carefully the natural resource base. Current efforts at land use planning and water resource management are hindered by both weak policies and fragmented institutional arrangements. With respect to pollution control, there is a reasonable policy framework in place, but institutional fragmentation has meant that standards have not been systematically enforced. The main challenge for the year ahead is to put in place institutional arrangements that will ensure that land and water resources are managed efficiently.

3.79 Land use and forest management. The population density on Java, which has 106 million people, is about 800 per square kilometer, one of the highest in the world. The population is increasing by about 1% p.a. in rural areas and 3.5% p.a. in urban areas. This has led to sharp competition for land between competing uses. For example, it is estimated that some 10% of agricultural land will be required for conversion to urban and industrial uses over the next 20 years, and such conversion carries with it a strong potential for environmental degradation. The efficient management of these intense pressures on available land is necessary if economic development is to proceed smoothly and be environmentally sustainable. The outer islands are sparsely populated, with an average population density of only 38 per sq. km. Most of the area in the outer islands is covered with either tropical rain forests (110 million ha), which are among the most important in the world or degraded and fragile deforested land. The forest resource is being rapidly reduced, with estimates of annual depletion ranging from 600,000 to over 1 million ha. Such rapid deforestation is very costly, both economically and in terms of the adverse effect on the environment (loss of species and land degradation).

3.80 Land use planning has been especially difficult in Indonesia because of three factors: (i) national land policies and institutional arrangements for land use classification are weak and fragmented; (ii) private land markets do not work efficiently; and (iii) government land acquisition procedures for infrastructure development are inefficient. Recognizing these problems, the Government set up a National Land Agency (Badan Pertanahan Nasional-BPN) in 1988 and charged it with the task of overall coordination of land use planning and registration. In the same year, the Ministry of Forestry took steps to reduce the backlog of uncollected royalties and made some progress in improving enforcement of regulations concerning timber-cutting.

3.81 In 1989, the Government moved to consolidate the initiatives of the previous year. To give BPN a higher profile and wider representation within government, the Government established an inter-ministerial committee to oversee and coordinate land use planning across all sectors. With respect to progress on the agenda for improving forestry management, the Ministry of Forestry has taken several steps in 1989/90 including: increasing the reforestation fee by 75%; improved monitoring of forests through remote sensing; and introducing a new Bill for Conservation in the Parliament for enactment in 1990.

3.82 Further progress in improving institutional arrangements, especially by clarifying and strengthening the role of BPN, is essential for successful land use planning and forestry management. As institutional arrangements are strengthened, future reforms should concentrate on land policies. Also high priority now must be given to the completion of the geodetic reference system, so that the committee and BPN will have accurate information necessary to develop and implement proper policies. In the forestry sector, further steps are needed to improve revenue collection and enforcement of regulations concerning timber cutting to ensure more sustainable development. A review of the recent sharp increase in the export tax on sawnwood would also be advisable.

3.83 Water resource management and pollution control. Due to the increasing densities of both industrial development and human habitation, water availability and quality are becoming major constraints in many areas, especially on Java. Rainfall on Java is relatively abundant, but it is heavily concentrated in a 6-month period. This concentrated rainfall, combined with increasingly deforested catchments and relatively short rivers, produces frequent flash floods, fast run-off, and sharp variations in flow. Due to the population density in Java, water availability is low and the problem is exacerbated by the scarcity of suitable dam sites for storage and river regulation. Coupled with rapid industrial growth, the competition for water has become intense.

3.84 Careful planning will be necessary to ensure orderly and efficient development in the future. The challenge is to ensure water for both industrial users and for human consumption. The designation of forestry lands for timber production or agricultural conversion also needs to take into account the impact on watersheds and catchments. Industrial development and forest land conversion both have broader implications for the availability of irrigation water needed to maintain agricultural production. The Government

is already undertaking initiatives to address water resource problems in specific areas. However, there is a strong need to consolidate these efforts into a standardized strategy and institutional arrangement.

3.85 With respect to pollution control, legislation already requires that environmental impact analysis (EIA) be done prior to approval of government projects. Most of the major external donors have now instituted EIA requirements for all projects they finance in both the public and private sectors. Private sector investors must also comply with certain environmental regulations. However, the responsibility for monitoring compliance with environmental regulations is extremely fragmented, and agencies lack the proper equipment and training.

3.86 The Government is currently considering the establishment of a centralized environmental agency that would have broad authority to set standards, assist in manpower development, and impose penalties for non-compliance with regulations. Issues related to the proposed agency's legal mandate and degree of authority at the provincial level, however, remain to be resolved.

CHAPTER 4

PUBLIC SECTOR MANAGEMENT FOR GROWTH AND POVERTY REDUCTION

A. Introduction

4.01 Indonesia's successful adjustment performance has set the stage for sustained growth and progress in poverty reduction in the 1990s. The sharp expenditure cutbacks made to restore macroeconomic balance, although focused on less vital areas, could not be sustained indefinitely without constraining growth. Accordingly the focus of the public sector has shifted from the management of expenditure cutbacks to the efficient management of a growing level of public spending. The rate of expansion of public expenditures, however, needs to be carefully balanced. The policy challenge for the public sector will be to provide sufficient complementary resources to support private sector growth and poverty reduction while containing the level of public expenditures to preserve macroeconomic stability and ensure adequate resources for financing private sector investment.

4.02 The realization of the Government's policy objectives for the 1990s calls for a sharper focus of public spending on two broad priorities: (a) ensuring adequate provision of basic infrastructure and services to remove potential bottlenecks constraining higher growth of private sector activity (agricultural support services, power, telecommunications and transport); and (b) better targeting of public expenditures to meet the needs of the poor for basic services (primary and nonformal education, community health, family planning, water supply and sanitation, and other social infrastructure). Allocations for REPELITA V (Table 4.1) show that the Government intends to respond to these requirements, and recent budgetary allocations have been consistent with these overall priorities. Key elements are: (a) a reduction in the share of development expenditure for direct production activities in industry and mining, falling from 10% in REPELITA IV to 7% in the 1990/91 Budget; (b) a sharp increase in the share of development expenditure allocated to complementary economic infrastructure and agricultural support services, rising from 40% to 52% in the 1990/91 Budget; and (c) a continued large share going to human resource development, up from 22% to 23%.

4.03 These broad shifts in resource allocation between sectors are appropriate. Adequate availability of economic infrastructure will be essential to support economic growth, non-oil exports, private investment and employment. Provision of agricultural support services will be necessary both to sustain the projected rate of agricultural output growth and to increase the earnings of poor smallholders and landless laborers. Human resource development will play an important dual role in promoting growth and poverty reduction by creating a more skilled and productive labor force. This chapter reviews and illustrates selected public resource management issues which need to be addressed in achieving these policy objectives. Section B analyses opportunities for allocating public spending within individual sectors to ensure that available resources are not spread thinly between low and high priority areas for public intervention. Section C examines the need to complement improved targeting of public expenditures with better pricing

Table 4.1: SECTORAL DISTRIBUTION OF DEVELOPMENT EXPENDITURES
(% of total)

	REPELITA IV Actual	REPELITA V Plan	1989/90 Budget/a	1990/91 Budget
Agriculture	15.2	20.8	19.7	20.3
Agriculture /b	5.3	9.8	9.6	10.1
Irrigation	4.4	6.2	4.7	4.6
Transmigration	3.2	3.0	2.7	3.6
Resources and environment	2.2	1.7	2.6	2.0
Infrastructure	29.2	30.0	32.3	31.5
Energy	13.3	9.9	11.3	11.5
Transportation and communications	16.0	20.2	21.0	20.0
Industry and mining	10.0	4.9	6.7	6.6
Industry	5.6	2.1	3.2	2.9
Business development	2.5	1.7	1.4	1.4
Mining	1.9	1.1	2.2	2.2
Regional development /c	9.7	10.5	11.6	12.3
Human resource development	21.5	27.2	21.8	22.6
Education and manpower	14.4	16.7	13.4	14.1
Health	2.0	2.6	1.9	2.5
Population and social welfare	1.3	1.4	1.2	1.2
Housing and water supply	3.8	6.5	5.3	4.8
General services /d	14.5	6.5	8.0	6.8
Total	100.0	100.0	100.0	100.0
Memo item (Rp. trillion):				
Total at current prices	48.0	101.7	13.5	15.2

/a Includes supplementary budget (ABT) allocations totalling Rp.1.15 trillion.
/b Excludes fertilizer subsidy (assumed to be Rp.1 trillion during the REPELITA V plan period).
/c Comprises INPRES grants, which include specific sectoral allocations.
/d Excludes defense.

policies designed to raise revenues, induce greater efficiency of resource use and improve the equity of public spending. Section D discusses selected areas where a concerted effort will be required to overcome institutional problems in program management which are likely to constrain the effectiveness of the projected expansion in the public expenditure program given the changing composition to smaller and more complex projects increasingly managed by the

regional governments. Finally, section E reviews the Government's progress in public enterprise reform aimed at streamlining their efficiency and financial performance. Since public enterprises provide a number of goods and services essential for private sector development (power and telecommunications) improved efficiency will contribute directly to sustaining growth. Better financial performance combined with selective divestiture will free public sector resources for higher priority uses.

B. Public Expenditure Priorities

4.04 The role of public expenditure in meeting the goals of stable growth and poverty reduction differs from sector to sector. Despite these differences all sectors face the same fiscal challenge of controlling total spending and allocating it efficiently to high priority uses. Resolving this in practice depends on an appreciation of where government involvement needs to be concentrated in order to complement and support private sector activities, and of where limited resources can be spent most effectively in areas where public involvement is called for. This section illustrates these considerations in selected sectors. It has four recurring themes: (a) opportunities exist for private sector participation in providing services that will remain largely in the public domain; (b) reallocation to higher priority programs could improve the effectiveness of public spending; (c) higher levels of operations and maintenance (O&M) spending are vital to improve the quality and productivity of public infrastructure; (d) greater emphasis needs to be placed an attracting and motivating qualified staff to improve the implementation of public programs.

Supporting Private Sector Development

4.05 An important requirement for rapid development of the private sector is the complementary development of basic infrastructure and support services to avoid bottlenecks to higher growth in the 1990s. Key areas for government involvement include the provision of agriculture support services to farmers, public utilities (power and telecommunications) and transportation (ports and roads). A critical potential constraint is the power capacity shortage emerging in the face of rapid economic growth which could disrupt the investment climate, manufacturing output growth and the non-oil export drive.

4.06 Agricultural support services. A vital factor in sustaining the projected rate of growth in agriculture will be the provision of agricultural support services to farmers. Opportunities exist for improving the effectiveness of public spending on these programs, notably in irrigation, tree crops and research and extension. The past emphasis on developing new irrigation systems played a major role in Indonesia's achievement of rice self-sufficiency and also raised the income of many poor farmers. However, most of the areas highly suitable for irrigation have now been developed and economic returns to construction of new systems (headworks and the main and secondary structures) are now very low (less than 10% in most areas). By contrast, the past underfunding of systems maintenance has led to a situation where higher funding of operations and maintenance (O&M) has very high returns (usually exceeding 50%). Ensuring efficient operations and maintenance (EOM) would improve water delivery throughout the system, especially to poorer

farmers at the tail end of the systems, who suffer most from irregular or inadequate water delivery. Better water delivery would permit a roughly 20% higher cropping intensity within existing systems, and this would yield higher rice production. These factors suggest that the REPELITA V period should be one of consolidating past investments and operating them efficiently. This is the approach outlined in the text of the REPELITA V plan. Although expenditures on O&M have been rising, adequate funding of EOM would require increasing the O&M budget by about Rp.80 billion over 1989/90 levels to around Rp.140 billion. The additional funding required would amount to only one-fifth of the amount spent on new irrigation system construction in 1989/90. The full benefits of increased funding will be reaped with greater attention to effective planning and budgeting of these resources (see para 4.52).

4.07 Recent studies indicate that about 200,000 to 275,000 hectares of additional irrigated land would be needed to meet rice production targets over the next five years. By concentrating on completing the backlog of land and tertiary development within existing command areas, the required increase in area could be achieved more quickly and at less cost than new system construction. These existing areas contain at least 500,000 hectares of potentially irrigable land, and the cost of bringing such land under irrigation is only about one-half the cost per hectare of constructing entirely new systems. These efficiency considerations need to be carefully weighed in evaluating proposals to construct new irrigation systems in areas that are presently entirely unirrigated.

4.08 In allocating tree crops expenditures the Government confronts a choice between concentrating its limited resources on a few farmers using costly high-input approaches or spreading them across a larger number of farmers using lower cost alternatives. To date, the smallholder tree crop program has reached less than 15% of existing rubber farmers and less than 5% of existing coconut farmers, many of whose trees are old and very low-yielding. This partly reflects the high costs of the current approach, which involves large amounts of agronomic inputs and technical support with the aim of achieving very high yields. This approach has also been constrained by difficulties in establishing a viable credit mechanism to finance farmers' purchase of inputs. Thus, the Government needs to consider developing lower cost per beneficiary approaches that would use lower levels of inputs and enable the farmer to self-finance a larger portion of total costs (see Table 4.2). Such approaches, such as provision of nursery material only, would place more emphasis on tree crops as only one component of a mixed farming system and would permit farmers to spread planting over a number of years. They would not attempt to reach the yield levels aimed for under the current higher cost approach, but they would still help many more existing tree crop farmers achieve much higher yields than are possible with their current unimproved tree crop varieties. They would also substantially raise the incomes of poor farmers who do not yet grow tree crops.

4.09 In order to support a progressive broadening of the production base and, in particular, to increase the productivity of dryland farmers, the Government's research and extension services need to be strengthened. The tight budgetary situation constrained the ability to carry out effective research in the 1980s. Similar constraints have meant that extension services reach only about half of all farmers. Expenditures on research and extension have since begun to rise, primarily because of new externally funded projects.

In conjunction with the increased funding, the Government is beginning to shift the focus of its research programs from a purely commodity-based approach to a greater emphasis on palawija (secondary) crops and a farming systems approach that treats the various on-farm activities as an integrated enterprise. This new focus holds special promise for helping poorer farmers in remote and upland areas, where soils are often poor and access to inputs is limited. It will be important to ensure that the extension system is appropriately structured and adequately funded to convey the results of such research to its intended beneficiaries.

Table 4.2: COSTS AND BENEFITS OF RUBBER DEVELOPMENT SCHEMES

Model	Financial Development Costs (Rp.'000/ha.)	Beneficiaries per Rp. billion	Economic Rate of Return (%)
Present approach	1,496	668	24
Partial assistance	1,196	836	23
Nursery material only	415	2,410	23

Source: Indonesia: Strategies for Sustained Development of Tree Crops, IBRD Report No.7697-IND, December 7, 1989.

4.10 Electricity. The projected growth in economic activity, particularly manufacturing, implies a rapid increase in the demand for power. Recent information from PLN's waiting list indicates that the annual increment in connections by industrial customers in Java-Bali, where most of the increase is concentrated, could double from about 500 MVA/year between 1986/87-89/90 to over 1000 MVA/year from 1990/91-93/94. As shown in Table 4.3, there is a clear risk of power shortages emerging in Java in the near future, as rising demand outstrips the available supply form PLN's grid. In view of the lead time required for increasing supply, it will be important for PLN for PLN to develop a strategy for balancing supply and demand in order to prevent load shedding and consequent disruptions to the economy.

4.11 A comprehensive strategy would include both supply and demand side measures to achieve equilibrium. Priority least-cost options for enhancing supply include the following. First, measures to accelerate planned additions to generating capacity, particularly the gas-fired Combined Cycle Plant at Gresik, the coal-fired Steam Power Plant at Paiton, and the Coal-fired Suralaya Steam Power Station. Implementation could be accelerated by using simplified procurement procedures. At the same time, it would be important to finalize arrangements for supply of gas to the Gresik plant to minimize initial reliance on more costly diesel oil. Second, measures to improve maintenance management to reduced planned downtime could have significant benefits. And third, measures by PLN to purchase surplus energy and capacity from capture generators for resale to its other customers.

4.12 Complementary demand management measures would take advantage of the existing large stock of captive capacity. In addition to maintaining appropriate electricity prices, the principal measures which need to be considered to reduce the demand from the grid in a least-cost manner include: (a) suspending the program to substitute grid supply for existing captive capacity in order to reduce the rapid rate of increase in sales. Of all types of customers, those that already have installed captive generation face the lowest alternative cost of supply, as they only have to pay the fuel and operating cost of their own equipment; and (b) encouraging PLN customers to use their existing generation equipment in lieu of PLN supply. This can be pursued through tariff incentives or administrative directives to ration the available supply.

4.13 Overall, as shown on Table 4.3, the above measures offer the potential for eliminating the imbalance between supply and demand. This would avoid the need for more costly and less desirable options, such as a freeze on new industrial customer connections, a slowdown of the rural electrification program, a crash program for the installation of gas turbines (other than those required for the Gresik Combined Cycle Plant), and major planned outages, with the attendant disruptions to the economy.

Table 4.3: ELECTRICITY SUPPLY AND DEMAND IN JAVA-BALI
(Gross energy generation in TWh)

	Supply		Demand a/	
	Without Enhanced supply	With Enhanced supply	Without Demand management	With Demand management
1990/91	29.0	29.2	28.9	28.1
1991/92	29.0	29.8	33.5	29.8
1992/93	29.1	30.5	39.1	30.5
1993/94	32.7	37.6	45.2	37.6
1994/95	40.2	43.1	51.9	43.1

a/ Includes transmission and generation losses and power plant use.

Source: PLN and World Bank staff estimates.

4.14 Telecommunications. A prerequisite for supporting private sector development is the provision of an efficient countrywide telecommunications network. In the past, the telecommunications network has not grown sufficiently to support the overall growth of the economy. Since 1981, the gap between expressed demand for telephone service and available telephone lines has widened. In recent years, the waiting list for telephones has increased at an average of 14% p.a. By end-1988, unmet registered demand for telephone service had increased as a proportion of total supply from 39% of lines in 1982 to 70%. At the expansion rate achieved during 1984-89 (average 50,000 lines p.a.), it would take 10 years to meet the current backlog of registered demand alone. Over the next five years, growth in demand for new

services is expected to surge, fueled by expansion of export-oriented industries and the tourism sector. The total demand for telephone service is expected to grow at only an average annual rate of 15%. Over the same period, the number of main lines is projected to grow at 15% per year, a rate which is too low to make any progress in reducing the backlog. Therefore, despite rehabilitation and a large increase in investment, the supply of telecommunications facilities and services is likely to remain inadequate relative to demand throughout REPELITA V and beyond.

4.15 Achieving a rapid and cost-effective increase in the availability and quality of telecommunications services in Indonesia will require substantially increased investment levels and improved implementation capacity. To relax these constraints the Government and PERUMTEL are seeking to identify activities, including the provision of certain network telecommunications services, where private sector participation can be increased. In the short term, PERUMTEL, as part of the process of increasing its commercial orientation and efficiency, may assess the merits of increased contracting out of a number of operations such as design and construction of outside plant and other telecommunications facilities on a turnkey basis, project and construction management, and the maintenance of certain telecommunications facilities.

4.16 With respect to ownership, long-term options extend from a 100% government-owned corporation to various levels of private sector ownership with or without foreign participation. Given the limitations of funds that can be obtained through the Government, a critical consideration in assessing these options is to ensure that investment levels adequate for the required rapid expansion in service and improvement in service quality will be available. In the short term, consideration could be given to increasing the operational autonomy of PERUMTEL by establishing it as a 100% government-owned corporation (along the lines of PT. Indosat) that would be allowed to retain earnings, subject to the payment of dividends and taxes.

4.17 Transport. Rapid growth of manufactured exports in recent years has been accompanied by dramatic increases in cargo flows at specific points in the maritime transport system. This is illustrated by developments at Tanjung Priok port container terminal where containerized exports have more than quadrupled over the past 4 years from 0.33 million to 1.4 million tons. The Government has taken major steps to provide new port infrastructure over the last decade. The result has been significant expansion and upgrading of numerous facilities and especially, the development of specialized container terminal facilities in Tanjung Priok (Jakarta), in Belawan (Medan) and in the near future, in Tanjung Perak (Surabaya). Because the Indonesian port system will need to become increasingly container-driven to support the growth in non-oil exports, port investment priorities need to focus on facilitating movement of general cargoes in containers from all locations, including interisland origins which are not yet equipped for containerisation. While there is currently adequate capacity in the key ports, it will be important to monitor the growth and pattern of demand very closely and to plan carefully for the provision of additional capacity.

4.18 Although the quality of Indonesia's main inter-urban road transport network has improved substantially in the past ten years, it is still largely unsatisfactory. Only about 40% of the 50,000 km of national and provincial

roads are in good or fair condition while about 25% requires heavy maintenance and 35% need rehabilitation or reconstruction. In addition, about 1,100 km located in suburban or very densely populated areas are faced with congestion problems. These circumstances should guide the allocation of expenditures to and within the highways sub-sector in the coming years. In broad terms, expenditures need to be allocated to minimize the total road transport system costs. The planning tools to facilitate this are available and are being implemented (see para 4.55). Given the high cost of transport on poor quality roads, the aim would be to maintain all roads in good or fair condition and upgrade those which have deteriorated or are carrying a larger volume of traffic. At the same time it will become increasingly important to increase the capacity of radial roads on the approaches to the major cities, and key links within those cities, which are becoming congested. Sound traffic management and road pricing policies would complement these expenditure priorities (see para 4.43). A key objective is to enhance the road network's ability to carry larger and heavier multi-axled commercial vehicles, in order to improve the overall efficiency of road transport.

4.19 The Government plans to spend about one-third of total road expenditures on rural roads. To achieve better returns from this expenditure the Government intends to raise quality standards for roads through higher allocations per unit. Improvement in local government and contractor capacity, together with more effective central and provincial government supervision and monitoring of the program, would complement this initiative. Future levels of spending on rural roads would need to be realistic and closely matched to improvements in the absorptive capacity of the kabupaten public works units (DPUKS).

Improving Basic Services for the Poor

4.20 Improving access to and the consumption of basic services (education, health, family planning and water supply and sanitation) is a necessary condition for the Government's anti-poverty policies to be successful in the long run. These interventions address first of all the most severe consequences of being poor. But they also constitute investments in human capital which address some of the most important causes of poverty, thus providing the basis for long-term poverty reduction.

4.21 Education. Education plays an important role in reducing poverty over the long term, both indirectly by improving the productivity of the work force and also directly by providing the poor with the skills necessary to raise their productivity and incomes. Primary education or its equivalency are critical for the latter, as shown by the high social rates of return to primary school education in Indonesia. In the past decade, the Government has made a concerted effort to improve the availability of education. This program has succeeded in providing access to primary schooling to virtually all Indonesian children of primary school age.

4.22 The nearly complete coverage of primary schooling leaves little room for differentials in enrollment by income class. Equalising educational opportunities at primary level is, therefore, principally an issue of equalising the quality of education. There are significant income-related quality differentials in both primary and secondary education. One indicator is primary school repetition rates, which vary considerably across provinces

and are significantly higher in poorer provinces. These differences in quality arise from differences in the capacity of individual communities to supplement budgetary resources which are inadequate for nonsalary needs. Thus, education quality is much higher in the more affluent communities which are able to raise funds through private contributions. Those communities or individuals that cannot afford to pay higher fees suffer because their schools do not have the complementary inputs necessary to improve education quality. The problem is that the allocation of central government funds for primary education does not compensate for the inability of poor areas to mobilize local resources.

4.23 There are two policy options for improving access by the poor to the full benefits of education. First, while primary school enrollment is virtually complete, there is evidence that inability to pay the costs of schooling increases primary school drop-out rates among the poor and is a deterrent to school attendance among the poor at higher levels of schooling. The Government might consider providing financial support to the poor for this purpose. Second, there is substantial scope to improve the quality of primary and secondary education provided to poor children and in poor areas. The most important needs are for adequate financing of essential supplies such as textbooks, teacher's manuals and chalk together with improving teacher quality through in-service training. Currently, budgetary allocations per student increase sharply with the level of education, indicating that the better off students who are able to remain in school are receiving a disproportionate share of the Government's education outlays. Some reorientation of budgetary priorities within the education sector would therefore be appropriate. In particular, increasing budgetary outlays for improving the quality of primary education, while restraining subsidies for higher education, would improve the efficiency and equity of the system. In addition, it will be essential to develop a proper mechanism for targeting larger subsidies to primary schools in poor communities.

4.24 Non-formal education (NFE) also has a role to play in poverty reduction. First, there is a close association between illiteracy and poverty. About one third of the poor are illiterate and almost 50% of the poor above the age of 29 are illiterate. Second, since the rapid expansion in primary school enrollments only occurred in the early 1980s, many older Indonesians have not had the opportunity to acquire the basic education skills needed to participate actively in the labor market. The non-formal education directorate of the Ministry of Education and Culture has a number of programs designed to teach basic literacy and numeracy, raise community awareness, and support local income generating activities. The options to improve NFE during the REPELITA V period include: (a) expanding the resources available to these NFE programs; (b) increasing the number of extension workers, as well as improve their training in the income generating aspects of NFE programs; and (c) targeting NFE activities to those areas where poverty is the highest.

4.25 Health. Indonesia's record of mortality reduction has been solid and impressive. A key indicator is infant mortality, which has been roughly halved in the past two decades. However, the poor have benefited much less from the progress in mortality reduction than the non-poor. In addition, the sick poor use fewer modern curative health services than the better-off. Most of this difference in outpatient visits is due to the higher use of high-quality providers (doctors and hospitals) among the better-off. The

differential in hospital admission rates is wide, averaging three times as many for the non-poor compared to the poor. Even more striking than the relatively low utilization rates among the poor in Indonesia, especially for hospital admissions, is the fact that overall these rates are extremely low, even for the non-poor, compared to levels prevailing in other countries. Other developing countries have average hospital admission rates between 5 and 10 times higher than the Indonesia average of 13.6 per 1,000 per year.1/ Even in the poorest consumption quintile, hospital admission rates are 3 to 6 times higher than the average for Indonesia as a whole.

4.26 The low level of utilization of health services by the poor in Indonesia indicates a need to further lower barriers to access by improving both the quality and quantity of available services. High priority needs to be given to the scope for raising recurrent expenditure on operations and maintenance inputs necessary to provide adequate service through fixed facilities, and to support the mobile outreach inputs to the village-level service delivery mechanism for preventive health intervention (POSYANDU). Key components of the effort to raise quality include: redistribution of specialist doctors from tertiary to lower level hospitals; increasing the supply of medical and paramedical staff to understaffed health centers; increasing the supply of health center drugs, which presently cover about three-quarters of annual requirements; and increasing the operational budget of health centers to ensure sufficient funds for travel in support of POSYANDU activities. On the investment side, priority needs to be given to increasing the supply of community health centers and subcenters in order to reduce travel time in poorer areas with more dispersed populations. The need to improve both the quantity and quality of health services for the poor presents a potential trade-off between investment and recurrent expenditure from constrained budgetary resources. Resolving this trade-off will require a stronger resource mobilization effort both to increase the low health sector budget share and to raise the low level of cost recovery in the sector. On the budgetary side, it will be important to continue to improve the distribution of government resources to poorer regions. On the cost recovery side, a key element will be to raise reimbursement levels from the health insurance scheme for government employees (ASKES) in order to reallocate subsidies now received by the better-off with insurance to the uninsured poor (see para. 4.46).

4.27 Family planning. The role of family planning in poverty reduction is well appreciated in Indonesia. A successful family planning program creates better conditions for sustained economic growth and improves the ability of the poor, and especially women, to participate in and benefit from economic development. Slower population growth also eases growing pressures on Indonesia's limited land and water resources, thus helping to postpone the emergence of environmental constraints. Although substantial progress has been made, much remains to be done about the population problem. The total fertility rate of 3.4 is still significantly higher than replacement level and the population is projected to rise to 195 million in 1994 and 213 million in 2000. Contraceptive prevalence overall remains at only 45% of married couples' and the contraceptive needs of large segments of the population

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1/ For details see Indonesia: Poverty Assessment and Strategy Report, IBRD Report No. 8034-IND.

remain unmet, particularly among the poor, less educated, and rural women. It is estimated, for example, that the vast majority of women with unmet family planning needs in Indonesia (71%) have not completed primary education.

4.28 To reduce the total fertility rate from 3.4 to the Government's 1994 target of 2.89 the number of couples using contraception would need to increase substantially, from 14.2 million in 1988 to 19.4 million in 1994. During this period, the contraceptive prevalence rate would have to rise from 45% to 54.4%. This would require a continuing increase in domestic budgetary outlays. At the same time it will be necessary to target these resources more efficiently to reach the large number of poor women with unmet needs for family planning. In particular, the Government might consider giving higher subsidies to contraceptive methods that are more cost-effective and for which there is unmet demand among the poor (e.g., sterilization).

4.29 Water supply and sanitation. Improved water supply and sanitation in rural areas can have wide-ranging health, economic, social and environmental benefits. The greatest effect on health from the provision of rural water supply and sanitation (RWSS) is likely to come from improved sanitation facilities and an increase in water quantity. Furthermore, the benefits of RWSS can be especially important for women and children, as they play a major role in carrying water. Rural service levels are low in Indonesia, with available coverage favoring water supply (36% of households) over sanitation (18% of households), and biased in favor of the better-off. The Government has committed itself to making an intensified effort in REPELITA V to increase substantially the coverage of RWSS. This will require: (a) a clear definition of institutional responsibilities and an effective coordinating mechanism; (b) the use of low-cost appropriate technology; (c) the use of a cost recovery mechanism to provide funds for the operations and maintenance of these systems with the capital cost provided through the INPRES program; and (d) the use of community-based groups in implementation to encourage local acceptance, provide education about health benefits, and help overcome the financial and staffing constraints of the Government.

4.30 Progress has been made in improving access to safe drinking water in urban areas but significant disparities in access still remain between poor and non-poor households. The situation for the poor is becoming critical, especially in the larger cities and the role of standpipes or a viable alternative has become increasingly important. Recognizing this, the Government has recently embarked on a major initiative to improve the access of the urban poor to water at affordable prices (see para. 4.48 and Box 4.1).

4.31 Human waste disposal is generally unsanitary in Indonesian cities. This can have severe effects upon human health, especially in crowded and congested urban areas. As with water, there is a significant disparity between the poor and the non-poor, with almost one third of poor households indicating that they do not use formal sanitation facilities. Despite the apparent need for and availability of appropriate technology, public expenditures on sanitation have lagged. The Government plans to give greater priority to the improvement of urban sanitation during REPELITA V. Although public investment in the subsector would increase significantly in real terms, it remains small compared to overall needs. Given these limited public resources, the focus should be on providing more and better toilets for poor households with on-site disposal. This would require the adoption of appropriate technologies on

a larger scale, clarification of institutional roles, formulation of a list or priority areas within cities, and greater involvement of the community. In this regard, an evaluation of the ongoing pilot program in Solo and Semarang could be undertaken with a view towards wider replication. It is also important to improve the knowledge of poor urban residents about the benefits of sanitary disposal of human waste.

4.32 Kampung improvement program (KIP). The KIP is a nationwide program for upgrading unplanned urban villages, particularly in lower-income communities and is, therefore an important mechanism for improving basic services for the urban poor. It provides a range of infrastructure at minimal standards including local roads, footpaths, drainage, water supply, public sanitation facilities and solid waste collection. In the past, this program has successfully focused on badly serviced areas in a number of cities. Recognizing its potential to address the needs of lower income groups, the Government is increasing its expenditures on the KIP program during REPELITA V. The effectiveness of expenditures in this area could be raised by more fully addressing community priorities, which is likely to result in more funding being allocated to sanitation, solid waste or water supply where the needs of the poor are the greatest. In order to improve the performance of these components, it will also be important to make complementary improvements to primary systems outside the kampung and to provide adequate O&M funding.

C. Pricing Policy for Public Services

4.33 Against a background of clear spending priorities, appropriate pricing policies can help to improve investment decisions, raise operational efficiency and reduce inequalities in public service provision. Many public services are provided free or at low cost for equity reasons so that poor people have access to them. But in practice budget constraints can ration the provision of subsidized services with the result that they disproportionately benefit the better-off. Charging efficient prices to better-off users while targeting available subsidies to poor beneficiaries can, therefore, help to alleviate poverty and improve efficiency at the same time. Even when revenue is not transferred directly to the budget, higher prices reduce the need for borrowing or budgetary payments for subsidized expenditure. The budgetary savings which result can provide more resources for priority needs or can be used to reduce the budget deficit. Thus, pricing policy can be an important complementary instrument in the effort to target public expenditures on high priority areas.

Agriculture

4.34 Most prominent among the policies affecting the allocation of public resources to agriculture are the input subsidies on fertilizer, credit, and irrigation. The policy of subsidizing fertilizer has kept the retail price well below economic levels, and Indonesia's farmgate prices are among the

lowest in the region.2/ The Government originally introduced the subsidy to encourage farmers to apply the inputs necessary to fully exploit the productive potential of the new high-yielding varieties of rice, and this policy succeeded: fertilizer application rates increased by over 500% between 1970 and the mid-1980s, and by 1984 application rates were more than twice as high as in the Philippines and more than three times as high as in Thailand. Indonesia's farmers are now generally well aware of the benefits of fertilizer. Given subsidized prices, however, profit maximizing farmers use more fertilizer than is economically optimal, which means that the fertilizer subsidy is generating very low returns. It also has negative environmental effects on water quality due to run-off. The Government's successful decision to eliminate the pesticide subsidy in 1989 demonstrated that input subsidies can be removed with little impact on production and with positive environmental effects. The integrated Pest Management initiative, introduced in 1988, attempts to train farmers to apply inputs such as fertilizer and pesticide more efficiently in order to lower costs and help to reduce environmental side-effects.

4.35 Recognizing that the fertilizer subsidy is now distorting the allocation of resources, the Government has begun a series of annual real increases in the retail prices per unit of fertilizer. However, these increases have been largely offset by higher overall fertilizer demand, so that the financial subsidy continues to exceed Rp.700 billion, which amounts to about one-third of total agricultural development expenditures. Recent agro-economic evidence suggests that prices for all the fertilizers could be increased substantially without slowing the growth of rice production, especially if rice prices remain strong; this evidence is supported by the experience of the last two years, during which rice production has increased about 10% despite a 27% rise in the real price of fertilizer. Reallocation of this subsidy could substantially increase the effectiveness of agricultural spending.

4.36 Major input subsidies on credit have been a past feature of agricultural strategy, but the Government has taken dramatic measures to remove them. Past programs nearly all lent money at highly subsidized rates, and all suffered both from diversion of funds to unintended beneficiaries and from high arrears. The banking deregulation of 1983 set the stage for the emergence of KUPEDES, a very successful unsubsidized rural lending program that has lent at market rates to over 6 million borrowers and achieved a recovery rate in excess of 96%. KUPEDES has also reached out to the poor. A recent survey suggested that over 70% of borrowers are landless or near-landless, and that over 70% of poor borrowers had climbed over the poverty line after three years of participation in the program. In early 1990, the Government announced the termination of most subsidized credit programs across all sectors. Of those left in the agriculture sector, intermediation margins and onlending rates have been increased significantly. Even though the onlending rates are still subsidized, the higher intermediation margins in conjunction with the withdrawal of government guarantees against default

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2/ In late 1989, for example, farmgate prices for urea and TSP in Indonesia were estimated to be 45% lower than their economic levels and 50% lower than the average farmgate prices prevailing in a wide selection of other Asian countries.

should strengthen financial discipline over time. One major remaining issue is the lack of long-term financing available in the agriculture sector. This problem is especially acute in subsectors such as tree crops, which yield high economic returns and have a substantial poverty reduction impact.

4.37 A third area where agricultural inputs are subsidized by the Government is in irrigation. Although farmers enjoy substantial benefits from irrigation, they are not required to pay directly for any of the costs of construction; however, some farmers have paid a small land tax which is an indirect cost-recovery mechanism. In a situation where many poor farmers have only limited or no access to irrigation services, it would be more equitable to redirect part of the subsidy away from already irrigated areas and use it for expanding the irrigation network to include more farmers. Indeed, the Government is now beginning to institute a system of partial cost recovery for irrigation O&M in a few provinces. Although this initiative is currently proceeding only on a pilot basis, it deserves high priority both for general cost recovery reasons and also because a well-designed cost recovery system can improve water delivery to farmers. Since O&M is currently underfunded by over 50%, and the returns to improved O&M are very high, farmers are likely to be willing to pay irrigation service fees if the revenue is used directly to improve O&M for the same systems and if farmers are given the opportunity to participate in water management

Energy

4.38 As Indonesia moves towards a more deregulated economy, there is a need to rationalize the structure of domestic energy prices to support the Government's strategy of guiding energy-related investment and operating decisions towards least-cost solutions and improved efficiency. Government price controls on energy (electricity and petroleum products) are among the most important domestic price controls in Indonesia. Power tariffs were raised on average by 25% on April 1, 1989, to improve the financial performance of the power utility and the efficiency of electricity consumption. Undertaking future adjustments in power tariffs on a more systematic basis would help to ensure that PLN is able to operate on a solid financial basis with adequate internal resource generation to implement its expansion plan. At projected prices for 1990/91 there are substantial budget subsidies (over Rp.600 billion) for petroleum products unless domestic sales prices increase in line with the rise in world oil prices. Elimination of these subsidies would have important macroeconomic effects by: (a) freeing up large fiscal resources for reallocation to higher priority uses; and (b) reducing the rapid growth in domestic demand for oil, thereby slowing the decline in the exportable oil surplus and avoiding adverse consequences for oil exports and the balance of payments. Thus, President Soeharto has recently announced that "low domestic oil fuel prices cannot be maintained for too long because it has encouraged inefficient use of the energy resource".3/

4.39 Petroleum prices are also characterised by cross-subsidization of some products. The primary objective of energy pricing is to signal to producers and consumers the economic cost of supply of the different energy sources. As petroleum products are traded goods, a straightforward

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3/ Jakarta Post, March 5, 1990.

rationalization of petroleum product pricing to reflect world prices would involve increases in the prices of diesel and kerosene which are subsidized at present, and reductions in the prices of fuel oil and gasoline which are taxed. Elimination of the diesel oil subsidy would have favorable efficiency implications by discouraging its use in industrial applications where less valuable fuels (gas, coal and fuel oil) can be substituted, and also the excessive use of heavy goods vehicles for commercial freight transport by road. Reducing the kerosene subsidy intended for poverty reduction purposes would reduce the disproportionate leakage to better-off domestic consumers.

Telecommunications

4.40 Tariff policies for telecommunications services need to be structured to meet several goals. In order to contribute to economic efficiency, tariffs should reflect costs and, where unmet demand exists, serve to ration scarce capacity. For the operating entity to achieve satisfactory financial returns, tariffs must also attain revenue targets. Finally, they should be seen as equitable by the public. In order to provide access to telephone service for those who cannot afford private connections at such prices, the tariff policies should be accompanied by a serious program to provide service through public pay phones.

4.41 Certain changes in the level and structure of tariffs would be appropriate. First, telephone installation charges (currently Rp.500,000 in the Jakarta area) could be increased in order to moderate the excess demand for new service. An additional measure would be to reserve a significant proportion of new lines for customers who would pay a higher installation fee in return for priority service within a one-month time frame. Second, telephone service monthly subscription charges (currently Rp.3,500 per month in Jakarta) are very low compared with costs and with charges in other countries. Significant increases would tend to remove the existing incentive for certain subscribers to retain telephone services that have a very low utilization. Third, while local calls are relatively inexpensive, long-distance calls (especially those over 1,000 km) are expensive relative to long-run marginal costs and to equivalent long-distance rates charged in other countries. The structure of telephone usage charges therefore needs to be reviewed and adjusted. Given the congestion problems on the network, it would also be appropriate to introduce peak and off-peak charges for local and long distance service.

4.42 In addition to the structure and level of rates, other important factors to be considered are: (a) tariff changes designed to moderate excess demand and to improve the financial viability of PERUMTEL should be considered as integral to the ambitious REPELITA V telecommunications investment program; and (b) PERUMTEL and the Government should agree to periodic revisions of telecommunications tariffs (for example, every two years) in order to avoid larger rate changes that would otherwise be required at longer intervals.

Transport

4.43 The level and structure of road user charges in Indonesia have been inadequate for many years. When properly structured so that payments by different categories of users reflect their road wear and tear, the user charge regime for roads would: (a) induce operators to make economically

efficient investment and operating decisions; (b) contribute towards eliminating distortions in the pattern of demand for different transport modes (particularly between road and rail); and (c) mobilize revenues to fund the road programs. In the past, total Government revenues from road users have not covered total expenditures on roads except in FY 1986/87. Moreover, there is a serious imbalance in the taxation structure, as more than 90% of tax receipts accrue from small gasoline-engined vehicles. Heavy goods vehicles, which cause most of the road damage and require the construction of strong pavements, contribute very little to their road wear and tear costs.

4.44 In Indonesia, the fuel tax and the annual vehicle registration tax (which are the two most commonly used instruments to achieve cost recovery from heavy road vehicles) are too low and are not appropriately structured to encourage the use of vehicles which are efficient from both the private and public point of view. In particular, diesel oil is subsidized (see para. 4.41) and the structure of the annual registration tax for heavy goods vehicles does not reflect the relative road wear and tear imposed by these vehicles. As a result, rigid two-axle trucks, which represent the majority of goods vehicles, carry loads which from the point of view of the road system would more economically be carried by multi-axled vehicles. Appropriate pricing of diesel to reflect world prices would help but would not be sufficient by itself to eliminate the distortion resulting from the low annual registration fees which are based on age and engine size. A restructuring of registration fees to encourage vehicle configurations and axle loads which are efficient from the point of view of the overall road transport system is also needed.

Health Services

4.45 Targeting more public expenditures on health to poor beneficiaries would be helped by charging higher prices to better-off users and lowering prices for the poor. This price discrimination could be effected by charging full cost-recovery tariffs to the insured who tend to be among the better-off. This would require a fundamental reform in the pricing structure for government-sponsored health insurance which is based on reimbursing public health services at regular tariffs which are heavily subsidized. On average this subsidy amounts to around 75% of the unit cost of public services.

4.46 The service utilisation rates of beneficiaries insured under the ASKES insurance scheme for government employees are around five times higher than for non-ASKES users of public services. Because of the subsidized reimbursement policy, this insurance-induced boost to the demand for services entails a larger requirement for public subsidies to finance services for the better-off with insurance, thus depriving the poor of the benefits which could be provided by those public resources. Subsidized health services therefore disproportionately benefit the better-off. For example, the net subsidy per capita for ASKES users of public sector hospitals and health centers is about Rp.6,500 compared to Rp.1,200 per capita for the rest of the population.

4.47 The unequal distribution of subsidies associated with the ASKES health insurance scheme will tend to be exacerbated by present efforts (through the experimental PKTK schemes) aimed at expanding coverage along similarly subsidized lines but on a mandatory basis for the potentially large social security scheme (ASTEK) membership base of 5.5 million private sector

Box 4.1: Water Prices and Subsidies for the Poor

Setting low official prices for public services does not necessarily ensure that intended subsidies benefit the poor. In 1988 only 14% of households in Jakarta had access to clean water through direct connections to the slowly expanding municipal water system. The rest generally relied on wells which are a cheap but increasingly contaminated source of groundwater. But in Northern Jakarta intensive withdrawal has resulted in depletion of the fresh water aquifers and alternative river sources are heavily polluted. As a result, private vendors had become the major source of drinking water for the less fortunate who do not have access to piped water.

The private vendors obtain their water supply mainly from public standpipes purchased by licensed operators from the municipal water company. The objective of this public standpipe program is to provide water for the poor who cannot pay for a house connection. The municipal water company sells subsidized water to the standpipe operators at an official tariff of Rp.150/m^3. The operators then sell the water to private vendors for prices ranging from Rp.600 to Rp.1,000/m^3, depending on the area and the season. Until recently, the vendors sold the water for prices which reached as high as Rp.9,000/m^3 in the dry season for households who are 2 km or more from the nearest standpipe; even in the rainy season the average price only fell to around Rp.4,000/m^3. Thus, the actual price charged to the end-user was usually much higher than the official subsidized price.

The key to helping the poor get better access to subsidized water is to relax the supply constraints which ration its availability. Recognizing this the Government has recently embarked on two major policy initiatives to increase the density of water outlets, and bring them closer to the poor. First, it is implementing an expanded investment program aimed at substantially increasing the number of public standpipes. An additional 655 were installed in Jakarta during 1989/90, thus raising the available number by nearly two-thirds. Program monitoring data indicate that this has already helped lower the average prices charged by water vendors by 40%. Second, this system expansion will be augmented by deregulation of the sale of water from private household connections. This would substantially increase the effective number of water outlets at no additional cost, thereby considerably improving access and further lowering prices for the poor.

employees. These considerations imply the need for a systematic review of issues and options for health insurance within the context of overall health financing arrangements aimed at improving access by the poor. This would need to provide an integrated analysis of the role of insurance, pricing policy and budgetary subsidies.

Water Supply

4.48 The main elements of the municipal water tariff structure are typically: (a) a relatively large cross-subsidy provided to connected households (in the form of subsidized water rates even at relatively high consumption levels) which is financed by a high surcharge levied on commercial and industrial users; and (b) high connection charges, which for certain areas are typically set above the cost of the installation. This pricing structure is not optimal given either the efficiency or the equity objectives of pricing policy. The high industrial and commercial water rates push these users towards private provision of water, which in turn risks inefficient over-extraction of groundwater resources. The large lump sum connection charge also prevents the poor from gaining access to the subsidized piped water. Thus, the domestic consumption subsidy disproportionately benefits the better-off users who are able to afford the connection charge and also consume water more heavily than low income users. These considerations indicate the need to redesign the tariff structure. For efficiency reasons the surcharge on industrial and commercial users should be dropped. For equity reasons, the residential subsidy should be targeted at lifeline consumption levels (e.g., $5m^3$/month) with higher rates charged for higher consumption volumes, in order to reduce the leakage of the subsidy to better-off users. The subsidy could then be reallocated to support the Government's intensified efforts in recent years to construct standpipes in poor residential areas (Box 4.1).

D. Program Management and Implementation Capacity

4.49 The projected expansion in public expenditure on infrastructure and human resources will pose a major challenge for project selection and implementation in the 1990s. Ensuring the efficiency and effectiveness of higher levels of public spending will require significant improvements in the planning, budgeting and implementation capacity of the Government departments. This section highlights three areas where improvements could bring substantial benefits to the project selection and implementation process: budgetary fragmentation, administrative reform and environmental assessment.

Budgetary Fragmentation

4.50 Effective sectoral expenditure planning is complicated by the lack of transparency caused by the fragmentation of funding sources across multiple budgetary channels. Development project funding is channelled through many different sources, including: (a) the normal DIP allocations to central sectoral departments, a large part of which is spent in the regions; (b) INPRES transfers to the regional governments, which are split between several different block and sectoral grant programs; and (c) provincial and district development expenditures financed by local resources. Recurrent expenditure financing for O&M also tends to be fragmented, including sectoral allocations

in both the central development and routine budgets, as well as lump-sum transfers (the SDO salary grant) to regional governments, together with locally financed expenditures.

4.51 Development of an information base which aggregates these budgetary expenditures into consolidated annual statements of expenditure totals and patterns for individual sectors would help sectoral planners to evaluate trends in the total amount of government spending, its composition between recurrent and investment spending, and its allocation between different sectoral programs and between regions. As such this information base on budgetary expenditures would improve the allocation of spending to high priority uses at a sectoral level. Development of consolidated budgetary information for individual sectors would, therefore, be an important step to improve sectoral planning and budgeting in the short term. In the longer term it may be desirable to move towards reform of the underlying budget structure in order to consolidate existing funding channels.

4.52 Budgetary fragmentation can also create difficulties in implementation. These are exemplified by the irrigation subsector where complex planning, budgeting, and implementation arrangements have put heavy strains on inter-agency coordination and made it difficult to ensure integrated development of irrigation works, agriculture, and land preparation. In this subsector, five central Government agencies (the Ministries of Agriculture, Public Works, Home Affairs, and Finance, and BAPPENAS) all have major roles in allocating expenditures for investment and O&M. However, it is the district branches of these agencies (most of which report to the provincial rather than central government) that actually implement the programs and are in the best position to estimate the timing and levels of funding needed for the development and efficient operation of the irrigation system. The situation is further complicated by the fact that funding comes from at least three sources: the central government DIP and INPRES channels, and the local routine budget. The irrigation service fee (para 4.37) will add yet another source of funding that will need to be considered. The division of planning, budgeting and implementation responsibilities makes it difficult for planners at the top to communicate effectively with implementers at the bottom, which means that funding allocations for O&M are often made on the basis of average costs per hectare rather than responding to specific needs in individual areas. Recognizing this, the Government has recently begun to give more emphasis to needs-based budgeting. Reducing the division of responsibilities between the implementing agencies would substantially improve long-term planning. It would also facilitate the ranking of projects according to a consolidated set of technical and economic criteria.

4.53 Budgetary fragmentation has also impeded successful implementation of urban programs. The Integrated Urban Infrastructure Development Program (IUIDP) attempts to overcome this by providing longer term perspective and predictability to the budget process. IUIDP is now being implemented in several provinces, notably in East Java and Bali. IUIDP provides a long term framework for a balanced expenditure program, together with a financing plan for urban infrastructure prepared with strong involvement of individual local governments, and to which provincial and central government agencies would also be committed. The IUIDP process does not generate budget commitments. It, however, provides a detailed indicative expenditure plan, with priorities

and an assurance that these priorities will be considered in the budget process. It also provides a systematic analysis of the capacity of the local government to mobilize resources and implement the development programs.

4.54 Budgetary fragmentation underlies the problems associated with dual administration of primary education. Recurrent expenditures for primary education are underfunded under the current arrangement of shared responsibility between the Ministry of Education and Culture (MOEC) and the provincial Ministry of Home Affairs (MOHA) for primary education. Additional recurrent budget resources are a prerequisite for improvement of primary education, yet neither ministry has sought the resources needed to improve the quality of primary education. Recently, BAPPENAS has made a creative effort to provide additional teaching resources to primary schools by earmarking a large part of the INPRES grant for improving essential instructional inputs such as textbooks, chalk and teachers' manuals. However, care needs to be taken to ensure the regional governments share these priorities and use these resources for quality-enhancing inputs to the teaching process.

4.55 The Government's systems for planning and budgeting works on national and provincial roads have improved considerably. Because of the considerable efforts that have been expended in the past years to develop a sophisticated road management system, the Government is developing an extensive data base on its road network and a stronger capability to identify expenditure priorities at a detailed sub-project level for road maintenance and rehabilitation. The quality of this data input needs to be improved to match the sophistication of the system; this could be facilitated by more training. On the basis of this system the Government has started to put in place a multi-year planning framework to assess the financing needs of road works on a comprehensive basis and to coordinate all internal and external sources of funding. However, full use has not yet been made of the system, with the result that the actual road programs selected do not fully conform to the economically optimal program.

Administrative Reform

4.56 The expanding public expenditure program, and its changing composition towards the provision of higher quality services and smaller and more complex projects increasingly managed by the regional Governments, will have important implications for the functions and administrative structure of the Government. The role of the Central Government is expected to shift away from detailed project implementation towards overall policy analysis, guidance and performance monitoring. This will entail the need for more highly educated and skilled civil servants, which in turn will require a thorough review of the compensation policies and practices of the Government. The shortage of highly qualified and motivated management and staff is one of the most serious impediments the Government is facing at every level and in every sector. Although the low level of official remuneration is a major disincentive, there are a host of other factors providing managers and staff with either incentives or disincentives. This is a complex issue which will require sustained attention from the Ministry for Utilization of State Apparatus (MENPAN), the Civil Servants Administration Agency (BAKN), and the National Institute of Administration (LAN). The introduction of a system of functional streams for some essential professions, allowing for remuneration based on professional training and experience, is a major step in the right direction. This needs to be expanded and also to cover essential regional

government staff. It should include the preparation of job descriptions, development of functional positions, development of personnel data, improvement of the training delivery system, and development of more effective training programs.

4.57 An example of the constraints imposed on implementing rapid program expansion by the shortage of high-level technical, management and financial staff is the telecommunications sector. This shortage is becoming increasingly serious in view of the growing technical sophistication and the planned expansion of the network. Time and resources are needed to train and develop managers as well as to install the systems needed to aid their decision-making. Another concern is the inadequacy of both the level and structure of compensation for staff and the poor working conditions of lower level staff. As a government institution, PERUMTEL's salary structure and levels are substantially below those paid by private enterprises. Although the salaries of higher level staff are supplemented by such facilities as cars and houses, they are still very low. Other classes of personnel must resort to a second job. Performance suffers accordingly. Review and reform of the compensation and reward system are needed to enable PERUMTEL to attract and retain the high quality staff needed to operate and expand the enterprise in an efficient and effective manner. Other public enterprises, such as PLN and the state banks, face similar difficulties.

Environmental Assessment

4.58 An emerging issue in project planning and implementation is the requirement for environmental impact analysis, which will be phased in over the period 1990-92. Government Regulation 29/1986 requires a preliminary environmental information review (PIL) for all projects, and a detailed environmental impact assessment (ANDAL) for projects that could have significant adverse impacts on the environment. In addition, the Regulation requires a retrospective environmental review of all ongoing projects. To minimize environmental degradation, it is important that this review process be carried out effectively. At the same time, however, such a comprehensive requirement for review is a potentially enormous task that could substantially slow the rate of new project implementation. External donors have committed substantial resources to help Government agencies formulate guidelines relevant to individual sectors, but more needs to be done to put in place the technical capacity and institutional arrangements necessary to ensure that projects are appropriately, but expeditiously screened. One potential problem is that there is no independent review of environmental assessments, as special committees within ministries are responsible for approving analyses undertaken by directorates within the same ministry. Government is now considering whether a centralized body with greater technical expertise might be useful for reviewing environmental assessments and providing technical assistance to the ministries.

E. Developments in the Public Enterprise Sector

Introduction

4.59 Indonesia has a large and diversified public enterprise sector, reflecting the major role in the past of public investment in providing direct production capacity in industry and, to a lesser extent, in agriculture. In parallel with an expanded role for the private sector, the role of public enterprises will be focused and modified. This shifting policy emphasis is shown in the sharp cutbacks in development budget allocations for industry and mining in recent years. The reorientation of Government involvement toward areas where private markets cannot produce outputs more efficiently has important implications for streamlining public enterprise management. The private sector growth impact of scarce public resources could be greatly enhanced if public enterprises operated more efficiency. Not only would this reduce the budgetary burden of public enterprises, thus freeing financial and administrative resources for higher priority uses, it would also improve the availability and efficiency of inputs supplied by public enterprises to the private sector (such as power and telecommunications). Against this background, this section reviews recent developments in the Government's policy towards the public enterprise sector.

Background, Current Reforms and Performance

4.60 Historically, the public enterprise (PE) sector expanded rapidly with the nationalization of Dutch companies in 1958. Subsequently, the PE sector expanded further in the 1970s, bouyed by large oil revenues, to perform four broad objectives: (1) contribute to economic development and state revenues; (2) provide basic goods and services for the general public; (3) pioneer activities, which promote or complement private sector development; and (4) generate income and profits.4/

4.61 The Government's past strategy for the PE sector is reflected in the classification of the state enterprises into three broad categories, reflecting the relative importance of social objectives: Perjans (Government agencies), Perums (public corporations), and Perseros (limited liability companies). The commercial motive becomes progressively more important along the spectrum from Perjans to Perseros. Other state enterprises, most importantly the state banks and Pertamina, derive their status and objectives from separate legislation.

4.62 Of the 212 PEs owned by the central government (there are also numerous provincial and local PEs) the largest number (116) are concentrated in the Persero class (with about 34 additional joint-venture Perseros). They span the tree crop PTPs, manufacturing and mining PEs, and service sector PEs (airlines, state trading companies). There are 33 Perums, mostly in the infrastructure areas, the most important ones being PLN in power, Perumtel in telecommunications, ports, housing, and gas. There are 2 Perjans, the most important one is the railways. Finally, there are 8 state-owned banks, and 18 enterprises in various sectors, the largest being Pertamina.

4/ These goals are set out in Government Regulation No. 3, 1983.

4.63 By 1983 the PEs contributed roughly 25% of overall GDP.5/ Although some PEs were efficient and profitable, the overall pre-tax rate of return on total assets in the PE sector had declined from about 4% in 1979 to about 1% in 1982. The Government then implemented a major policy shift to focus the role of the PE sector in the economy while increasing efficiency. This shift involved reforms specific to PEs, as well as general reforms.

4.64 Among the general reforms the process of deregulation and trade reform has been particularly important. Although there are some key areas (e.g., strategic industries, steel, fertilizer, and agriculture) where competition from imports and/or private investment is still restricted, many PEs now operate in a more competitive environment. Good examples are the airline and financial service sectors. The reduction of import and investment barriers across a range of manufacturing sub-sectors where PEs are particularly important is also laudatory, though import bans in some sectors continue to provide protection. Another key area affected by deregulation is the financial sector, where the Government has moved to lower barriers to entry and introduce market pricing. This has profoundly affected the performance and prospects of state-owned financial intermediaries. A further area of improvement has been a reduction of the regulatory impediments to the efficient functioning of key PEs, e.g., the deregulation of maritime and port services. A start has also been made in dealing with the labor laws and regulations that have prevented almost all PEs from streamlining their workforce. Here an important precedent was set in the Tanjung Priok port reforms of 1984.

4.65 Critical targeted reforms carried out include the curtailment of transfers to PEs for new investments. The use of bank credits, including that from Bank Indonesia, has been restrained (see Annex 1, Table 8).6/ Public enterprises have also not been allowed to borrow independently from foreign sources. To lower the budgetary impact of PEs and promote the efficient use of there products by the public the Government has moved in some cases to market- or efficiency-based pricing, while increasing the flexibility companies have in setting their prices. Examples of this include the banking and manufacturing sector, as well as more gradual reforms in power, telecommunications and agriculture.

4.66 Much of the Government's current efforts at improving PE efficiency and financial soundness are embodied in a series of three decrees dating from October 1988 through June 1989. Collectively, these decrees establish a set of financial soundness measures covering profitability, liquidity, and solvency, which are used to rank individual PEs. Using financial data from 1985-88, 189 PEs have been classified into four categories: very sound, sound, less sound and unsound. Based on the type of good or service involved and these financial indicators, a set of corporate restructuring options have been

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5/ Exact calculation of the contribution of PEs to GDP is not possible because firms do not separately report employee wages, a critical element of their value added.

6/ The large increase in 1989 is due to borrowings by BULOG for increasing commodity buffer stocks.

proposed jointly by the Ministry of Finance (MOF) and the line ministries. These options, specified in MOF Decree 740/1989, range from change in legal status of the firm, to sale of equity on the bourse, to liquidation.7/

4.67 Accompanying this initial design for restructuring are also instructions to the PEs to prepare five-year corporate plans and annual work programs for use by the management of the PEs (Boards of Directors, BOD), Boards of Commissioners and Supervisors (BOC/BOS), the line ministries, and MOF in managing, monitoring, and evaluating the operations of PEs. MOF Decree 741/1989 briefly sets out the uses to which both corporate and annual plans will be put to by the relevant actors. These two instruments, and the clarified roles of the PE management, BOD, BOC/BOS, MOF and line ministries are the nucleus of an improved system of accountability and control of PEs.

4.68 The reforms undertaken so far are in part responsible for an improvement in the fiscal impact of PEs. The overall budgetary burden of PEs has shrunk from -4.6% of GDP in 1983 to -0.6% in 1988/89.8/ Since 1982, profitability has steadily risen to about 5.2% in 1989 (see Table 4.4). The improved profitability is due chiefly to higher profit margins, rather than expanding production or increased Government transfers. This reflects, in part, the increased flexibility in setting prices allowed PEs by the Government. Non-operating performance has improved as the discrepancy between the after-tax profit and operating margins has declined (tax payments have held steady). Measures of capital structure and liquidity also show improvement particularly after 1986-87.

4.69 Despite this improvement, the rate of return to PEs overall remains low compared to the general rate of return to investment in the economy (about 13-22% between 1982-88), or in relation to the real rates of interest on lending in the financial sector (over 10% p.a.), a measure of the opportunity cost of capital. Furthermore, the bulk of profits are concentrated in a few sectors. Finally, the current level of profits is still low in comparison to the investment requirements of the public enterprises. By streamlining the public enterprise sector and further improving its efficiency, this sector could contribute more substantially to public resource mobilization and to overall growth in the economy.

7/ Seven different options are actually set out in the decree. They are: 1) Change of legal status; 2) Sale of stock on the bourse; 3) Direct placement of stock; 4) Consolidation or merger; 5) Sale of company to a third party; 6) Establishment of a joint venture; and 7) Liquidation.

8/ As noted in Table 4.4, the budgetary burden of PEs is the sum of profit transfers, debt service, less capital participation, subsidies and "two step loan" disbursements. Tax receipts from PEs are excluded because the concept of fiscal burden quantifies the annual financial cost of keeping enterprises in the public sector (if private, the enterprises would make the same tax payments). This figure may underestimate the burden as there are central government domestic and foreign loan guarantee costs, as well as implicit interest subsidies which are not included. Furthermore, unrealized losses and gains, for example losses from probable non-performing assets on the books of state banks, are not included.

Table 4.4: AGGREGATE INDICATORS OF PUBLIC ENTERPRISE PERFORMANCE, 1983-1989
(Percent)

	1983	1984	1985	1986	1987	1988	1989
Financial profitability							
PE profit/total assets /a	n.a	2.9	3.0	2.8	2.0	2.6	3.1
NFPE profit/total assets /b	2.3	3.0	1.8	1.9	2.2	4.0	5.2
NFPE profit/non-current assets	3.2	4.4	2.6	2.7	3.1	5.8	7.2
NFPE profit/net worth	4.9	6.5	3.9	4.2	4.8	6.6	8.7
NFPE after tax profit margin	2.6	4.8	2.8	3.5	3.4	5.7	6.3
NFPE operating profit margin	8.4	10.1	5.1	5.1	5.1	8.2	9.1
Number of firms	184	184	184	179	174	183	179
Capital structure (ratio)							
NFPE total debt/net worth	n.a	2.1	2.1	2.2	2.2	1.2	1.6
NFPE LT debt/net worth	n.a	0.7	0.7	0.8	0.8	0.2	0.4
Liquidity (ratio)							
NFPE current assets/current liab.	n.a	1.4	1.4	1.8	1.8	1.2	2.2
Budget impact							
Overall budgetary impact of PEs (% of GDP) /c	-4.6	-2.6	-2.6	-1.8	-0.6	-0.6	n.a

/a Consolidated public enterprises; profits are defined before tax and treat depreciation as cost. Assets are evaluated at current cost for some enterprises, but for many enterprises assets are measured at historical cost.

/b Consolidated non-financial public enterprises; profits are defined before tax and treat depreciation as cost.

/c Defined as: profit transfers plus debt service payments less "two-step loans", capital participation, and transfers; on a fiscal year basis.

Source: Ministry of Finance and World Bank staff estimates.

Remaining Reform Agenda

4.70 An overall policy framework. The reforms outlined above are evolving into an overall policy framework. A concise presentation of this policy framework, however, that set out clearly the overall goals of the PE sector, and the strategy for restructuring the sector to achieve these goals, would

aid in speeding the process. Once such a framework is in place, particular options for reforming individual PEs, many of which are now under consideration, can be chosen more coherently.

4.71 The goal of public enterprises. PEs are expected to strengthen the economy through the efficient production of high quality goods and services to meet the needs of the public. In reaching this goal, the Government needs to retain in the public fold only those core PEs where public ownership is judged essential for the firm to meet its economic and social goals efficiently. This change in the role of PEs is possible because, with the general growth in the economy and the deregulation efforts, the private sector is now better able to meet the needs of the public for many goods and services. As the response of non-oil exports has demonstrated, the private sector is also capable of responding to government policy initiatives promptly and effectively. At the same time, years of experience have demonstrated that PEs have not been overly successful in their efforts to meet their objectives.

4.72 Underlying strategy. The key elements of the Government's strategy are to: a) prepare for divestiture to the private sector viable PEs which should not remain in the public sector; b) liquidate non-viable commercial PEs; and c) define a core group of enterprises that will stay in the public sector and institute appropriate reforms aimed at improving their performance.

4.73 Broadly, the Government strategy would be to divest itself of those firms which produce goods and services that can be efficiently produced and allocated by the private sector (private goods). Where such firms are already performing well, their divestiture could take place in the short term. For others, some adjustments may be needed to make them attractive to private owners. Where such firms are insolvent, they may have to be liquidated. At the same time, the Government would need to take measures to improve the performance of the few enterprises that will remain under government control or ownership, chiefly those producing public goods at natural monopolies.

4.74 Divestiture. The Government is tentatively planning the partial divestiture of over 52 firms through the sale of stock as part of the restructuring plan (see para. 4.66). This is an important signal about government intentions and will foster the continued expansion of the capital market. However, it may have limited effect on the operations of public enterprises in the near future. The rights of minority private shareholders and the determination of share issue prices are critical issues both for the impact of the sales of shares on PE performance and the impact on the capital markets, respectively. The benefits of private ownership for the performance of the enterprise might be few since the Government effectively retains majority control of these enterprises. As with any large public offering it is important that it be properly priced to avoid unnecessary price variations which reduce investor confidence. The chief short-term gains are the improvement in debt to equity ratios for the PEs and the financial disclosure that would accompany public stock issuance.

4.75 A difficulty with partial divestiture using public stock offerings will arise if the enterprises prove unprofitable or unable to pay adequate dividends. Some of the PEs identified as suitable for going public are not yet financially sound. It is likely that divestiture through the capital

markets will be possible for only a smaller number of the soundest PEs, and, even then, only after some adjustments to their present operations, so that they can meet the private profitability test. The ability of the stock market to absorb new issues is another reasons to employ this method of divestiture gradually. Also, for these PEs to be effectively subject to market discipline, the Government would need to more clearly define minority shareholder rights and responsibilities. Altogether, these factors imply that divestiture of minority holdings through the stock market is likely to be a gradual process whose main benefits will emerge only slowly.

4.76 In some cases more rapid benefits could be realized by relying on other divestiture options, such as management contracts, joint ventures and assets sales, all which are outlined in Decree 740. Some 20 firms are slated for actions of this kind. Proceeding with implementation of these options will be a more important part of the reform process than divestiture through the capital markets.

4.77 Liquidation. There are currently plans to liquidate three firms, although there are many more PEs whose financial performance remains unsound. Following appropriate analysis, liquidation of non-viable PEs would have substantial benefits for the economy.

4.78 Core PEs. For the small number of Perums and Perjans, which are mostly natural monopolies and utilities in basic infrastructure areas, the principal objective is to ensure greater economic efficiency. Even in such cases Government ownership or management may not necessarily be the best option; leasing, management contracts, regulation, etc. may achieve the same objectives. Nonetheless, some of these PEs might have to be retained in the public fold as a core group because of difficulties in structuring incentives such that the private sector would provide these services efficiently. The remaining Perums and Perjans should be transferred to the Persero category and handled (see para. 4.73). This process has begun with the Government planning to convert the two Perjans, the railway and pawn brokering business into Perums. The financial costs of social objectives for the core PEs can be explicitly calculated and progressively financed from the Budget; where they are not essential, such social subsidies should be eliminated.

4.79 Implementation. The effort required to deal with all 189 PEs and work out detailed options for each is a herculean task. Major gains might, therefore, be achieved by initially concentrating efforts on the options for reforming or restructuring a smaller number of the PEs most important in terms of their size and role in the economy. Stocks sales, joint ventures, management contracts, liquidations, etc. carried out at first could serve as prototypes for extending the restructuring program more widely.

4.80 Institutional framework, autonomy, and accountability. The institutional framework connecting the PE managers, the line ministries, and MOF is another key element of the overall policy framework. Regulation No. 3 of 1983 was designed to rationalize the structure of PE administration. There is, however, further scope to improve the institutional framework for enterprises that will remain in the public domain.

4.81 Decree 741/1989 partly responds to this need. The corporate 5 year and annual planning exercises set up in the decree could provide an excellent

vehicle to define and operationalize a new set of relationships. This approach could provide more elaboration on the relative roles of each party to increase the autonomy and accountability for PEs. The 5-year plans would provide a means for the Government to set and agree on the objectives for particular enterprises, and then grant much greater autonomy to the Boards of Directors to meet these objectives and hold them accountable for performance. This would entail more streamlined procedures for routine budgetary approvals, larger scope for financing investments and setting tariffs, and generally less intervention by technical ministries. The other actors could concentrate on monitoring and evaluating the results, at progressively higher levels: Boards of Supervisors could perform the individual PE annual monitoring and evaluation role, the technical Ministry could monitor the attainment of sector policy objectives, and MOF could manage the portfolio of all PEs (including tracking of key macroeconomic variables for the PE sector as a whole, such as profits, investment, foreign borrowing, and transfers). A key ingredient for the smooth operation of the new institutional framework would be the definition of a few critical but simple performance indicators.

4.82 This new framework of management autonomy would need to be complemented with a system of management performance measurement and accountability. A system of rewards and sanctions would need to be put into place to elicit efficiency in management. Weaknesses in management lie behind many of the performance problems of PEs. Treating management problems also requires giving attention to training programs, and corporate planning. The renewed importance given corporate planning in the June 1989 decrees provides a starting point for dealing with this last issue.

RECENT ECONOMIC DEVELOPMENTS

Economic Activity

1. Preliminary estimates indicate that Gross Domestic Product (GDP) grew sharply, by about 7.4% in real terms in 1989, fueled by strong growth in the non-oil sector and a recovery in the oil sector (Table 1). Manufacturing, mining, construction, and other services all grew faster than GDP as a whole. The agriculture sector registered impressive gains for the second straight year.

Table 1: GROWTH IN SECTORAL VALUE ADDED, 1975-1989 /a
(% p.a. at 1983 prices)

	Average 1975-83	Average 1984-85	1986	1987	1988	1989	Sector Shares in 1989 (% of GDP)
OIL/LNG Sectors	2.2	2.5	4.9	1.6	-0.6	4.3	18.8
Oil & gas	0.3	-2.0	5.0	-0.1	-3.5	4.0	14.3
LNG & refined oil	14.9	28.5	4.5	8.3	9.7	5.0	4.5
Non-Oil Sectors	7.0	5.2	6.2	5.8	7.3	8.1	81.2
Agriculture	3.5	4.2	2.5	2.2	4.3	4.4	20.5
Mining	6.8	-1.8	10.7	7.0	4.8	11.0	1.2
Manufacturing	10.6	12.7	11.1	11.4	13.5	12.2	14.3
Construction	10.8	-1.0	2.2	4.2	8.9	10.0	5.4
Other services	8.6	4.9	7.4	6.3	6.7	8.4	39.8
Gross Domestic Product (GDP)	6.5	4.6	5.9	5.0	5.6	7.4	100.0

/a In 1989, CBS released new GDP estimates for the years 1983-1988 (see Annex 2). The series prior to 1983 has not been revised, however, so the average growth rate for the 1975-83 period is derived using the 1983 production level from the old series, which is at constant 1973 prices.

Source: Central Bureau of Statistics (CBS) and World Bank staff estimates.

2. The oil/LNG sector grew by over 4% in 1989, following a slight contraction in 1988 and slow growth in 1987. This growth was fueled largely by a 4% increase in crude oil production, due largely to the start of production at several new oil fields, which offset production declines at older fields. Indonesia's OPEC quota was also increased 15% during the year. Production of natural gas was up by over 6%, reflecting buoyant domestic demand. There was no increase in LNG output, but there was a major increase in LPG production and refinery output.

3. The expansion of the non-oil sector accelerated to over 8% in 1989, with all subsectors registering high growth by historical standards. Growth in agricultural production (4.4%) continued strong for the second straight year, following slow growth in 1986 and in 1987 due primarily to bad weather. Within the food subsector, rice growth was very high (5.5%) as a result of several factors: good prices and rainfall, an increase (3% or over 300,000 ha.) in area planted, and a 2.3% increase in yields. The increase in area resulted partly from a shift out of corn and soybeans due to farmers' perceptions of relative profitability. It also reflected the Government's decision to allow 40,000-50,000 hectares of previously designated sugar area to revert to riceland. The loss of area in corn led to a 7% fall in production, while the loss in soybean area was compensated for by rising yields so that production remained unchanged over 1988 levels.

4. The fishery subsector expanded by nearly 6%, following robust growth in both freshwater and saltwater fish production. The animal husbandry subsector grew by 5%, with rapid growth (15%) in both eggs and milk. The non-food crop subsectors as a whole (smallholders and estates combined) grew at over 4.5%. This average masks important differences between major crops, however. Production of palm oil increased by over 25%, as large areas planted in the mid-1980s came into bearing. Production of tea and cocoa was also up strongly--by 15% and 20% respectively. Coffee production grew by 6% to record levels in response to both good weather and the removal of export quotas. Rubber production, which is by far the largest contributor to non-food crop GDP, grew by less than 2%, however, due partly to the age structure of the tree stock and partly to lower prices.

5. Real growth in the non-oil manufacturing sector continued strong at over 12% during 1989. Manufacturing now accounts for over 14% of GDP. This growth has been spread across both intermediate and consumer goods. Non-traditional manufacturing goods are playing an increasingly important role in the economy and in non-oil exports, with production growth rates above 40% recorded in subsectors such as: footwear, paint, glass, radios and television sets, motorcycles, batteries and structural metal products. This strong manufacturing sector performance is being supported by an acceleration of foreign and domestic private investment, and the present outlook is that the expansion of the manufacturing sector will remain strong over the medium term.

6. The construction sector also grew rapidly for the second straight year in 1989, recording an increase of 10%, far above the 1984-87 average of only 1%. Construction now accounts for over 5% of GDP. The improved performance of the construction sector reflected the higher demand from the surge in private investment. Other services grew by over 8% in 1989, maintaining the strong performance in the previous year. The banking sub-sector, responding to deregulation measures in the financial sector, grew by 13%. The transport and communications sub-sector also expanded strongly (at over 9%).

7. Income and expenditure. Preliminary figures indicate that Indonesia's Gross National Income (GNY) rose by nearly 8% in 1989, supported by an acceleration in GDP and higher oil prices (Table 2). This allowed substantial increases in both consumption and investment. Due mainly to the pay raise granted civil servants during the year, Government consumption rose by nearly 7%, as compared to well under 3% in 1988 and minimal or negative

growth in 1986-87. Growth in private consumption rose from 4% in 1988 to over 6% in 1989. Total fixed investment rose dramatically. The recovery in oil prices enabled Government to expand its investment program by 6%, and private investment rose by nearly 18%, much of which was directed toward increasing export capacity.

Table 2: INCOME AND EXPENDITURE, 1975-1989
(at 1983 prices)

	Growth rates (% p.a.)						1989
	Average 1975-83 /a	Average 1984-85	1986	1987	1988	1989 /c	Share in GDP (%)
Consumption	8.9	3.7	4.9	3.5	4.0	6.5	69.3
- Public	8.5	5.4	0.1	-3.7	2.4	6.7	8.8
- Private	11.9	3.5	5.7	4.7	4.2	6.5	60.5
Fixed investment	10.7 /b	-5.8	-5.5	2.6	10.3	13.0	19.5
- Public	12.6 /b	-2.9	-19.1	-4.5	10.2	6.2	7.4
- Private	9.1 /b	-8.6	8.7	8.1	10.4	17.7	12.1
GDP	6.5	4.6	5.9	5.0	5.6	7.4	100.0
GNP	6.4	4.6	7.1	5.1	5.9	7.4	96.2
GNY	8.5	3.8	0.1	5.7	6.0	7.8	89.5

/a 1975-83 average is at 1973 prices
/b These fixed investment averages are for the period 1978-82 only, and are at 1983 prices.
/c Preliminary.

Source: World Bank staff estimates.

The Balance of Payments

8. The strong growth performance of the economy also influenced developments in the balance of payments during 1989/90 (Table 3). Net oil/LNG exports rose by US$1.2 billion, reflecting increased production and an 18.5% increase in the price of oil. Non-oil exports also continued to grow rapidly, increasing by 15.6% to an estimated US$14.1 billion. As in the past several years, the primary impetus to this growth was from a broad range of manufacturing goods. In response to trade deregulation and buoyant economic growth, non-oil imports surged in 1989/90, after several years of very slow growth. This demonstrates the strength of the private sector's response to deregulation, with private sector capital and intermediate good imports accounting for the largest share of import growth. Capital good imports by the public sector also increased from the depressed levels of the past several years, as a result of the continued recovery in public investment during 1989/90. Monetary policy appeared to accommodate this rise in imports.

Table 3: BALANCE OF PAYMENTS, 1981/82-1989/90
(US$ billion at current prices)

	Actuals					Estimated
	1982/83	1985/86	1986/87	1987/88	1988/89	1989/90
Merchandise exports (fob)	18.6	18.5	13.7	18.1	19.8	23.4
Oil & LNG	14.7	12.3	7.0	8.6	7.6	9.3
Non-oil	3.9	6.2	6.7	9.5	12.2	14.1
Merchandise imports (cif)	-20.6	-14.4	-12.7	-14.2	-15.7	-19.0
Oil & LNG	-4.8	-3.2	-2.3	-2.4	-2.1	-2.6
Non-oil	-15.8	-11.2	-10.4	-11.8	-13.6	-16.4
Trade balance	-2.0	4.1	1.0	3.9	4.1	4.4
Non-factor services (net)	-1.7	-1.8	-1.5	-1.2	-1.2	-0.9
Interest payments (MLT)	-1.5	-2.2	-2.5	-2.8	-3.0	-3.1
Other factor services and transfers (net)	-2.1	-2.2	-1.2	-1.6	-1.7	-2.1
Current account balance	-7.3	-2.1	-4.2	-1.7	-1.8	-1.7
Public MLT loans (net)	4.0	1.3	2.7	1.9	2.9	1.6
- Disbursements	5.1	3.8	5.2	6.1	7.3	6.1
- Principal repayments /a	-1.1	-2.5	-2.5	-4.2	-4.4	-4.5
Other capital (net)	0.0	1.7	-1.5	1.0	-1.3	-1.0
Use of net foreign assets	3.3	-0.9	3.0	-1.2	0.2	1.1
Memo items:						
Net official reserves /b	3.0	5.8	5.0	6.0	5.4	5.7
- Months of imports /c	(2.0)	(5.5)	(4.3)	(4.6)	(3.4)	(3.2)
Total net foreign assets	7.5	12.6	9.6	10.8/d	10.6	9.5
Current account/GNP (%)	-7.8	-2.6	-5.8	-2.3	-2.2	-1.9
Non-interest current account balance (% of GDP)	-6.0	0.7	-1.7	2.4	2.3	2.4
MLT debt service/ exports (%) /e	16.8	25.1	38.0	35.5	36.1	32.1

/a Includes prepayments of US$420 million in 1985/86, US$626 million in 1987/88, US$341 million in 1988/89 and US$300 million in 1989/90.

/b Net official reserves are defined as gross official reserves minus outstanding liabilities to the IMF and other short term liabilities.

/c Net official reserves in months of next year's expected imports (oil/LNG and non-oil) of goods.

/d Excludes US$326 million of prepayments, committed during the year but not completed until June 1988.

/e Debt service on public and private debt, excluding prepayments; denominator is gross exports of goods and services.

Source: Bank Indonesia and World Bank staff estimates.

9. The overall effect of these developments was that the current account deficit declined slightly from US$1.8 billion (2.2% of GNP) in 1988/89 to US$1.7 billion (1.9%) in 1989/90. The net outcome, therefore, was that the balance of payments remained comfortable; this is also reflected in the maintenance of a significant surplus in the non-interest current balance (2.4% of GNP). Nevertheless, given that the level of non-oil exports still remains significantly below the level of non-oil imports, and the uncertainties surrounding oil prices, more rapid expansion of non-oil imports relative to non-oil exports will be difficult to sustain. A continued cautious management of the balance of payments, based on prudent macroeconomic policies and sustained rapid growth of non-oil exports, will be essential. Regarding the financing of the current account deficit, total capital flows registered a decline in 1989/90 compared with 1988/89. Public MLT disbursements fell by US$1.2 billion as a result of declines in disbursements from all financing sources.

10. Exports. Crude oil prices rose significantly, reaching an average price of US$17.9/barrel for 1989/90 compared with US$15.1/barrel for 1988/89. The main factors underlying stronger prices were buoyant world demand, especially in developing countries, and supply constraints in non-OPEC countries (US, UK, and USSR), which offset the fact that OPEC production exceeded quota. For 1989/90, Indonesian exports increased by about 6% in volume terms over 1988/89 to reach 365 million barrels. Similarly, higher export volumes of LNG and LPG in 1989/90 were accompanied by higher prices. As a result, the value of LNG/LPG exports are estimated at about US$2.8 billion in 1989/90, compared to US$2.4 billion in 1988/89. Total gross earnings from oil and LNG exports are estimated to reach US$9.3 billion in 1989/90, an increase of 22% over the preceding year.

11. Non-oil exports expanded about 16%, from US$12.2 billion in 1988/89 to an estimated US$14.1 billion in 1989/90 (Table 4). Export volumes also grew by about 16%. This growth exceeded the projections made in last year's Economic Report and is largely attributable to continued rapid expansion in manufactured goods exports which contributed almost 90% of the increase in non-oil export earnings. Within manufacturing, almost two-thirds of the growth was contributed by the diversified group of commodities grouped together in "other" manufactured goods (Table 5). Exports of this group of commodities are estimated to have more than doubled since 1987/88 to reach US$3.2 billion in 1989/90. The continued strong expansion of this group of commodities reflects the increased foreign and domestic investment that has occurred in manufacturing in response to trade reform and private enterprise deregulation. A number of commodity exports within the "other" category have expanded at over 100% p.a. since 1985, and now make a substantial contribution to exports, though they started from a very small base. Of particular note is the strong performance of ceramics, plastics, shoes, furniture and other articles of basic metals.

12. Even though the volume of agricultural exports was up 5%, export values rose only 1.5% in 1988/89 because prices of many commodities fell. Palm oil export volumes grew by 25%, due to large recent new investments coming to maturity, but export values rose by only 5% because of sharply lower edible oil prices. Increased domestic and foreign investment in shrimp production has supported the continued rapid growth in shrimp exports with value and volume growing at 18% and 14%, respectively. The 11% increase in

Table 4: NON-OIL MERCHANDISE EXPORTS, 1982/83-1988/89

	Value at current prices (US$ million)				Growth in volume terms (% p.a.)		
	Actual			Estimate			
	1983/84	1987/88	1988/89	1989/90	1983/84-1987/88	1988/89	1989/90
Agricultural commodities	3,084	3,885	4,742	4,813	4.1	9.1	5.2
Timber products	582	627	810	827	-2.6	15.1	-17.9
Rubber	984	1,055	1,236	1,185	1.1	1.8	5.2
Coffee	506	497	572	423	-2.1	16.8	10.6
Palm oil	92	214	313	329	26.0	14.6	25.4
Tea	156	119	134	156	3.6	10.2	3.7
Shrimp	206	368	537	632	19.9	4.4	13.7
Rattan	87	162	37	43	13.0	-77.8	5.0
Others	471	844	1,103	1,219	7.1	30.9	7.7
Minerals & metals	800	1,080	1,444	1,596	8.0	1.9	12.7
Tin	309	143	165	207	-2.6	7.3	23.4
Gold	0	308	309	322	-	3.2	3.3
Aluminum	165	245	308	382	7.9	-16.4	24.4
Copper	89	186	238	258	11.0	9.7	6.9
Nickel (total)	170	146	357	349	-12.9	20.6	-0.6
Others	68	52	67	72	-9.6	-12.6	13.3
Manufactured goods	1,484	4,537	5,998	7,691	26.7	23.1	25.7
Textiles	365	1,283	1,815	2,184	31.1	33.5	17.9
Plywood/ panel products	579	1,834	2,069	2,288	24.2	12.3	6.7
Others	540	1,420	2,114	3,219	26.2	25.9	49.2
Total non-oil exports	5,368	9,502	12,184	14,100	12.3	14.5	15.9

Source: Bank Indonesia and World Bank staff estimates.

coffee export volume suggests that coffee exports had been significantly constrained by the previous export quotas, but the collapse of the International Coffee Agreement caused world prices to plunge, and export values fell by over 25%. The imposition of a prohibitive export tax on sawn timber led to an 18% decline in export volumes of timber products, but higher prices meant that export values actually increased slightly. Rubber export volumes increased 5%, but export values fell by 4% because of the decline in natural rubber prices during 1989, which was caused by a slowdown in the US automobile industry.

13. The volume of metals and minerals export earnings recovered significantly during 1989/90 and grew by almost 13%. Aluminum exports rebounded in 1989/90, growing by 24% in both volume and value terms. Likewise, tin production continues to expand due to higher quote allocations from the Association of Tin Producing Countries (ATPC), with both volumes and values increasing by 25%. The slower growth in nickel represents a plateau in capacity reached after the reopening of a ferronickel plant during 1988/89.

Table 5: MAJOR ITEMS WITHIN "OTHER" MANUFACTURED EXPORTS
(US$ million at current prices)

Products	Actual 1985	1986	1987	1988	Estimate 1989	Average Annual Growth Rate 1985-89 (%)
Ceramics	0.5	1.2	4.5	14.1	27.8	178.8
Plastics	1.5	12.5	24.7	56.1	72.1	162.5
Sandal, Shoes	8.2	8.8	23.5	82.6	186.9	118.7
Furniture	7.1	9.2	27.2	69.7	154.7	116.0
Other articles of basic metal	5.4	7.6	17.4	56.9	89.0	101.9
Iron/steel	34.2	69.5	196.0	296.2	464.0	91.9
Glass & its product	8.3	12.7	30.7	93.7	94.5	83.7
Rubber products	7.5	11.3	24.2	48.8	75.9	78.3
Paper & its products	20.9	31.8	95.8	138.2	170.0	68.8
Cements	21.5	39.8	56.1	75.6	126.8	55.9
Processed food	56.7	81.5	105.9	139.2	228.4	41.7
Other	93.8	122.7	91.9	240.7	356.8	39.7
Matting	13.3	19.4	47.2	76.4	48.1	38.0
Leather & its product	37.5	43.9	53.8	77.6	76.4	19.5
Fertilizer	80.0	127.3	86.0	134.1	152.0	17.4
Animal feed	90.8	97.8	113.2	147.5	126.6	8.7
Pharmaceutical products	6.5	7.0	9.4	15.4	7.4	3.3
Total	493.5	703.9	1007.7	1762.6	2457.4	49.4

Source: Central Bureau of Statistics and World Bank staff estimates.

14. Imports. For much of the 1980s, non-oil import levels were compressed as a result of the Government's efforts to address external and internal imbalances to stabilize the economy (Table 6). The compression was achieved through depreciation of the real exchange rate, rephasing and cutbacks in real capital spending, and strict limits on non-concessional external borrowing. In the early phase of the adjustment period, non-tariff barriers were also used to limit imports. The effect of these policies is shown by the decline in import volumes of about 4% p.a. over the period 1983/84 to 1987/88. However, as the economy has moved from stabilization towards adjustment and sustained growth, imports have expanded significantly. Very buoyant private sector activity resulted in about an 18% increase in non-oil import volumes in 1989/90.

15. The strength of the private sector response is shown by the surge in capital good import volumes, which grew at 38% in 1989/90 and accounted for about 41% of the increase in total imports. These imports are the result of the large increase in investment that has taken place. Imports of intermediate products grew more slowly, but from a larger base so that they accounted for about half of the increase in total imports. Imports of consumer goods were up 38% in volume terms, but contributed relatively little to overall import growth, as consumer goods only account for about 5% of total imports. Most of the growth in this category has been from non-food consumer goods.

Table 6: NON-OIL MERCHANDISE IMPORTS, 1983/84-1989/90

	Value at current prices (US$ million)				Growth in volumes (% p.a.)			% Share in 1989/90 Volume Growth
	Actual			Estimate	1983/84-1987/88	1988/89	1989/90	
	1983/84	1987/88	1988/89	1989/90				
Consumer goods	730.5	398.5	563.6	785.8	-9.7	20.9	37.4	8
Intermediate	8,146.8	8,513.4	9,856.0	11,218.7	-3.2	9.2	11.6	51
Capital goods	2,592.3	2,545.0	2,717.5	3,827.9	-4.7	0.7	38.1	41
Total	11,469.6	11,456.9	13,137.1	15,832.4	-3.9	8.0	18.5	100

Source: Central Bureau of Statistics and World Bank staff estimates.

16. Capital flows and debt. In aggregate, public MLT disbursements declined by US$1.2 billion, resulting from lower disbursements of special assistance (about US$0.3 billion), a decline in project disbursements from official donors (about US$0.2 billion),1/ a slowdown in import-related credits (roughly US$0.4 billion), a reduction in the use of untied commercial credits (about US$0.1 billion), and a decline in financing for LNG/LPG projects (about US$0.2 billion). While disbursements declined, repayment of principal increased by about US$0.1 billion. Thus, net inflows from public MLT declined by US$1.3 billion. Other capital outflows continued to be positive in 1989/89, although the level of outflows was smaller than in 1988/89. The total debt service ratio fell to 32.1% in 1989/90, compared to 36.1% in 1988/89, reflecting higher total export earnings and nearly constant debt service payments.

17. Disbursements of project aid, primarily from the IGGI, declined by about US$0.2 billion to US$2.3 billion in 1989/90 but still accounted for about one third of public MLT disbursements. To some extent, this decline in project disbursements reflects a diminished pipeline, as new commitments of project assistance have fallen in recent years due to the rise in commitments of special assistance. In addition, in some cases the processing of disbursement applications may have encountered bottlenecks during 1989/90, and

1/ This was caused partly by the shift in the composition of donor's commitments towards special assistance in the past several years, which has reduced the pipeline of project aid.

the pace of project implementation may have slowed slightly. As commitments of special assistance are phased out, project commitments are expected to rise over the medium term, and it will thus be important to ensure that project implementation proceeds smoothly.

18. The provision of special assistance, in the form of fast-disbursing program aid and local-cost financing, again made a significant contribution to financing the current account deficit. While a total of US$1.8 billion in special assistance was pledged at the 1989 IGGI meeting, actual commitments amounted to US$1.6 billion. Total disbursements of special assistance during the 1989/90 fiscal year, however, are estimated at about US$1.7 billion, reflecting carry-overs from commitments made in previous years. This brings total disbursements of special assistance over the past three years to US$5.4 billion. In 1989/90, special assistance continued to play a valuable role in helping the Government push ahead with its trade deregulation measures and in facilitating the recovery of private investment and economic activity. It has also enabled Indonesia to improve the term structure of its external debt, while maintaining confidence in financial markets about the viability of the Government's adjustment program.

19. There has been a steady decline in the use of import-related credits in recent years, with disbursements falling from a peak of US$2.1 billion in 1983/84 to about US$650 million in 1989/90. This trend reflects the Government's decision to reduce public investment in large capital-intensive projects and to place strict limits on the use of non-concessional financing under Presidential Instruction No.8 of 1984. Disbursements of untied commercial credits totalled US$1.2 billion in 1989/90, about a US$0.1 billion decline from 1988/89. However, only about US$0.9 billion were used in the balance of payments, as US$0.3 billion were drawn from an expired line of credit to prepay two unexpired lines of credit. The pipeline of undisbursed commercial credits totalled about US$1.8 billion at the end of March 1990.

20. Other capital flows 2/ were significantly negative. While direct foreign investment increased, private capital outflows have remained strong. Unlike the past year, however, these outflows do not appear to be speculative in nature. Indeed, activity at the bourse was normal. One important factor underlying these outflows appears to be the very large unwinding of swap transactions with Bank Indonesia. The combination of a lower net inflow of capital from public sources and a continued net outflow from private sources caused total net capital inflows to fall below the level of the current account deficit. This shortfall resulted in a decline in total net foreign assets by US$1.1 billion; Bank Indonesia's reserves rose by US$0.3 billion, however, while net foreign assets of commercial banks declined by US$1.4 billion. Bank Indonesia's reserve position was further strengthened by a substantial reduction in swaps outstanding during the year.

21. Indonesia's stock of public and private MLT external debt outstanding rose slightly during calendar year 1989, from US$47.7 billion to an estimated US$48.3 billion. Of this amount, US$43.7 billion was public debt, including

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2/ As defined in Table 3, other capital flows are a residual item, including direct foreign investment, oil/LNG export credits, all private capital flows, valuation adjustments, and errors and omissions.

US$24.8 billion of assistance from the IGGI. In contrast to earlier years, the debt burden in US dollars was reduced by exchange rate movements over the past year. As a result, total MLT debt payments declined slightly from US$8.8 billion in 1988 to US$8.5 billion in 1989. In combination with higher non-oil export earnings, the debt service ratio declined from 36.1% in 1988 to 32.1% in 1989. As discussed in Chapter 2, the debt service ratio and other debt indicators are projected to decline in future years.

Budgetary Developments

22. The Central Government Budget for 1989/90 cautiously assumed an average oil price of US$14.0/barrel, lower than the average price for 1988/89 of US$15.1/barrel. To offset the loss of oil/LNG revenues, the Budget projected a 25% increase in non-oil taxes. As shown in Table 7, the stronger non-oil tax effort was budgeted to allow the Government to finance a higher level of total expenditure while reducing the budget deficit, from 3.1% of GDP in 1988/89 to 2.4% in 1989/90. The actual outcome is likely to be much better than expected, however, primarily because of higher oil revenues but also because non-oil tax revenues were higher than budgeted. Despite lower aid disbursements, this additional revenue enabled the Government to undertake a sizeable expansion in the level of spending while reducing the deficit more than originally budgeted. Thus, the budget deficit declined to 1.4% and the primary balance (net of external interest payments) registered a surplus of 1.3% of GDP.

23. Revenues. Oil/LNG revenues in 1989/90 exceeded the Budget target by 42% (Rp.3.4 trillion), largely because of much higher world oil prices (averaging around US$17.9/barrel). Non-oil taxes were also higher than expected (Rp.0.5 trillion over Budget) mainly because of the large increase in income taxes. This reflected the effects of the automatic revenue response to GDP growth, the full impact of the withholding tax on interest earnings from time deposits introduced in November 1988, and improvements in tax administration. Higher income taxes offset the slightly lower-than-budgeted performance of the VAT, despite the extension of the VAT to wholesale activities. The property tax also failed to reach its ambitious budget target, and its yield remains well below potential.

24. Expenditures. Central Government current expenditures in 1989/90 are estimated to have grown by 18% over the previous year, mainly because of the 15% structural pay increase awarded to Government employees in the 1989/90 budget and the additional increase of 10% announced in the 1990/91 budget that became effective in January 1990. The budgetary burden of subsidies also remained large and well in excess of the Budget targets. The fertilizer subsidy, despite an increase in retail prices implemented in October 1989, remained near 1988/89 levels because of increased fertilizer consumption. The projected oil surplus from domestic sales turned out to be a subsidy because domestic prices were not increased in line with world prices.

25. The level of capital expenditure in 1989/90 was much higher than budgeted. This was made possible by the higher level of government savings, which offset the large decline in net external loans disbursements. As a result, capital spending rose by 5% in real terms over the previous year. However, this was still lower (in real terms) than the capital expenditure level achieved in 1985/86.

Table 7: CENTRAL GOVERNMENT BUDGET, 1987/88-1990/91
(Rp. trillion at current prices)

	1987/88	1988/89	1989/90		1990/91
	Actual		Budget	Estimate	Budget
Revenues and grants	21.8	23.2	25.3	29.5	31.6
Oil/LNG	10.4	9.2	7.9	11.3	10.8
Non-oil taxes	9.0	11.9	14.9	15.4	18.2
Non-tax revenue /a	2.0	1.6	2.4	2.1	2.6
Grants	0.4	0.5	0.1	0.7	0.0
Current expenditures	15.5	16.8	18.5	19.9	21.7
External interest	3.8	4.3	4.8	4.5	5.2
Subsidies	1.4	1.0	0.2	1.5	0.8
Other	10.3	11.5	13.5	13.9	15.7
Government savings	6.3	6.4	6.8	9.6	9.9
Capital expenditure	8.9	10.8	10.8	12.0	13.6
Budget balance	-2.6	-4.4	-4.0	-2.4	-3.7
Financed by:					
External loans (net)	2.5	4.5	4.0	2.7	3.7
Disbursements	8.9	11.6	11.3	10.2	11.3
- Project aid /b	(5.5)	(5.9)	(7.2)	(5.6)	(7.3)
- Other /c	(3.4)	(5.6)	(4.1)	(4.6)	(4.0)
Amortization	6.4	7.1	7.3	7.5	7.6
Asset drawdown	0.1	-0.1	0.0	-0.3	0.0
Memo items (as % of GDP)					
Revenues and grants	17.0	15.7	15.3	17.3	16.9
Non-oil taxes /d	8.8	10.1	11.0	11.3	11.8
Government savings	4.9	4.4	4.1	5.6	5.2
Budget balance	-2.0	-3.0	-2.4	-1.4	-2.0
Total expenditure	19.0	18.7	17.7	18.7	18.9
Net domestic expenditure /e	3.5	2.8	0.4	2.4	1.3
Primary balance /f	1.1	0.0	0.5	1.3	0.9

/a Includes domestic oil surplus in 1989/90 (Budget).
/b Includes import-related credits.
/c Includes program loans, rupiah support and commercial borrowing.
/d As % of non-oil GDP.
/e Domestic content of expenditure less non-oil revenues.
/f Budget balance net of external interest payments.

Source: Ministry of Finance and World Bank staff estimates.

26. The budget for 1990/91. In January, the Government announced its Budget for 1990/91. Overall, the new Budget reflects the Government's continuing effort to achieve a macroeconomic balance consistent with sustainable growth and poverty alleviation. Recognizing the uncertainties associated with the international oil market, the Budget assumed an average oil price of US$16.5/barrel, around US$1.4 lower than was realized during 1989/90 (but consistent with World Bank projections). In order to offset the projected loss of oil/LNG revenues, the Government intends to maintain its emphasis on non-oil revenue mobilization. Together with a level of net foreign assistance higher than was realized in 1989/90 (but about the same as was budgeted in 1989/90), these revenue targets would allow the Government to finance an additional 10% structural increase in the pay of Government employees, and also to support economic growth and poverty alleviation by raising the level of capital spending. Based on these assumptions, the budget deficit would rise to 2.0% of GDP (from 1.4% of GDP in 1989/90). Nevertheless, the overall fiscal stance would remain prudent, as net domestic expenditure is projected to decline to 1.3% of GDP (from 2.4% in 1989/90), while the primary balance is projected to remain in surplus at 0.9% of GDP.

27. Achieving the Budget's non-oil tax targets will require continuing improvements in tax administration. A key step in meeting this challenge will be to continue to increase the scope and effectiveness of tax audits. The level of subsidies on fertilizer and petroleum products however, are likely to be substantially larger than budgeted in the absence of an increase in domestic sales prices. Rapid progress on reducing these subsidies will be necessary to sustain expenditure on infrastructure and basic services while maintaining fiscal discipline.

28. As noted, oil/LNG revenue projections in the Budget were based on an average oil price of US$16.5/barrel, and this Report's projections in Chapter 2 use the same figure. This is a prudent planning assumption, but since the Budget was prepared, oil price developments have tended to be more favorable, and the current average market price for Indonesia's crude is about US$17.5/barrel. In the event that Indonesia gains another revenue windfall from higher than budgeted oil prices during 1990/91, one policy option would be to improve the fiscal balance by using some of the revenue gains to reduce dependence on net external borrowing instead of using the resources to increase domestic public expenditure. It will also be necessary to ensure that the oil revenue windfall does not compromise the non-oil resource mobilization effort.

Money and Prices

29. Monetary policy. The goal of monetary policy in 1989 continued to be control of inflationary pressures and the maintenance of an adequate level of international reserves. Bank Indonesia (BI) also was concerned over the level of interest rates in the face of persistent commercial bank excess reserves. Inflationary pressures abated during the year, benefiting from positive output supply developments, low international inflation and no abrupt movements in the exchange rate. Meanwhile, net foreign assets of the monetary system changed little in rupiah terms between December 1988 and December 1989, despite an unexpectedly high oil price.

Table 8: FACTORS AFFECTING MONEY SUPPLY AND LIQUIDITY, 1985-89
(Billions of Rupiah)

Changes in	Change in Year End Stocks /b					% Change in Stocks /b			
	1985	1986 /a	1987	1988	1989	1986 /c	1987 /d	1988	1989
Net foreign assets	2,182	1,850	2,452	-549	409	-29.8	15.3	-3.0	2.3
Use of Government deposits	-626	470	1,529	-248	-1,153	24.9	-2.2	-3.3	-16.1
Credit to public enterprises	421	227	729	659	1,444	6.8	12.2	9.8	19.6
Credit to private sector	3,333	4,547	6,245	11,069	20,097	19.3	28.1	38.9	50.1
Net other assets	-94	-2,586	-4,731	-3,314	-4,458	-30.1	-39.7	-27.0	-28.5
Broad money (M2)	5,216	4,508	6,224	8,113	16,048	15.0	22.5	23.9	38.2
Narrow money (M1)	1,523	1,573	1,008	1,707	5,686	17.5	8.6	13.5	39.5
- Currency	728	898	444	464	1,182	20.2	8.3	8.0	18.9
- Demand deposits	795	675	564	1,243	4,504	15.3	8.9	18.0	55.3
Time & saving deposits (QM)	3,693	2,935	5,216	6,406	10,362	13.0	32.6	36.2	37.5
Rupiah liquidity /e	4,883	3,180	5,883	6,416	14,643	18.9	25.5	22.2	41.4
Reserve money	1,020	1,373	858	-490	1,909	24.2	11.0	-6.0	23.3
Memo items:									
M2/GDP ratio	24.5	28.3	29.6	31.8	34.9				
QM/GDP ratio	13.8	16.4	18.5	20.9	22.8				

/a Includes effect of exchange rate adjustment on September 12, 1986.
/b December vs. previous December.
/c Excludes valuation changes resulting from the September 12 devaluation.
/d Excludes recording adjustment on unused commercial loans amounting to Rp. 1,725 billion, which were previously shown as "net government deposits" but since September 1987 shown as Bank Indonesia assets and moved to "net other assets".
/e Excludes foreign currency deposits.

Source: Bank Indonesia

30. Unlike the last few years, reserve money, the monetary aggregate most subject to BI control, expanded sharply in 1989, rising 23.3% overall, with the bulk of the expansion in the last quarter. The expansion was due to a 38% increase in commercial bank reserves held at BI, reflecting strong growth in M2. However, of the total of Rp.2.5 trillion in reserves, some Rp.1.5 trillion were excess reserves kept idle at BI. SBI operations could, in principle, have mopped up these excess reserves, though during the year BI actually released a small amount of liquidity into the system with SBIs.

31. Credit and interest rates. Both the expansion in base money and the moderate use of SBIs were designed to lower domestic interest rates. Rates did decline by about 3 percentage points over the year. Part of the fall occurred in the early part of 1990 when, encouraged by BI, state banks lowered their prime lending rates by 3 percentage points to 16% and their deposit rates to 15.25%. However, given Indonesia's open capital account, these rates have a floor determined by international rates and expectations of depreciation and inflation. Consequently, a sustained adjustment in interest rates requires changes in these variables. This can best be achieved by continued stable macroeconomic management, which will enhance confidence in the Rupiah and in the economy in general. Improved efficiency in the financial system can reduce spreads and lower lending rates. Credit expansion is unlikely to have more than a limited temporary effect on interest rates.

Table 9: INTEREST RATES OF COMMERCIAL BANKS, 1985-89 /a

	December				Sept.	Dec.	Feb.
	1985	1986	1987	1988	1989	1989/g	1990/g
Nominal deposit rates /b							
State banks	16.0	14.7	17.3	18.4	17.7	16.0	15.2
Private banks	17.8	16.2	19.3	20.3	19.5	17.6	17.2
Real deposit rates /c							
State banks	9.6	6.9	11.2	10.1	10.0	9.2	8.4
Private banks	11.4	8.4	13.2	12.0	11.8	10.8	10.4
Nominal lending rates /d							
State banks	15.3	18.5	20.0	20.2	19.9	19.7	16.0
Private FX banks	24.2	23.0	23.6	23.8	22.7	21.7	n.a.
All deposit money banks	n.a.	n.a.	22.1	22.3	21.6	21.0	n.a.
Real lending rates /c							
State banks	8.9	10.7	13.9	11.9	12.2	12.9	9.2
Private FX banks	17.8	15.2	17.5	15.5	15.0	14.9	n.a.
All deposit money banks			16.0	14.0	13.9	14.2	n.a.
Memo items	1985	1986	1987	1988	1989		
LIBOR /e	8.6	6.9	7.3	8.1	9.3		
Inflation differential between Indonesia and USA /f	1.0	3.8	6.2	5.3	1.4		

/a For Rupiah transactions, excluding liquidity credit program.
/b Unweighted average rates on six-month time deposits.
/c Ex-post rate calculated using actual CPI movement in the period.
/d Average nominal rates on working capital.
/e London Interbank offered rate on six month US Dollar deposits.
/f US WPI, Indonesian adjusted CPI.
/g Unweighted average rate.

Source: Bank Indonesia and IMF International Financial Statistics.

32. Both narrow and broad money continued to show very robust growth in 1989, spurred by high interest rates and income growth. Narrow money, in particular, expanded almost 40% during the year. Both growth rates are in excess of base money growth, implying a growing money multiplier. Much of this expansion was absorbed by rising demand for financial assets as a result of the deregulation policies. The pace of growth, however, calls for careful monitoring by BI to ensure that future expansion does not undermine inflation or international reserve targets, particularly given lower levels of deposit rates. Net foreign assets of commercial banks rose in dollar terms by about US$0.2 billion during calendar year 1989. They are likely, however, to end the fiscal year some US$1.4 billion (see para. 20) lower than March 1989,

reflecting in part the strong build-up in net foreign assets during January-March 1989, a change in regulations governing banks' net open positions in foreign exchange, and the pace of monetary expansion during the latter part of the year.

33. The asset counterpart of the expansion in base money by BI was growing domestic credit to the banking system. Liquidity credits, which expanded by Rp.2.7 trillion through December to reach Rp.16.2 trillion, were chiefly responsible for the expansion; they represented 92% of the expansion of domestic credit by BI and 13% of net domestic credit from the banking system. The January announcement of the phasing out of liquidity credits means, however, that in the coming year the decline in liquidity credits will serve to contract base money. Net foreign assets at BI, after falling through the first two quarters of the year, were bolstered by disbursements of special assistance, ending the fiscal year up US$0.3 billion.

34. The 50% expansion of domestic credit to the private sector shows that the financial system is contributing on a greater scale to the economy's credit needs, particularly for investment. While the bulk of the increase in credit was supplied to the private sector, there was a strong expansion in lending to public enterprises, which if continued, could be inconsistent with overall policies in that sector and thus requires close monitoring. The continued rapid pace of overall credit expansion also means that the quality of the new loans being made needs to be carefully monitored (see section D of Chapter 3 on financial sector for a broader discussion).

Domestic Inflation

35. For the second year in a row inflation fell. Urban consumer price inflation decreased by 3 percentage points, to 6.3%, as measured by the 17-city index (see Table 10). The decline was due in large measure to the leveling off of rice prices after a good 1989 harvest. The CPI rate of inflation may be an under-estimation of the general rate, as both the non-oil GDP deflator and the wholesale price index showed higher rates of increase, although each declined compared to the previous year. This may reflect the lower weight of price-controlled items and different commodity mixes. The import price index increased by 9.0% in 1989, due to further Rupiah depreciation. The inflation rate of non-traded goods continued to be lower than that of export goods, implying that by this measure exports remain competitive. Since import price increases exceeded those of non-traded and export goods, the import-competing sector has seen the largest gain in competitiveness in 1989.

36. The impact of inflation on the poor may have lessened during the last year in comparison to other groups and previous years. The nine essential commodities index shows an inflation rate of only 5% for both urban and rural areas. Rice prices in urban areas increased by less than 1%. The farmer's consumption basket increased at a rate greater than the 17-city CPI, but it was still below last year's increase. 3/

3/ This index was rebased to 1983, causing large changes in the historical inflation trends.

Table 10: DOMESTIC INFLATION INDICATORS, 1985-89
(% change in yearly average)

	1985	1986	1987	1988	1989
General Indicators					
CPI-17 cities /a	4.7	5.8	9.5	9.3	6.3
WPI /b	5.4	8.5	18.5	10.0 /c	8.0
Non-oil GDP deflator	6.6	7.1	9.8	9.5	7.9
Specific Indicators					
CPI-Jakarta /a	4.9	5.5	9.6	8.0	6.5
KFM-K3 /d	4.2	-2.0	10.6	3.9	-1.9
Nine essential commodities					
- Urban /e	2.4	5.4	6.7	13.4	5.0
- Rural /f	-1.1	11.8	12.9	17.1	5.0 /g
Farmers household consumption /h	0.6	9.2	12.3	12.0	7.2
Proximate Indicators					
Import goods prices /i	5.3	8.4	22.7	11.5 /c	9.4
Non-oil export goods prices /i	1.0	13.0	30.5	8.0	6.1
Urban rice prices /j	2.6	-10.6	11.8	36.4	0.9
Non-traded goods prices /k	7.0	3.7	6.4	4.7	5.2

/a Revised estimates from 1987-89 reflecting adjusted rice prices for Jakarta.
/b Excluding exports of oil and gas.
/c Revised estimate reflecting adjusted import prices.
/d Physical Minimum Requirements index for 3-child family; weighted average for 26 province (excluding East Timor).
/e Component of CPI-17 cities index.
/f Unweighted average of Java and Madura and Outer Island.
/g Rate through October.
/h Component of Farmers' Terms of Trade index rebased last year to 1983 = 100; weighted average for Yogyakarta and West, Central and East Java.
/i Component of WPI.
/j Weighted average of urban medium-quality rice prices in 14 provincial capitals.
/k Constructed from components of the CPI.

Source: Central Bureau of Statistics and World Bank staff estimates.

NOTE ON REVISIONS TO GDP SERIES

1. In mid-1989, Government released a revised production series for the period 1983-1988 (Annex 2 Table 1). The main adjustments were due to: (a) a new census of manufacturing enterprises, which revealed the number of manufacturing enterprises to be far higher than previously estimated, and (b) new data on oil production. As a result of these (and other smaller) changes, the revised series showed a higher base year (1983) GDP level than the earlier series (Rp. 77.7 trillion vs Rp. 73.7 trillion), as well as higher real growth for the years 1984-1988 (5.1% vs 4.1% p.a.). For the oil/LNG subsector, the base year value added was increased 13% in the revised series, primarily due to an increase in reported oil production, which contributes over 90% of oil/LNG GDP. The average growth for oil/LNG over the period was revised substantially downward, however, from 3.4% p.a. to 2.1% p.a. The base year value for refineries (which contributes less than 10% of oil/LNG GDP) was raised by over 175%, due to changes in the calculation of value added, but the growth rate was lowered substantially, so that by 1988 the value added was nearly the same in the two series. As a consequence of these adjustments, the share of oil/LNG in total GDP over the period fell substantially in the revised series, from 22.3% to 19.3%, while it fell only slightly in the earlier series, from 20.8% to 20.1%.

2. In the non-oil subsector, the base year value added was increased by only 3%, but the growth rate was increased from 4.2% p.a. to 5.9% p.a. These changes were driven largely by manufacturing, where the base value was increased by 23% and the growth rate was revised from 6.1% p.a. to 12.4% p.a. (This had the effect of increasing manufacturing's share of 1988 GDP from 9.3% in the earlier series to 13.8% in the revised series.) Other major changes were in "other services" (trade, banking, ownership of dwellings, public administration and defense, and other services) and mining. The base year value for "other services" (which contribute over 40% of non-oil GDP) was not significantly altered, but the growth rate was increased from 4.3% in the earlier series to 6.1% in the revised series. The base year for the mining sector (which contributes only about 1% of non-oil GDP) was increased by over 60%, and the growth rate was increased from 3.9% to 4.4%. Overall, the share of non-oil value added in total GDP rose from 77.7% to 80.7% in the revised series, as compared to a smaller increase, from 79.2% to 79.9%, in the earlier series.

3. In conjunction with the revision in the production series, Government also released a preliminary revision to the expenditure series (Statistical Annex, Tables 2.3-2.6). Government is currently undertaking a systematic review of these estimates. Pending the results of this review, the expenditure series used in this report (text and Annex 1) is a Bank staff estimate that attempts to maintain consistency with the consumption and investment trends implied by the earlier expenditure series.

Annex 2 Table 1: GDP SERIES -- REVISED VS. PREVIOUS /a

	V.A. (Rp. B. 1983) 1983	V.A. (Rp. B. 1983) 1988	Average Growth 1984-1988	Sectoral Share 1983	Sectoral Share 1988
OIL/LNG					
--revised	17,333	19,273	2.1%	22.3%	19.3%
--previous	15,347	18,106	3.4%	20.8%	20.1%
Oil & Gas					
--revised	15,103	14,691	-0.6%	19.4%	14.7%
--previous	13,346	13,528	0.3%	18.1%	15.0%
LNG/Refinery					
--revised	2,230	4,582	15.5%	2.9%	4.6%
--previous	2,001	4,578	18.0%	2.7%	5.1%
NON-OIL					
--revised	60,343	80,457	5.9%	77.7%	80.7%
--previous	58,351	71,840	4.2%	79.2%	79.9%
Agriculture					
--revised	17,696	21,010	3.5%	22.8%	21.1%
--previous	17,696	20,975	3.5%	24.0%	23.3%
Manufacturing					
--revised	7,666	13,758	12.4%	9.9%	13.8%
--previous	6,211	8,363	6.1%	8.4%	9.3%
Mining					
--revised	1,004	1,243	4.4%	1.3%	1.2%
--previous	622	754	3.9%	0.8%	0.8%
Electricity					
--revised	314	548	11.8%	0.4%	0.5%
--previous	524	883	11.0%	0.7%	1.0%
Transport/Communications					
--revised	4,098	5,224	5.0%	5.3%	5.2%
--previous	3,978	5,039	4.8%	5.4%	5.6%
Construction					
--revised	4,597	5,151	2.3%	5.9%	5.2%
--previous	4,597	5,276	2.8%	6.2%	5.9%
Other Services /b					
--revised	24,967	33,524	6.1%	32.1%	33.6%
--previous	24,723	30,550	4.3%	33.5%	34.0%
TOTAL GDP					
--revised	77,676	99,729	5.1%	100%	100%
--previous	73,698	89,946	4.1%	100%	100%

/a Previous series was published only through 1987; 1988 figures in previous series were preliminary estimates only.

/b Includes trade, banking, ownership dwellings, public administration and defense, and other services.

Source: BPS and World Bank staff estimates.

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COUNTRY ECONOMIC REPORT

STATISTICAL ANNEX /a

List of Tables

/a With the exception of the tables on External Debt, the Statistical Annex is a compilation of official data from Government sources. In some instances, these data may differ from data in the main text and Annex 1 due to different Bank definitions and methodologies in constructing the statistical series.

Monetary Statistics

Agricultural Statistics

Industrial Statistics

Prices

Investment Statistics

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Population And Growth Rates by Province, 1930-1985

Region	Population ('000)					Average growth rate (% p.a.)			
	1930	1961 /a	1971 /a	1980	1985	1930-61	1961-71	1971-80	1980-85
Java	41,718	63,059	76,086	91,270	99,852	1.3	1.9	2.0	1.8
DKI Jakarta	811	2,973	4,579	6,503	7,885	4.3	4.4	4.0	3.9
West Java	10,586	17,615	21,624	27,454	30,830	1.7	2.1	2.7	2.3
Central Java	13,706	18,407	21,877	25,373	26,945	1.0	1.7	1.7	1.2
DI Yogjakarta	1,559	2,241	2,489	2,751	2,930	1.2	1.1	1.1	1.3
East Java	15,056	21,823	25,517	29,189	31,262	1.2	1.6	1.5	1.4
Sumatra	8,255	15,739	20,809	28,017	32,603	2.1	2.8	3.4	3.1
Lampung	361	1,668	2,777	4,625	5,905	5.1	5.2	5.8	5.0
Bengkulu	323	406	519	768	943	0.7	2.5	4.5	4.2
South Sumatra	1,378	2,773	3,441	4,630	5,370	2.3	2.2	3.4	3.0
Riau	493	1,235	1,642	2,169	2,548	3.0	2.9	3.1	3.3
Jambi	245	744	1,006	1,446	1,745	3.6	3.1	4.1	3.8
West Sumatra	1,910	2,319	2,793	3,407	3,698	0.6	1.9	2.2	1.7
North Sumatra	2,542	4,965	6,622	8,361	9,422	2.2	2.9	2.6	2.4
Aceh	1,003	1,629	2,009	2,611	2,972	1.6	2.1	3.0	2.6
Kalimantan	2,170	4,102	5,155	6,723	7,722	2.1	2.3	3.0	2.8
West Kalimantan	802	1,581	2,020	2,486	2,819	2.2	2.5	2.3	2.5
Central Kalimantan	203	497	702	954	1,118	2.9	3.5	3.5	3.2
South Kalimantan	836	1,473	1,699	2,065	2,273	1.8	1.4	2.2	1.9
East Kalimantan	329	551	734	1,218	1,512	1.7	2.9	5.8	4.4
Sulawesi	4,231	7,079	8,528	10,409	11,554	1.7	1.9	2.2	2.1
Central Sulawesi	390	693	914	1,290	1,511	1.9	2.8	3.9	3.2
North Sulawesi	748	1,310	1,719	2,115	2,313	1.8	2.8	2.3	1.8
South Sulawesi	2,657	4,517	5,181	6,062	6,610	1.7	1.4	1.8	1.7
Southeast Sulawesi	436	559	714	942	1,120	0.8	2.5	3.1	3.5
Other Islands	4,219	7,106	8,630	11,071	12,316	1.7	2.0	2.8	2.2
Bali	1,101	1,783	2,120	2,470	2,649	1.6	1.7	1.7	1.4
West Nusa Tenggara	1,016	1,808	2,203	2,725	2,995	1.9	2.0	2.4	1.9
East Nusa Tenggara	1,344	1,967	2,295	2,737	3,061	1.2	1.6	2.0	2.3
Maluku	579	790	1,089	1,410	1,609	1.0	3.3	2.9	2.7
Irian Jaya	179	758	923	1,174	1,371	4.8	2.0	2.7	3.2
East Timor	n.a	n.a	n.a	555	631	n.a	n.a	n.a	2.6
Total Indonesia	60,593	97,085	119,208	147,490	164,047	1.5	2.1	2.4	2.2

/a Includes adjustment for the exclusion of rural Irian Jaya.

Source: Central Bureau of Statistics, Population Census Reports, 1961, 1971, and 1980; Statistical Yearbook Of Indonesia, 1984; and SUPAS 1985.

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Distribution of Population by Age Group and Sex, 1961-1985
('000)

Age Group	1961 Males	1961 Females	1961 Total	1971 Males	1971 Females	1971 Total	1980 Males	1980 Females	1980 Total	1985 Males	1985 Females	1985 Total
0-4	8,529	8,649	17,178	9,675	9,560	19,235	10,872	10,422	21,294	11,008	10,543	21,551
5-9	7,744	7,701	15,445	9,593	9,302	18,895	10,889	10,446	21,335	11,379	10,739	22,118
10-14	4,353	3,892	8,245	7,406	6,875	14,281	9,179	8,525	17,704	10,783	10,113	20,896
15-19	3,865	3,905	7,770	5,627	5,779	11,406	7,552	7,806	15,358	8,335	8,232	16,567
20-24	3,480	4,373	7,853	3,627	4,461	8,088	6,010	7,055	13,065	6,385	7,903	14,288
25-34	7,392	8,610	16,002	7,722	9,226	16,948	9,685	9,920	19,605	12,026	12,442	24,468
35-44	5,765	5,406	11,171	7,062	7,119	14,181	7,876	8,172	16,048	8,538	8,485	17,023
45-54	3,587	3,511	7,098	4,360	4,213	8,573	5,761	5,856	11,617	6,418	6,514	12,932
55-64	1,913	1,865	3,778	2,224	2,373	4,597	3,297	3,354	6,651	4,150	4,474	8,624
65+	1,183	1,245	2,428	1,450	1,539	2,989	2,200	2,593	4,793	2,619	2,954	5,573
Unknown	60	57	117	7	8	15	11	9	20	4	3	7
Total	47,871	49,214	97,085	58,753	60,455	119,208	73,332	74,158	147,490	81,645	82,402	164,047
						Percentage distribution						
0-4	17.8	17.6	17.7	16.5	15.8	16.1	14.8	14.1	14.4	13.5	12.8	13.1
5-9	16.2	15.6	15.9	16.3	15.4	15.9	14.8	14.1	14.5	13.9	13.0	13.5
10-14	9.1	7.9	8.5	12.6	11.4	12.0	12.5	11.5	12.0	13.2	12.3	12.7
15-19	8.1	7.9	8.0	9.6	9.6	9.6	10.3	10.5	10.4	10.2	10.0	10.1
20-24	7.3	8.9	8.1	6.2	7.4	6.8	8.2	9.5	8.9	7.8	9.6	8.7
25-34	15.4	17.5	16.5	13.1	15.3	14.2	13.2	13.4	13.3	14.7	15.1	14.9
35-44	12.0	11.0	11.5	12.0	11.8	11.9	10.7	11.0	10.9	10.5	10.3	10.4
45-54	7.5	7.1	7.3	7.4	7.0	7.2	7.9	7.9	7.9	7.9	7.9	7.9
55-64	4.0	3.8	3.9	3.8	3.9	3.9	4.5	4.5	4.5	5.1	5.4	5.3
65+	2.5	2.5	2.5	2.5	2.5	2.5	3.0	3.5	3.2	3.2	3.6	3.4
Unknown	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source : Central Bureau of Statistics, Census Reports, 1961, 1971, 1980 and 1985; Intercensal Population Survey, 1985.

Statistical Annex
Table 1.3

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Employment by Main Industry, 1971-1985 /a

Main Industry	1971 million	1971 %	1980 million	1980 %	1982 million	1982 %	1985 million	1985 %
Agriculture, forestry, hunting & fishery	26.5	64.2	28.0	54.8	31.6	54.7	34.1	54.6
Mining and quarrying	0.1	0.2	0.4	0.7	0.4	0.7	0.4	0.7
Manufacturing	2.7	6.5	4.4	8.5	6.0	10.4	5.8	9.3
Electricity, gas & water	0.0	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Construction	0.7	1.6	1.6	3.1	2.2	3.7	2.1	3.4
Wholesale and retail trade & restaurants	4.3	10.3	6.6	12.9	8.6	14.8	9.4	15.0
Transportation, storage & communications	1.0	2.3	1.5	2.9	1.8	3.1	2.0	3.1
Finance, insurance, real estate & business services	0.1	0.2	0.2	0.4	0.1	0.2	0.3	0.4
Public services	4.1	10.0	7.7	15.1	7.1	12.3	8.3	13.3
Others	1.9	4.6	0.7	1.4	0.0	0.0	0.1	0.1
Total	41.3	100.0	51.2	100.0	57.8	100.0	62.5	100.0

/a Refers to population 10 years of age and above who worked during the week previous to the census.

Source: Central Bureau of Statistics, Statistical Yearbook of Indonesia, 1975, 1982, 1985.

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COUNTRY ECONOMIC REPORT

Gross Domestic Product by Industrial Origin at Current Market Prices, 1978-1988 /a
(Rp. billion)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /b
Agriculture	6,780	9,384	11,726	13,698	15,062	17,696	20,334	22,414	24,751	29,016	33,598
Farm food crops	3,892	4,774	6,103	7,826	9,162	11,057	12,606	13,761	14,965	17,387	20,681
Farm non-food crops	1,104	1,614	1,924	2,048	1,915	2,295	2,739	2,979	3,534	4,140	4,403
Estate crops	175	273	303	294	270	375	593	715	690	978	1,01[illegible]
Livestock products	537	809	1,191	1,478	1,611	1,754	2,084	2,427	2,640	3,015	3,545
Forestry	616	1,292	1,412	1,077	990	994	939	938	1,001	1,247	1,370
Fishery	456	623	793	976	1,114	1,220	1,373	1,595	1,921	2,249	2,569
Mining and quarrying	4,263	6,866	11,238	13,218	12,153	16,107	16,838	13,571	11,503	17,267	16,185
Oil & natural gas	4,081	6,541	10,610	12,673	11,648	15,103	15,917	12,584	10,502	15,979	14,442
Other	182	324	628	544	505	1,004	1,021	987	1,001	1,287	1,743
Manufacturing	2,816	4,003	6,353	7,067	7,482	9,896	13,113	15,503	17,185	21,140	25,821
Refinery oil	115	97	94	180	155	359	1,013	1,864	1,915	1,820	1,824
LNG	200	582	1,198	1,282	1,615	1,871	2,707	2,424	1,969	2,097	2,587
Other	2,501	3,324	5,061	5,605	5,712	7,666	9,394	11,216	13,301	17,223	21,410
Electricity, gas & water	128	130	231	292	341	314	354	396	647	757	837
Construction	1,371	1,945	2,562	3,500	3,769	4,597	4,757	5,302	5,314	6,087	6,988
Trade	3,530	5,608	7,323	8,781	9,947	11,541	13,363	15,355	17,083	20,870	24,167
Retail & wholesale trade	2,893	4,800	6,314	7,586	8,567	9,933	11,300	12,900	14,116	17,383	20,144
Hotels & restaurants	637	809	1,009	1,194	1,380	1,608	2,063	2,455	2,967	3,487	4,023
Transport & communications	1,234	1,681	2,211	2,370	3,164	4,098	5,051	6,100	6,407	7,414	8,059
Transport	1,167	1,568	2,060	2,182	2,942	3,694	4,611	5,539	5,770	6,639	7,237
Communications	67	113	150	188	222	404	440	562	637	775	822
Banking, etc.	470	680	924	1,406	1,783	2,359	3,080	3,511	4,059	4,824	5,263
Ownership of dwellings	703	960	1,228	1,494	1,731	2,356	2,573	2,775	2,976	3,349	3,736
Public admin. & defence	1,766	2,099	3,225	4,203	4,706	5,712	6,470	7,925	8,307	8,912	9,446
Other services	1,186	1,496	1,872	2,099	2,339	3,001	3,718	3,999	4,315	4,903	5,351
Gross Domestic Product	24,246	34,840	48,914	58,127	62,476	77,676	89,750	96,850	102,546	124,539	139,452

/a In 1989, Government released a revised national account series for the period 1983-1988. Since the 1978-1982 series has not yet been revised, it is not directly comparable with the 1983-1988 series.
/b Preliminary figures.

Source : Central Bureau of Statistics.

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Gross Domestic Product by Industrial Origin at Constant 1983 Market Prices, 1978-1988 /a
(Rp. billion)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /b
Agriculture	14,334	15,249	16,303	17,270	17,407	17,698	18,431	19,209	19,699	20,136	21,008
Farm food crops	8,400	8,838	9,661	10,639	10,736	11,057	11,599	11,895	12,186	12,306	12,797
Farm non-food crops	1,651	1,866	2,050	2,219	2,274	2,295	2,349	2,576	2,581	2,693	2,833
Estate crops	267	290	317	343	363	375	446	511	562	565	577
Livestock products	1,315	1,414	1,538	1,634	1,703	1,754	1,890	2,037	2,064	2,111	2,212
Forestry	1,818	1,796	1,620	1,296	1,165	994	894	851	889	968	1,013
Fishery	983	1,046	1,116	1,139	1,167	1,220	1,253	1,341	1,418	1,494	1,576
Mining & quarrying	16,364	16,093	16,078	16,340	13,876	16,107	17,120	15,480	16,309	16,366	15,934
Oil & natural gas	15,923	15,590	15,525	15,767	13,249	15,103	16,187	14,513	15,237	15,219	14,691
Other	441	502	553	573	627	1,004	933	968	1,072	1,146	1,243
Manufacturing	5,108	5,952	7,304	7,878	7,973	9,896	12,079	13,431	14,678	16,235	18,340
Refinery oil	148	173	188	170	142	359	626	767	927	938	980
LNG	725	1,230	1,672	1,712	1,782	1,871	2,790	2,919	2,923	3,233	3,601
Other	4,235	4,549	5,447	5,997	6,049	7,666	8,663	9,746	10,828	12,064	13,758
Electricity, gas and water	244	265	312	361	422	314	324	361	430	495	548
Construction	2,904	3,266	3,850	4,368	4,409	4,597	4,394	4,508	4,609	4,803	5,119
Trade	8,210	8,906	10,303	10,968	11,603	11,541	11,793	12,389	13,450	14,356	15,662
Retail & wholesale trade	6,866	7,520	8,819	9,436	10,057	9,933	10,010	10,402	11,229	12,007	12,999
Hotels & restaurants	1,344	1,387	1,484	1,532	1,546	1,608	1,783	1,987	2,221	2,351	2,664
Transport & communications	2,506	2,670	2,911	3,309	3,540	4,098	4,443	4,487	4,669	4,937	5,225
Transport	2,366	2,513	2,722	3,083	3,276	3,694	4,008	4,032	4,178	4,394	4,638
Communications	140	157	188	226	263	404	435	455	490	544	588
Banking, etc.	1,123	1,159	1,263	1,762	2,073	2,359	2,802	2,999	3,465	3,531	3,597
Ownership of dwellings	1,462	1,573	1,683	1,823	1,879	2,356	2,412	2,461	2,545	2,654	2,762
Public admin. & defence	3,397	3,787	4,053	4,682	5,329	5,712	5,997	6,455	6,962	7,366	7,932
Other services	2,484	2,581	2,663	2,792	2,851	3,001	3,117	3,180	3,299	3,422	3,570
Gross Domestic Product	58,133	61,500	66,723	71,553	71,361	77,676	82,911	84,959	90,014	94,302	99,697

/a In 1989, Government released a revised national account series for the period 1983-1988. Since the 1978-1982 series has not yet been revised, it is not directly comparable with the 1983-1988 series.
/b Preliminary figures.

Source : Central Bureau of Statistics.

Statistical Annex
Table 2.3

INDONESIA

COUNTRY ECONOMIC REPORT

Expenditure on GDP at Current Market Prices, 1978-1988 /a
(Rp. billion)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /b
Private consumption	15,125	19,516	25,595	32,294	37,924	47,063	54,067	57,201	63,355	71,989	80,996
Government consumption	2,557	3,277	5,148	6,452	7,229	8,077	9,122	10,893	11,329	11,764	12,756
Gross fixed investment	5,494	7,668	10,550	14,135	15,822	19,468	20,136	22,367	24,782	30,980	33,907
Changes in stock /c	574	2,166	1,345	3,189	1,584	2,847	3,272	4,690	4,106	7,851	8,181
Exports of goods and nonfactor services	5,241	10,003	16,162	16,177	15,103	19,846	22,999	21,534	20,010	29,895	34,622
Less: Imports of goods and nonfactor services	4,745	7,791	9,886	14,119	15,186	19,625	19,845	19,835	21,036	27,939	31,009
Gross Domestic Product	24,246	34,840	48,914	58,127	62,476	77,676	89,750	96,850	102,546	124,539	139,452

/a In 1989, Government released a revised national account series for the period 1983-1988. Since the 1978-1982 series has not yet been revised, it is not directly comparable with the 1983-1988 series.
/b Preliminary figures.
/c Residual.

Source : Central Bureau of Statistics.

Statistical Annex
Table 2.4

INDONESIA

COUNTRY ECONOMIC REPORT

Expenditure on GDP at Constant 1983 Market Prices, 1978 - 1988 /a
(Rp. billion)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /b
Private consumption	29,848	32,491	36,037	39,699	42,172	47,063	48,942	49,448	50,530	52,200	54,212
Government consumption	5,139	5,767	6,801	7,567	8,291	8,077	8,353	8,991	9,241	9,226	9,924
Gross fixed investment	11,289	12,382	15,646	17,659	18,740	19,468	18,297	19,616	21,422	22,597	23,246
Changes in stock /c	181	27	(3,077)	5,475	3,239	2,847	4,325	6,519	6,266	4,836	2,750
Exports of goods and nonfactor services	23,907	24,458	26,182	21,163	19,242	19,846	21,145	19,495	22,460	25,743	25,983
Less: Imports of goods and nonfactor services	12,231	13,625	14,866	20,010	20,323	19,625	18,151	19,109	19,906	20,299	16,418
Gross Domestic Product	58,133	61,500	66,723	71,553	71,361	77,676	82,911	84,959	90,014	94,302	99,697

/a In 1989, Government released a revised national account series for the period 1983-1988. Since the 1978-1982 series has not yet been revised, it is not directly comparable with the 1983-1988 series.
/b Preliminary figures.
/c Residual.

Source : Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Distribution of GDP at Current Market Prices, 1978-1988 /a
(%)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /b
Economic sectors											
Agriculture, forestry, fishery and livestock	28.0	26.9	24.0	23.6	24.1	22.8	22.7	23.1	24.1	23.3	24.1
Mining & quarrying	17.6	19.7	23.0	22.7	19.5	20.7	18.9	14.0	11.2	13.9	11.6
Manufacturing	11.6	11.5	13.0	12.2	12.0	12.7	14.6	16.0	16.8	17.0	18.5
Electricity, gas and water	0.5	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.6	0.6	0.6
Construction	5.7	5.6	5.3	6.0	6.0	5.9	5.3	5.5	5.2	4.9	5.0
Transport & communications	5.1	4.8	4.5	4.1	5.1	5.3	5.6	6.3	6.2	6.0	5.8
Other services	31.6	31.1	29.8	30.9	32.8	32.1	32.5	34.7	35.8	34.4	34.4
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expenditure categories											
Private consumption	62.4	56.0	52.3	55.6	60.7	60.6	60.2	59.1	61.8	57.8	58.0
Government consumption	10.5	9.4	10.5	11.1	11.6	10.4	10.2	11.2	11.0	9.4	9.1
Gross domestic investment	25.0	28.2	24.3	29.8	27.9	28.7	26.1	27.9	28.2	31.2	30.2
Net exports	2.0	6.4	12.8	3.5	-0.1	0.3	3.5	1.8	-1.0	1.6	2.6
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

/a In 1989, Government released a revised national account series for the period 1983-1988. Since the 1978-1982 series has not yet been revised, it is not directly comparable with the 1983-1988 series.
/b Preliminary figures.

Source: Tables 2.1 and 2.3.

Statistical Annex
Table 2.6

INDONESIA

COUNTRY ECONOMIC REPORT

Distribution of GDP at Constant 1983 Market Prices, 1978 - 1988 /a
(%)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988/b
Economic Sectors											
Agriculture, forestry, fishery and livestock	24.7	24.8	24.4	24.1	24.4	22.8	22.2	22.6	21.9	21.4	21.1
Mining & quarrying	28.1	26.2	24.1	22.8	19.4	20.7	20.6	18.2	18.1	17.4	16.0
Manufacturing	8.8	9.7	10.9	11.0	11.2	12.7	14.6	15.8	16.3	17.2	18.4
Electricity, gas and water	0.4	0.4	0.5	0.5	0.6	0.4	0.4	0.4	0.5	0.5	0.5
Construction	5.0	5.3	5.8	6.1	6.2	5.9	5.3	5.3	5.1	5.1	5.1
Transport & communications	4.3	4.3	4.4	4.6	5.0	5.3	5.4	5.3	5.2	5.2	5.2
Other services	28.7	29.3	29.9	30.8	33.3	32.1	31.5	32.3	32.9	33.2	33.6
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expenditure categories											
Private consumption	51.3	52.8	54.0	55.5	59.1	60.6	59.0	58.2	56.1	55.4	54.4
Government consumption	8.8	9.4	10.2	10.6	11.6	10.4	10.1	10.6	10.3	9.8	10.0
Gross domestic investment	19.7	20.2	18.8	32.3	30.8	28.7	27.3	30.8	30.8	29.1	26.1
Net exports	20.1	17.6	17.0	1.6	-1.5	0.3	3.6	0.5	2.8	5.8	9.6
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

/a In 1989, Government released a revised national account series for the period 1983-1988. Since the 1978-1982 series has not yet been revised, it is not directly comparable with the 1983-1988 series.
/b Preliminary figures.

Source : Tables 2.2 and 2.4.

Statistical Annex
Table 3.1

INDONESIA

COUNTRY ECONOMIC REPORT

Balance of Payments, 1978/79 - 1988/89
(US$ million)

	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89
1. Net oil exports /a	3,785	6,308	9,345	8,379	5,788	6,016	5,845	4,004	1,426	2,334	1,535
2. Net LNG exports /a	225	667	1,256	1,382	1,378	1,355	1,971	2,119	1,158	1,426	1,525
3. Non-oil exports (net)	-5165	-4777	-8470	-12551	-14205	-11522	-9784	-7955	-6635	-5467	-4919
Exports, fob	3,979	6,171	5,587	4,170	3,928	5,367	5,907	6,175	6,731	9,502	12,184
Imports, cif	-7543	-9028	-11837	-14561	-15824	-14346	-12921	-11186	-10385	-11763	-13586
Services (nonfreight)	-1601	-1920	-2220	-2160	-2309	-2543	-2770	-2944	-2981	-3206	-3517
4. Current account (1+2+3)	-1155	2,198	2,131	-2790	-7039	-4151	-1968	-1832	-4051	-1707	-1859
5. SDRs											
6. Official capital disbursements	2,101	2,690	2,684	3,521	5,011	5,793	3,519	3,432	5,472	4,575	6,588
IGGI	1,567	2,237	2,406	2,415	2,905	4,255	3,189	2,751	3,978	4,368	5,468
Program aid	94	239	118	50	21	84	52	38	48	30	23
Project aid	1,473	1,998	2,288	2,365	2,884	4,171	3,137	2,713	3,930	4,338	5,445
ODA	814	1,106	1,299	996	1,356	1,902	1,442	1,332	1,932	2,807	3,973
Non-ODA	659	892	989	1,369	1,528	2,269	1,695	1,381	1,998	1,531	1,472
Non-IGGI	534	453	278	1,106	2,106	1,538	330	681	1,494	207	1,120
Cash loan	0	0	0	0	0	0	0	0	0	0	0
7. Amortization	-632	-692	-615	-809	-926	-1010	-1292	-1644	-2129	-3049	-3763
8. Other capital (net)	542	-1312	-361	1,140	1,795	1,191	499	572	1,232	1,709	-211
Direct investment	271	217	140	142	311	193	245	299	252	544	585
Oil sector	75	-1237	-685	791	1,322	n.a	n.a	n.a	n.a	n.a	n.a
Others	196	-292	184	207	162	998	254	273	980	1165	-796
9. Total (4 through 8)	856	2,884	3,839	1,062	-1159	1,823	758	528	524	1,528	755
10. Errors and omissions	-62	-1256	-1165	-2050	-2121	247	-91	-498	-1262	57	-1432
11. Monetary movements /b	-794	-1628	-2674	988	3,280	-2070	-667	-30	738	-1585	677

/a Gross exports less imports of goods and services of the oil and LNG sector respectively.
/b A negative amount refers to an accumulation of assets.
/c Preliminary figures.

Source: Bank Indonesia.

Statistical Annex
Table 3.2

INDONESIA

COUNTRY ECONOMIC REPORT

Non - oil Exports, 1981/82 - 1988/89

	Value (US $ million)								Volume ('000 tons)							
	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89 /a	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89 /a
Agricultural	2,930	2,722	3,662	3,663	3,780	4,419	5,719	6,811								
Timber	952	899	1,161	1,167	1,217	1,592	2,462	2,879	5,938	5,101	5,843	5,201	4,670	5,509	6,718	7,634
a. Log	504	310	267	135	2	3	3	5	4,212	2;785	2,536	1,223	79	168	146	195
b. Plywood	199	324	579	697	848	1,156	1,834	2,069	591	876	1,603	2,105	2,495	2,949	3,820	4,290
c. Sawn timber	244	256	302	320	349	408	540	676	1,100	1,365	1,630	1,789	2,017	2,267	2,473	2,764
d. Other	4	10	13	16	18	25	85	129	35	75	74	84	79	125	279	385
Rubber	770	615	984	856	714	752	1,055	1,236	883	877	1,145	1,042	1,082	1,063	1,198	1,219
Palm oil	79	103	92	95	170	119	214	313	183	315	279	175	504	569	704	807
Coffee	343	363	506	568	659	753	497	572	219	239	298	308	294	310	274	320
Tea	94	116	156	211	134	106	119	134	88	68	85	91	101	93	98	108
Tobacco	49	37	50	44	55	78	65	73	26	19	28	23	21	27	30	33
Pepper	49	41	56	66	82	152	158	144	38	34	51	34	25	33	36	53
Copra cake	33	38	33	18	35	34	41	38	301	367	338	213	433	348	384	308
Tapioca	20	9	33	31	42	52	93	154	267	107	299	418	534	439	833	1,362
Rattan	85	82	87	96	80	99	162	37	84	89	83	101	92	116	135	30
Hides	32	25	27	40	37	45	59	68	6	6	6	2	8	10	6	4
Other foodstuff	71	50	101	98	122	84	102	166	704	492	900	748	885	542	1,490	1,097
Animal products	213	251	276	219	274	380	466	783	105	109	194	87	109	128	183	225
of which shrimps	165	204	206	183	228	317	368	537	39	44	44	44	50	58	91	95
Others	140	93	98	155	160	175	228	216	n.a	n.a	n.a	n.a	n.a	n.a	n.a	
Mineral	756	676	800	775	800	725	1,080	1,445								
Tin	437	349	309	252	248	156	143	165	31	27	24	22	23	24	22	24
Copper	133	115	89	132	133	144	186	238	210	217	191	242	279	271	290	318
Nickel	145	139	170	121	140	112	146	357	1,174	922	721	955	943	1,288	1,455	1,585
Aluminum	n.a	48	165	208	223	201	245	308	n.a	32	112	153	219	177	152	127
Granite	6	5	13	9	8	8	6	6	933	676	169	1,300	1,194	1,272	858	860
Others	36	20	54	53	49	104	353	370	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Manufactured	333	530	905	1,469	1,595	1,587	2,703	3,930								
Textiles	129	158	290	418	577	632	996	1,371	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Handicraft	19	23	75	116	187	142	287	445	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Electrical app.	72	112	130	134	45	46	55	105	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Cement	23	9	11	14	23	47	54	85	471	236	306	516	955	2,012	2,316	3,316
Fertilizer	11	21	50	31	109	97	117	135	41	103	377	208	1,047	1,212	1,272	998
Others	80	207	349	757	655	623	1,194	1,789	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Unclassified	151	0	0	0	0	0	0	0	n.a	0	0	0	0	0	0	0
Total Non-oil Exports	4,170	3,928	5,367	5,907	6,175	6,731	9,502	12,185								

/a Preliminary figures.

Source: Bank Indonesia (based on PEB Export Declaration Form).

Statistical Annex
Table 3.3

INDONESIA

COUNTRY ECONOMIC REPORT

Value of Exports by Principal Country of Destination, 1978-1989
(US$ million)

Countries	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989 /a
Asean	1,478	2,233	3,054	3,415	3,499	3,476	2,487	1,982	1,515	1,703	2,079	1,995
Malaysia	21	66	67	75	59	58	98	77	82	94	164	180
Thailand	18	38	35	35	26	49	98	81	83	87	151	204
Philippines	198	165	161	411	293	242	166	199	108	71	87	123
Singapore	1,241	1,964	2,771	2,894	3,121	3,128	2,126	1,626	1,239	1,449	1,653	1,483
Brunei	0	0	0	0	0	0	0	0	2	3	4	7
Hongkong	43	99	152	135	145	182	261	348	345	420	554	455
Japan	4,566	7,192	12,042	11,950	11,193	9,678	10,353	8,594	6,644	7,393	8,018	7,725
Other Asia	631	807	802	805	970	801	1,254	1,475	1,170	1,869	2,415	2,346
Africa	37	32	56	37	57	79	140	160	179	150	272	184
USA	2,962	3,171	4,801	4,852	3,546	4,267	4,505	4,040	2,902	3,349	3,074	2,870
Canada	30	28	28	22	19	28	46	46	60	94	101	87
Other America	766	431	956	1,960	929	1,015	1,031	326	182	48	47	42
Australia	107	190	339	447	674	208	275	149	159	310	293	312
Other Oceania	7	51	109	211	278	264	236	81	83	43	31	55
EEC	874	1,173	1,388	1,063	894	953	1,036	1,113	1,340	1,541	2,152	1,837
United Kingdom	54	89	142	131	126	199	168	191	197	212	349	302
Netherlands	355	399	415	347	265	289	332	392	453	493	646	530
West Germany	226	338	389	239	253	252	246	255	334	361	456	397
Belgium & Luxemburg	18	18	25	18	20	33	63	45	91	109	177	140
France	54	77	122	52	77	53	49	71	93	102	164	163
Denmark	40	43	40	15	10	4	6	3	6	13	20	29
Ireland	1	0	1	0	0	1	4	2	2	7	17	16
Italy	126	210	254	168	142	120	167	152	152	175	221	186
Greece	0	0	0	93	1	1	1	3	6	3	2	3
Portugal	0	0	0	0	0	0	0	0	7	10	22	10
Spain	0	0	0	0	0	0	0	0	0	55	78	61
Soviet Union	52	55	73	80	22	50	59	76	52	84	38	81
Others in Europe	91	130	152	187	102	145	206	194	174	133	144	141
Total	11,643	15,590	23,950	25,165	22,328	21,146	21,888	18,587	14,805	17,136	19,219	18,128

/a January-October 1989.

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Value of Imports by Principal Country of Origin, 1978-1989
(US$ million)

Countries	1978	1979	1980	1981	1982	1983	1984 /a	1985	1986	1987	1988	1989 /b
Asean	652	839	1,350	1,702	3,302	3,915	1,948	962	1,121	1,244	1,305	1,375
Malaysia	22	35	36	60	56	60	86	32	50	139	276	266
Thailand	101	219	288	146	199	209	55	48	72	75	96	181
Philippines	76	49	90	253	228	182	15	23	28	82	36	39
Singapore	453	536	936	1,243	2,819	3,465	1,791	839	969	947	896	887
Brunei	0	0	0	0	0	0	0	0	1	0	1	1
Hongkong	142	102	139	68	87	65	86	53	94	104	133	141
Japan	2,016	2,103	3,413	3,989	4,279	3,793	3,308	2,644	3,128	3,596	3,386	3,106
Other Asia	995	1,249	1,992	1,986	2,452	2,220	2,338	1,727	1,681	1,924	2,266	2,622
Africa	69	132	130	252	202	135	171	160	103	153	201	153
USA	832	1,028	1,409	1,795	2,417	2,534	2,560	1,721	1,483	1,415	1,736	1,772
Canada	83	73	97	102	138	186	319	198	214	303	274	259
Other America	77	56	111	266	166	129	139	191	174	211	224	389
Australia	218	223	378	362	365	402	372	461	413	463	578	726
Other Oceania	38	43	76	98	96	72	78	69	71	80	96	92
EEC	1,267	1,074	1,445	2,200	2,656	2,234	2,062	1,706	1,796	2,353	2,510	2,075
United Kingdom	208	198	261	547	445	364	297	300	342	325	340	286
Netherlands	146	119	116	205	185	257	266	215	189	316	258	218
West Germany	594	462	685	905	1,193	741	820	677	719	836	887	738
Belgium & Luxemburg	33	63	56	86	97	124	102	101	89	142	159	135
France	166	143	236	344	571	591	432	284	281	392	465	314
Denmark	60	19	12	14	54	21	20	18	26	26	22	24
Ireland	2	2	3	4	4	8	8	9	4	6	6	6
Italy	59	67	76	96	104	125	113	101	144	237	248	285
Greece	0	0	0	0	3	3	4	0	0	2	3	2
Portugal	0	0	0	0	0	0	0	0	2	6	3	2
Spain	0	0	0	0	0	0	0	0	0	66	120	65
Soviet Union	15	14	20	41	39	25	12	3	5	16	45	44
Others in Europe	287	269	274	412	663	641	490	365	435	510	494	519
Total	6,690	7,203	10,834	13,272	16,859	16,352	13,882	10,259	10,719	12,370	13,249	13,272

/a Since 1984, excludes the value of processing deals in the oil sector.
/b January-October 1989.

Source: Central Bureau of Statistics.

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Summary of External Debt Data, 1979-1989 /a

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
External debt data						(US $ million)					
Disbursed and outstanding debt (DOD) /b	13,377	15,021	15,903	18,522	21,611	22,277	26,842	32,959	41,412	41,377	41,026
Bilateral/multilateral	8,608	9,557	10,092	11,118	11,957	12,245	15,171	18,760	25,020	26,692	27,924
Other /c	4,769	5,464	5,811	7,403	9,654	10,032	11,671	14,199	16,392	14,686	13,102
Total debt outstanding, including undisbursed (TDO)	21,302	24,502	27,243	32,234	35,485	36,501	42,866	50,338	60,683	60,309	59,290
Bilateral/multilateral	14,300	16,727	17,999	19,568	20,770	21,669	25,503	29,720	37,522	39,127	40,905
Other /c	7,002	7,775	9,244	12,666	14,716	14,831	17,363	20,618	23,161	21,182	18,385
Commitments	4,101	4,277	5,627	7,074	5,689	4,806	4,586	4,276	5,945	6,034	6,377
Bilateral/multilateral	2,251	2,639	2,833	2,610	2,310	2,737	2,406	2,098	4,743	4,781	5,020
Other /c	1,850	1,638	2,795	4,464	3,379	2,068	2,180	2,178	1,202	1,253	1,357
Gross disbursements	1,887	2,551	2,672	4,191	4,932	3,806	3,615	4,255	5,530	6,407	6,047
Bilateral/multilateral	826	1,131	1,363	1,835	1,712	1,867	1,692	1,981	3,718	4,241	3,780
Other /c	1,062	1,420	1,309	2,356	3,220	1,939	1,923	2,275	1,812	2,166	2,267
Net disbursements	555	1,611	1,619	3,088	3,643	2,194	1,268	1,850	2,146	2,875	5,229
Bilateral/multilateral	555	807	986	1,367	1,162	1,285	1,059	1,065	2,537	2,875	2,373
Other /c	-1	804	632	1,721	2,481	910	210	785	-391	-1,247	2,855
Net resource transfers	-216	788	624	1,942	2,388	568	-373	-199	-226	-906	-739
Bilateral/multilateral	259	496	651	959	690	704	354	115	1,439	1,553	966
Other /c	-475	292	-27	983	1,698	-137	-727	-314	-1664	-2460	-1705
Public debt service	2,103	1,762	2,048	2,250	2,544	3,239	3,987	4,455	5,755	7,313	6,787
Amortization	1,329	937	1,054	1,103	1,289	1,612	2,346	2,406	3,384	4,779	4,262
Interest	774	825	994	1,146	1,255	1,627	1,641	2,049	2,372	2,534	2,525
Public debt service	2,103	1,762	2,048	2,250	2,544	3,239	3,987	4,455	5,755	7,313	6,787
Bilateral/multilateral	567	635	712	877	1,022	1,163	1,338	1,866	2,279	2,688	2,814
Other /c	1,536	1,128	1,336	1,373	1,522	2,076	2,650	2,589	3,476	4,625	3,972
Disbursement indicators						(%)					
Undisbursed debt/TDO /b	37	39	42	43	39	39	37	35	32	31	31
Bilateral/multilateral	40	43	44	43	42	43	41	37	33	32	32
Other /c	32	30	37	42	34	32	33	31	29	31	29
Gross disbursements/commit.	46	60	47	59	87	79	79	100	93	106	95
Bilateral/multilateral	37	43	48	70	74	68	70	94	78	89	75
Other /c	57	87	47	53	95	94	88	104	151	173	167
Gross disbursements/undisbursed debt and commitments /d	19	21	18	23	25	20	19	21	24	25	24
Bilateral/multilateral	12	14	14	17.	16	16	14	16	24	25	22
Other /c	32	37	26	30	37	27	28	29	24	27	29
Net disbursements/gross disbs.	29	63	61	74	74	58	35	43	39	45	86
Bilateral/multilateral	67	71	72	74	68	69	63	54	68	68	63
Other /c	-0	57	48	73	77	47	11	35	-22	0	126
Net resource transfers/gross disb.	11	31	23	46	48	15	-10	5	-4	-14	-12
Bilateral/multilateral	31	44	48	52	40	38	21	6	39	37	26
Other /c	-45	21	-2	42	53	-7	-38	-14	-92	-114	-75

/a Data in this sector refer to public sector medium and long term loans. Loans with a maturity of less than one year, credits for LNG expansion, LPG and paraxylene projects, and grants are not included.
/b End of year.
/c Suppliers' credits, loans from financial institutions, export credits, bonds and nationalization only.
/d Gross disbursements as a percentage of undisbursed debt (TDO-DOD) at beginning of year plus commitments during the year.

Source: IBRD Debtor Reporting System, based on data provided by Bank Indonesia.

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External Public Debt Outstanding as of December 31, 1989
(US$ '000)

Type of creditor/ creditor country	Debt outstanding Disbursed	Undisbursed	Total	Major reported new commitments Jan 1-Dec 31 1989
Suppliers' Credits				
Finland	8,337	4,071	12,408	0
France	33	-	33	0
Japan	3,007,189	1,981,868	4,989,057	63,641
Korea, Republic of	19,397	-	19,397	0
Pakistan	6,341	-	6,341	0
Switzerland	1,054	-	1,054	0
United States	457	-	457	0
Yugoslavia	7,710	-	7,710	0
Total suppliers' credits	3,050,518	1,985,939	5,036,457	63,641
Financial Institutions				
France	133,542	87,233	220,775	0
Germany, Fed. Rep. of	9,178	1,078	10,256	0
Hongkong	1,014,775	863,987	1,878,762	500,000
Italy	2,640	-	2,640	0
Japan	3,328,038	739,864	4,067,902	376,802
Multiple Lenders	468,750	-	468,750	0
Netherlands	4,219	-	4,219	0
Singapore	210,855	-	210,855	0
United Kingdom	362,566	160,550	523,116	0
United States	963,672	180,000	1,143,672	0
Total financial institutions	6,498,235	2,032,713	8,530,949	876,802
Bonds				
Germany, Fed. Rep. of	176,699	-	176,699	0
Japan	48,797	-	48,797	0
Kuwait	6,877	-	6,877	0
Netherlands	20,882	-	20,882	0
Saudi Arabia	75,000	-	75,000	0
Switzerland	82,500	-	82,500	0
United Kingdom	103,600	-	103,600	0
United States	300,000	-	300,000	0
Total bonds	814,356	-	814,356	0
Nationalization				
Netherlands	127,591	-	127,591	0
Total nationalization	127,591	-	127,591	0
Multilateral Loans				
Asian Dev. Bank	2,427,596	2,261,483	4,689,078	597,541
EEC	4,351	-	4,351	0
IBRD	8,542,224	3,943,326	12,485,550	2,007,400
IDA	853,598	842	854,440	0
Intl Fund Agr Dev (IFAD)	30,920	83,281	114,201	0
Islamic Dev. Bank	710	9,114	9,824	0
Nordic Invest Bank	26,000	38,500	64,500	0
Total multilateral loans	11,885,398	6,336,545	18,221,943	2,604,941

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External Public Debt Outstanding as of December 31, 1989
(US$ '000)

Type of creditor/ creditor country	Debt outstanding Disbursed	Undisbursed	Total	Major reported new commitments Jan 1-Dec 31 1989
Bilateral Loans				
Australia	148,774	132,407	281,181	85,620
Austria	64,023	25,680	89,703	0
Belgium	90,893	1,193	92,086	0
Brunei	100,000	-	100,000	0
Bulgaria	1,078	-	1,078	0
Canada	324,708	120,937	445,645	0
China	69,447	-	69,447	0
Czechoslovakia	35,937	-	35,937	0
Denmark	33,331	1,655	34,986	0
Egypt, Arab Republic of	1,592	-	1,592	0
France	514,123	361,435	875,558	167,157
German Dem. Rep.	29,555	-	29,555	0
Germany, Fed. Rep. of	1,864,611	609,711	2,474,322	296,107
Hungary	8,965	-	8,965	0
India	23,935	4,880	28,815	0
Italy	47,544	40,216	87,760	40,180
Japan	8,354,285	4,104,862	12,459,147	1,479,836
Korea, Republic of	-	13,156	13,156	13,315
Kuwait	90,430	59,208	149,638	0
Multiple Lenders	17,818	-	17,818	0
Netherlands	911,056	212,150	1,123,206	128,692
New Zealand	1,179	-	1,179	0
Other	20,000	-	20,000	0
Pakistan	3870	-	3,870	0
Ploand	50,478	-	50,478	0
Romania	7,237	-	7,237	0
Saudi Arabia	47,711	114,853	162,564	0
Spain	145,937	-	145,937	0
Switzerland	-	32,978	32,978	0
United Arab Emirates	6,050	1,713	7,763	0
United Kingdom	40,662	61,719	102,381	0
United States	2,432,282	745,795	3,178,077	204,248
USSR	490,264	-	490,264	0
Yugoslavia	60,503	-	60,503	0
Total bilateral loans	16,038,279	6,644,547	22,682,826	2,415,155
Export Credits				
Austria	101,442	38,521	139,963	5,676
Belgium	105,868	122,920	228,788	50,751
France	663,078	755,617	1,418,695	219,717
Germany, Fed. Rep. of	222,912	54,505	277,417	27,687
Japan	182,182	11,244	193,426	0
Netherlands	284,398	154,590	438,988	13,465
Norway	9,767	-	9,767	0
Singapore	7,902	-	7,902	0
Sweden	170,226	8,745	178,971	8,500
Switzerland	56,028	25,395	81,423	0
United Kingdom	807,954	146,214	954,168	90,317
Total export credits	2,611,757	1,317,750	3,929,507	416,113
Total external public debt	41,026,134	18,317,495	59,343,629	6,376,652

Source: IBRD Debtor Reporting System, based on data provided by Bank Indonesia.

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Service Payments, Commitments, Disbursements and Outstanding Amounts of External Public Debt
(US$ '000)

	Debt outstanding at end of period		Transactions during period					Other Changes	
	Disbursed only	Including Undisbursed	Commitments	Disbursements	Service Payments: Principal	Service Payments: Interest	Service Payments: Total	Cancellations	Adjustment /a
Actual									
1979	13,377,200	21,301,762	4,101,016	1,887,246	1,332,396	770,904	2,103,300	128,422	-446,710
1980	15,021,487	24,502,044	4,277,373	2,550,505	939,185	823,138	1,762,324	118,261	-19,644
1981	15,903,027	27,243,376	5,627,466	2,672,429	1,053,805	994,324	2,048,129	163,286	-1,669,042
1982	18,521,744	32,234,475	7,073,633	4,191,377	1,103,446	1,146,392	2,249,838	7,043	-972,044
1983	21,611,250	35,485,484	5,688,551	4,932,075	1,288,805	1,255,100	2,543,905	191,969	-956,767
1984	22,277,161	36,500,824	4,805,789	3,806,370	1,612,123	1,626,636	3,238,758	25,234	-2,153,767
1985	26,841,698	42,865,748	4,585,869	3,614,549	2,346,227	1,641,246	3,987,473	516,776	4,642,057
1986	32,958,834	50,337,801	4,276,117	4,255,390	2,405,671	2,048,961	4,454,631	187,968	5,789,575
1987	41,412,488	60,683,274	5,944,558	5,529,952	3,383,619	2,371,840	5,755,458	673,682	8,458,216
1988	41,377,385	60,308,738	6,033,506	6,406,908	4,778,691	2,534,349	7,313,040	492,503	-1,136,846
1989	41,026,133	59,343,629	6,367,652	6,047,241	4,262,029	2,524,532	6,786,561	363,061	-2,716,671
Projected									
1990	40,228,162	52,779,119	-	3,747,842	4,474,821	2,623,799	7,098,620	2,018,697	-70,991
1991	39,650,322	48,427,740	-	3,773,538	4,351,378	2,513,860	6,865,238	-	-
1992	38,463,773	44,011,576	-	3,229,616	4,416,164	2,408,878	6,825,041	-	0
1993	36,234,352	39,375,495	-	2,406,683	4,636,103	2,258,938	6,895,041	-	22
1994	33,861,952	35,520,349	-	1,482,804	3,855,204	2,047,099	5,902,303	-	58
1995	31,035,889	31,937,510	-	756,822	3,582,885	1,855,353	5,438,238	-	46
1996	28,350,372	28,805,011	-	446,983	3,132,500	1,658,225	4,790,725	-	2

/a This column shows the amount of arithmetic imbalances in the amount outstanding, including undisbursed, from one year to the next. The most common causes of imbalances are changes in exchange rates and transfers of debts from one category to another in the table.

Source: IBRD Debtor Reporting System, based on data provided by Bank Indonesia.

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Central Government Budget Summary, 1978/79-1990/91
(Rp. billion)

	Actual											Budget	
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
1. Domestic revenues	4,266	6,697	10,227	12,213	12,418	14,433	15,906	19,253	16,141	20,803	23,004	25,250	31,584
2. Routine expe.ditures /a	2,744	4,062	5,800	6,978	6,996	8,412	9,429	11,952	13,559	17,482	20,739	23,445	26,648
3. Government saving (1-2)	1,522	2,635	4,427	5,235	5,422	6,021	6,477	7,301	2,581	3,322	2,265	1,805	4,936
4. Development expenditures	2,556	4,014	5,916	6,940	7,360	9,899	9,952	10,873	8,332	9,477	12,251	13,130	16,225
5. Balance (3-4)	(1,033)	(1,379)	(1,489)	(1,705)	(1,938)	(3,878)	(3,475)	(3,572)	(5,751)	(6,156)	(9,985)	(11,325)	(11,290)
Financed by:													
6. Program aid	48	65	64	45	15	15	69	69	1,958	728	2,041	1,799	2,885
7. Project aid	987	1,316	1,430	1,664	1,925	3,868	3,409	3,503	3,795	5,430	7,950	9,526	8,404
8. Change in balances (- = increase)	(2)	(2)	(5)	(4)	(2)	(4)	(3)	(1)	(2)	(2)	(5)	(0)	(0)

/a Includes debt service payments.

Source: Ministry of Finance.

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Central Government Receipts, 1978/79 - 1990/91
(Rp. billion)

	Actual											Budget	
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Taxes on income	2,996	5,129	8,230	10,100	10,010	11,605	12,847	13,625	8,798	12,988	13,901	13,486	17,919
Income tax	122	148	164	207	289	399	451	675	2,271	2,663	3,949	4,948	6,516
Corporate tax /a	227	297	448	559	675	757	1,670	1,638					
Corporate tax on oil /b	2,309	4,280	7,020	8,629	8,170	9,520	10,430	11,144	6,338	10,047	9,527	7,900	10,783
Witholding tax /c	233	291	434	513	642	628							
IPEDA/property tax /d	63	71	87	95	105	132	157	168	190	275	424	639	620
Others /e	43	62	78	99	129	168	138						
Taxes on domestic consumption	491	537	733	888	1,137	1,392	1,510	3,479	5,156	4,719	6,187	8,135	9,025
Sales/value added tax	221	192	268	311	477	575	637	2,327	2,900	3,390	4,505	5,831	6,825
Excises	253	326	438	544	620	773	873	944	1,056	1,106	1,390	1,487	1,911
Other oil revenues /f	0	0	0	0	0	0	0	0	1,010	0	0	393	0
Miscellaneous levies	17	19	29	33	41	44	0	208	190	223	292	425	289
Taxes on international trade	587	843	948	888	835	916	862	658	1,039	1,122	1,348	1,581	2,080
Import duties	295	317	448	536	522	557	530	607	960	938	1,192	1,421	1,972
Sales tax on imports /g	126	137	195	223	231	255	241						
Export tax	166	389	305	128	83	104	91	51	79	184	156	160	108
Nontax receipts	191	187	316	336	436	520	687	1,492	1,147	1,977	1,569	2,048	2,560
Domestic revenue	4,266	6,697	10,227	12,213	12,418	14,433	15,906	19,253	16,141	20,803	23,004	25,250	31,584
Development funds	1,036	1,381	1,494	1,709	1,940	3,882	3,478	3,573	5,752	6,158	9,991	11,325	11,290
Program aid	48	65	64	45	15	15	69	69	1,958	728	2,041	1,799	2,885
Project aid /h	987	1,316	1,430	1,664	1,925	3,868	3,409	3,503	3,795	5,430	7,950	9,526	8,404
Total revenues	5,302	8,078	11,721	13,922	14,358	18,315	19,384	22,825	21,893	26,961	32,995	36,575	42,873

/a Since 1986/87 included in income tax.
/b For 1974/75, excludes underpayment of revenues, estimated at about Rp. 340 billion, due to Government from Pertamina.
/c Since 1984/85, witholding tax eliminated as separate category and combined with income tax.
/d Since January 1986, Ipeda replaced by property tax.
/e Classification changed to other tax (included in miscellaneous levies which consist of other taxes and stamp duty).
/f Oil subsidies shown as Government expenditures from 1977/78 (see Table 5.3).
/g Since 1984/85 classification changed to value-added tax and tax on luxury goods.
/h Includes commercial bank and suppliers' credits for development projects.

Source: Ministry of Finance.

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Central Government Expenditures, 1978/79 - 1990/91
(Rp. billion)

	Actual											Budget	
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Personnel expenditures	1,002	1,420	2,023	2,278	2,418	2,757	3,047	4,018	4,311	4,617	4,998	5,967	6,909
Wages and salaries	760	1,054	1,483	1,660	1,749	1,996	2,207	3,073	3,330	3,561	3,833	4,608	5,487
Rice allowance	133	180	252	253	290	346	407	402	406	451	518	616	636
Food allowance	51	110	193	241	255	261	271	300	288	299	327	371	381
Other	34	47	61	80	79	88	90	161	177	176	185	207	216
External	24	29	34	43	46	66	72	82	110	130	135	165	190
Material expenditures	420	569	671	922	1,041	1,057	1,183	1,367	1,366	1,329	1,492	1,477	1,721
Domestic	398	540	638	891	1,007	1,007	1,134	1,310	1,294	1,239	1,378	1,345	1,568
External	21	29	33	32	34	50	49	58	73	90	114	132	153
Subsidies to region /a	522	670	976	1,209	1,315	1,547	1,883	2,489	2,650	2,816	3,038	3,594	4,227
Irian Jaya	22	25	34	42	43	42	0	0	0	0	0	0	0
Other region	500	645	942	1,167	1,272	1,505	1,883	2,489	2,650	2,816	3,038	3,594	4,227
Debt service payments	535	684	785	931	1,225	2,103	2,777	3,323	5,058	8,205	10,940	12,237	12,984
Internal	9	37	31	16	20	30	39	20	0	39	78	149	245
External	526	648	754	915	1,205	2,073	2,737	3,303	5,058	8,166	10,863	12,088	12,739
Other expenditures	266	719	1,345	1,637	997	948	540	754	174	515	271	171	807
Food subsidy	44	125	282	224	1	0	0	0	29	0	0	0	0
Oil subsidy	197	535	1,022	1,316	962	928	507	374	0	0	0	0	627
Others /b	25	59	42	97	34	20	33	380	145	515	271	171	180
Routine expenditures	2,744	4,062	5,800	6,978	6,996	8,412	9,429	11,952	13,559	17,482	20,739	23,445	26,648
Development expenditures /c	2,556	4,014	5,916	6,940	7,360	9,899	9,952	10,873	8,332	9,477	12,251	13,130	16,225
Total expenditures	5,299	8,076	11,716	13,918	14,356	18,311	19,381	22,825	21,891	26,959	32,990	36,575	42,873

/a Since 1984/85, this item is sub-divided into wage/salary and non wage/salary expenditures without identifying regions.
/b *This line shows debt service transfers to PERTAMINA (1976/77 - Rp. 31 billion,* 1977/78 - Rp. 86.4 billion), PERTAMINA subsidy (1979/80 - Rp. 81.0 billion) and expenditures on the general election (1976/77 - Rp. 37.0 billion, 1981/82 - Rp. 81.0 billion, 1985/86 - Rp. 40 billion).
/c For details see Tables 5.4 and 5.5.

Source: Ministry of Finance.

Statistical Annex
Table 5.4

INDONESIA

COUNTRY ECONOMIC REPORT

Development Expenditures, 1978/79 - 1990/91
(Rp. billion)

	Actual											Budget	
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
1. Departments	851	1,480	2,533	2,725	3,261	3,220	3,474	4,467	2,004	2,113	1,861	1,474	4,316
2. General INPRES programs	182	219	337	448	535	539	540	575	568	656	714	706	1,058
Subsidies to provinces	87	101	167	215	253	253	253	287	293	290	334	324	486
Subs/dies to kabupatens	71	87	119	163	194	194	195	189	188	263	267	270	392
Subsidies to villages	24	31	51	71	88	92	93	99	86	102	112	112	181
3. Sectoral INPRES programs	176	252	377	585	444	771	824	754	721	451	429	536	1,274
Primary schools	112	156	250	375	267	549	572	526	496	193	131	100	370
Health	27	30	50	79	80	87	65	111	108	74	99	122	189
Markets	1	12	3	6	5	11	26	4	12	3	3	3	3
Replanting/reforestration	36	41	49	70	50	59	61	43	31	16	17	16	33
Roads	0	13	26	55	42	65	101	70	75	164	180	295	679
4. IPEDA	63	71	87	95	105	132	157	168	171	223	344	517	503
5. Irian Jaya and East Timor	10	7	6	7	6	5	4	7	7	5	0	0	0
Subtotal of transfers to local governments (2 - 5)	431	549	808	1,134	1,090	1,448	1,526	1,503	1,467	1,334	1,486	1,759	2,835
6. Fertilizer subsidy	83	125	284	371	420	324	732	477	467	756	200	155	155
7. Government capital participation (PMP)	129	253	477	481	337	592	336	412	86	336	125	58	75
8. Others	75	291	386	565	327	449	475	511	514	515	629	158	440
Total (1 - 8)	1,568	2,698	4,486	5,276	5,435	6,032	6,543	7,370	4,537	5,054	4,301	3,604	7,821
9. Project aid /a	987	1,316	1,430	1,664	1,925	3,868	3,409	3,503	3,795	4,423	7,950	9,526	8,404
Total (1 - 9)	2,556	4,014	5,916	6,940	7,360	9,899	9,952	10,873	8,332	9,477	12,251	13,130	16,225

/a For 1987/88 excluding project aid in Rupiah.

Source: Ministry of Finance.

Statistical Annex
Table 5.5

INDONESIA

COUNTRY ECONOMIC REPORT

Development Expenditures by Sector, 1978/79 - 1990/91
(Rp. billion)

Sector	Actual											Budget	
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Agriculture and irrigation	450	508	929	954	931	913	1,699	1,138	890	1,937	1,614	1,994	2,392
(of which fertilizer subsidy)	(82.6)	(125.0)	(283.6)	(371.4)	(420.1)	(324.2)	(731.6)	(477.1)	(467.2)	(756.4)	(200.0)	(155)	(155)
Industry and mining	205	403	491	827	913	2,153	839	1,189	681	335	565	523	661
Electric power	272	330	431	530	758	660	911	1,447	960	1,085	1,955	1,433	1,759
Transportation and tourism	413	466	781	807	876	1,528	1,428	1,484	1,131	1,598	2,011	2,522	3,042
Manpower and transmigration	[illegible]	162	326	417	436	456	422	665	292	200	266	335	556
Regional development	275	336	482	616	711	749	791	850	939	930	1,137	1,552	1,873
Education	251	361	575	726	703	1,032	1,231	1,413	1,184	1,181	1,606	1,683	2,065
Population & Health	79	142	218	286	259	279	320	398	326	225	339	434	592
Housing and water supply	56	117	191	166	151	221	224	335	337	432	481	620	729
General public services /a	225	473	699	800	786	899	927	977	769	652	733	941	1,166
Government capital participation	162	466	389	389	281	234	292	221	211	219	238	291	339
Others /b	73	250	404	423	555	776	867	758	611	684	1,305	800	1,051
Total development expenditures	2,556	4,014	5,916	6,940	7,360	9,899	9,952	10,873	8,332	9,477	12,251	13,130	16,225
Total (excluding fertilizer subsidy)	2,473	3,889	5,633	6,569	6,940	9,575	9,220	10,396	7,865	8,721	12,051	12,975	16,070

/a Law and order, defence and security, government apparatus.
/b Trade and cooperatives, religion, information and science. From 1979/80 includes natural resource development and environment.

Source: Ministry of Finance.

INDONESIA

COUNTRY ECONOMIC REPORT

Project Aid by Sector, 1978/79 - 1990/91
(Rp. billion)

	Actual											Budget	
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Agriculture and irrigation	135	155	223	136	101	155	472	180	237	576	1,087	1,675	1,756
Industry and mining	199	307	226	581	734	1,051	671	668	632	267	327	492	564
Electric power	208	257	265	308	506	1,182	653	1,172	791	769	1,783	1,400	1,384
Transportation and tourism	250	192	308	264	332	889	601	688	729	845	1,424	2,003	1,376
Manpower and transmigration	12	23	31	31	15	45	76	36	123	62	98	174	63
Regional development	8	18	24	17	3	7	1	8	25	4	45	308	245
Education	35	43	50	37	24	211	180	59	346	718	1,236	1,303	992
Population & Health	22	34	36	34	24	37	78	56	100	38	99	143	61
Housing and water supply	18	28	33	22	21	51	84	77	139	273	400	560	512
General public services	54	175	154	180	83	152	255	186	257	350	382	641	734
Government capital participation	33	34	36	28	47	45	160	203	185	168	213	280	128
Others /a	14	50	45	29	35	42	179	171	231	355	855	549	589
Total project aid /b	987	1,316	1,430	1,664	1,925	3,867	3,409	3,503	3,795	4,423	7,950	9,526	8,404

/a Since 1979/80 includes natural resources development and environment.
/b Includes commercial credits for development programs/projects.

Source: Ministry of Finance.

INDONESIA

COUNTRY ECONOMIC REPORT

Money Supply, 1974 - 1988
(Rp. billion)

End of	Total	Currency		Demand deposits		Change over period	
		Amount	(%)	Amount	(%)	Amount	(%)
1974	937	494	53	443	47	268	40
1975	1,250	625	50	625	50	313	33
1976	1,603	781	49	822	51	353	28
1977	2,006	979	49	1,027	51	403	25
1978	2,488	1,240	50	1,248	50	482	24
1979	3,385	1,552	46	1,833	54	897	36
1980	4,995	2,153	43	2,842	57	1,610	48
1981	6,486	2,557	39	3,929	61	1,491	30
1982	7,121	2,934	41	4,187	59	635	10
1983	7,569	3,333	44	4,236	56	448	6
1984	8,581	3,712	43	4,869	57	1,012	13
1985	10,104	4,440	44	5,664	56	1,523	17
1986	11,677	5,338	46	6,339	54	1,573	16
1987	12,685	5,782	46	6,903	54	1,008	9
1988	14,392	6,246	43	8,146	57	1,707	14

Source: Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Changes in Factors Affecting Reserve Money Supply, 1974-1988
(Rp. billion)

End of period	Net foreign assets	Net claims on Central Government	Claims on official entities & public enterprises	Blocked account /a	Claims on business & individuals	Time & savings deposits /b	Net other items	Total change in Money Supply: Amount	Total change in Money Supply: Percentage (%)
1974	364	-132	294	-	147	-196	-209	268	40
1975	-588	162	926	-415	298	-213	143	313	33
1976	345	-333	449	-51	356	-300	-113	353	28
1977	568	-275	35	67	284	-96	-180	403	25
1978 /c	50	-311	349	88	546	-112	-128	482	24
1979	1,788	1,779	371	85	557	-516	-436	897	36
1980	3,040	-1,868	489	-5	1,178	-859	-365	1,610	48
1981	149	-591	593	36	1,756	-535	83	1,491	30
1982	-1,237	129	689	109	2,260	-724	-591	635	10
1983 /d	1,180	-1,286	-42	118	2,183	-2.520	815	448	6
1984	3,531	-3,359	190	124	3,646	-2,262	882	1,012	13
1985	1,751	-278	511	64	3,333	-3,693	-115	1,523	17
1986 /e	1,870	498	252	-29	4,547	-2,935	-2496	1,573	16
1987	2,444	1,541	720	-3	6,245	-5,216	-4710	1,008	9
1988	-549	229	659	18	11,069	-6,406	-3053	1,707	14

/a Refers to government accounts blocked for special purposes.
/b Includes foreign currency deposits held by residents.
/c Does not include revaluation adjustment to foreign exchange balances resulting from the rupiah devaluation of November 15, 1978. The adjustments amount to Rp. 650 billion in net foreign assets; Rp. 46 billion in net claims on Central government; Rp. 551 billion in claims on official entities; Rp. 164 billion in blocked account; Rp. 41 billion in claims on businesses and individuals; Rp. 83 billion in time and savings deposits; and Rp. 1,041 billion in net other items.
/d Does not include revaluation adjustment to foreign exchange balances resulting from the rupiah devaluation of March 30, 1983. The adjustments amount to Rp. 1,962 billion in net foreign assets; Rp. 131 billion in net claims on Central government; Rp. 146 billion in claims on official entities and public enterprises; Rp. 106 billion in blocked account; Rp. 148 billion in claims on businesses and individuals; Rp. 620 billion in time and savings deposits; and Rp. 1,399 billion in net other items.
/e Includes revaluation adjustment due to devaluation on September 12, 1986.

Source: Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Consolidated Balance Sheet of the Monetary System, 1978-1988
(Rp. billion)

End of period	1978	1979	1980	1981	1982	1983 /b	1984	1985	1986 /c	1987	1988
Net foreign assets	1,663	3,318	6,419	6,811	5,565	8,837	12,368	14,119	15,989	18,433	17,884
Domestic credit	4,046	4,232	3,979	5,651	8,846	9,744	10,345	13,975	19,245	27,755	39,730
Claims on public sector											
Central government	-878	-1,703	-3,619	-4,330	-4,193	-5,739	-9,098	-9,376	-8,878	-7,337	-7,108
Claims on official entities and public enterprises /a	2,796	3,167	3,655	4,247	4,979	5,040	5,230	5,741	5,993	6,722	7,381
Government-blocked account	-476	-391	-396	-360	-252	-240	-116	-52	-81	-84	-66
Claims on private enterprises and individuals	2,604	3,159	4,339	6,094	8,312	10,683	14,329	17,662	22,209	28,454	39,523
Loans	2,493	2,993	4,107	5,844	7,995	10,184	13,550	16,392	20,409	26,072	36,502
Other claims	111	166	232	250	317	499	779	1,270	1,800	2,382	3,021
Assets = liabilities	5,709	7,550	10,398	12,462	14,411	18,581	22,713	28,094	35,234	46,188	57,614
Import deposits	174	213	365	298	300	242	218	268	402	424	684
Net other items	1,726	2,114	2,342	2,448	3,036	3,676	4,558	4,600	7,169	11,879	14,932
Money and quasi money	3,809	5,223	7,691	9,716	11,075	14,663	17,937	23,153	27,661	33,885	41,998
Money	2,488	3,386	4,995	6,485	7,121	7,569	8,581	10,104	11,677	12,685	14,392
Currency	1,240	1,552	2,153	2,557	2,934	3,333	3,712	4,440	5,338	5,782	6,246
Demand deposits	1,248	1,834	2,842	3,928	4,187	4,236	4,869	5,664	6,339	6,903	8,146
Quasi money /d	1,321	1,837	2,696	3,231	3,954	7,094	9,356	13,049	15,984	21,200	27,606

/a For 1979, includes changes resulting from the exchange rate adjustment on November 15, 1978 from Rp. 415 to Rp. 625 per US$.
/b Includes changes resulting from the exchange rate adjustment of March 30, 1983 from Rp. 702.50 to Rp. 970 per US$.
/c Includes changes resulting from the exchange rate adjustment on September 12, 1986 from Rp 1,134 to Rp 1,644 per US$.
/d For 1979, includes revaluation of foreign exchange deposits amounting to Rp. 99 billion.

Source: Bank Indonesia.

Statistical Annex
Table 6.4

INDONESIA

COUNTRY ECONOMIC REPORT

Banking System Credits by Economic Sector, 1978-1988 /a
(Rp. billion)

Sectors	1978 /b	1979 /c	1980	1981	1982	1983 /i	1984	1985	1986 /j	1987	1988
Agriculture	345	438	539	813	1,025	1,226	1,318	1,656	2,097	2,656	3,610
In rupiah	344	436	539	813	1,025	1,226	1,318	1,656	2,097	2,630	3,572
In foreign exchange	1	2	0	0	0	0	0	0	0	26	38
Mining /d	1,699	1,893	1,867	1,693	1,472	806	384	258	394	385	444
In rupiah	230	1,893	1,867	1,693	1,472	806	384	258	394	372	424
In foreign exchange	1,469	0	0	0	0	0	0	0	0	13	20
Manufacturing industry /e	1,624	1,933	2,213	2,762	3,923	5,207	6,667	7,592	9,005	10,917	14,956
In rupiah	1,265	1,536	1,826	2,376	3,429	4,595	6,205	7,069	8,839	10,508	13,994
In foreign exchange	359	397	387	386	494	612	462	523	166	409	962
Trade /f	1,114	1,338	1,976	3,062	4,129	5,132	6,344	7,255	8,399	10,247	13,888
In rupiah	1,105	1,334	1,970	3,046	4,009	4,781	6,299	7,214	8,329	10,065	13,682
In foreign exchange	9	4	6	16	120	351	45	41	70	182	206
Service rendering industry /g	389	422	946	1,385	1,867	2,277	3,169	4,183	4,345	5,460	7,382
In rupiah	385	418	939	1,382	1,860	2,253	3,088	4,047	4,130	5,151	6,917
In foreign exchange	4	4	7	3	7	24	81	136	215	309	465
Others	223	244	333	444	606	651	931	1,213	2,162	3,187	3,721
In rupiah	221	241	331	444	606	651	929	1,210	2,156	3,143	3,667
In foreign exchange /h	2	3	2	0	0	0	2	3	6	44	54
Total	5,394	6,268	7,874	10,159	13,022	15,299	18,813	22,157	26,402	32,852	44,001
In rupiah	3,550	5,858	7,472	9,754	12,401	14,312	18,223	21,454	25,945	31,869	42,256
In foreign exchange	1,844	410	402	405	621	987	590	703	457	983	1,745

/a Credits outstanding end of period. Includes investment credits, KIK and KMKP. Excludes interbank credits, credits to central government and to nonresidents, and foreign exchange component of project aid.
/b Includes foreign exchange revaluation amounting to Rp. 681.8 billion.
/c Includes foreign exchange revaluation amounting to Rp. 698.0 billion.
/d Includes credits to PERTAMINA for repayment of foreign borrowing. Since March 1979, credit in foreign exchange to PERTAMINA has been converted to rupiah credits.
/e Processing of agricultural products is classified under manufacturing industry according to International Standard Industrial Classification (ISIC 1968). Starting 1980, credits for construction which were previously included in manufacturing industry are now included in service-rendering industry.
/f Includes credits for food procurement and hotel projects.
/g Credits for electricity, gas and water supply are included in service-rendering industry sector.
/h 1974 figure refers to credits in foreign exchange given to all sectors, except trade.
/i Includes foreign exchange revaluation amounting to Rp. 251 billion.
/j Includes revaluation adjustment due to the devaluation of September 12, 1986.

Source: Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Banking Credits Outstanding in Rupiah and Foreign Exchange by Group of Banks, 1978-1988 /a
(Rp. billion)

	1978 /b	1979 /c	1980	1981	1982	1983 /d	1984	1985	1986 /e	1987	1988
Bank Indonesia direct credits /f	1,935	2,163	2,454	2,649	2,771	2,356	870	964	1,144	1,347	1,547
In rupiah	466	2,163	2,454	2,649	2,771	2,356	870	964	1,144	1,347	1,547
In foreign exchange	1,469	0	0	0	0	0	0	0	0	0	0
State commercial banks /g	2,832	3,270	4,295	5,881	8,031	9,787	13,345	15,374	17,782	21,676	28,631
In rupiah	2,549	2,958	3,954	5,523	7,474	8,910	12,959	14,925	17,711	21,225	27,614
In foreign exchange	283	312	341	358	557	877	386	449	71	451	1,017
National Private Banks /h	366	493	711	1,081	1,554	2,294	3,552	4,746	6,272	8,423	11,910
In rupiah	360	466	705	1,069	1,534	2,279	3,480	4,631	6,061	8,175	11,536
In foreign exchange	6	27	6	12	20	15	72	115	211	248	374
Foreign Banks	262	342	414	548	666	862	1,046	1,073	1,204	1,406	1,913
In rupiah	176	271	359	513	622	767	914	934	1,029	1,122	1,559
In foreign exchange	86	71	55	35	44	95	132	139	175	284	354
Total	5,394	6,268	7,874	10,159	13,022	15,299	18,813	22,157	26,402	32,852	44,001
In rupiah	3,550	5,858	7,472	9,754	12,401	14,312	18,223	21,454	25,945	31,869	42,256
In foreign exchange	1,844	410	402	405	621	987	590	703	457	983	1,745

/a Credits outstanding at end of period. Includes investment credits, KIK and KMP. Excludes interbank credits, credits to Central Government and to non-residents, and foreign exchange component of project aid.
/b Includes foreign exchange revaluation amounting to Rp. 681.8 billion.
/c Includes foreign exchange revaluation amounting to Rp. 698.0 billion.
/d Includes foreign exchange revaluation amounting to Rp. 251.0 billion.
/e Includes revaluation adjustment due to devaluation on September 12, 1986.
/f Excludes liquidity credits, includes credits to Pertamina for repayment for foreign borrowing.
/g Includes state development bank and liquidity credits.
/h Includes liquidity credits. National private banks refer to national private commercial banks and regional development banks.

Source : Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Small-Scale Investment Credits and Permanent Working Capital Credits, 1974-1988

	Small-Scale Investment Credits /a			Permanent Working Capital Credits /a		
	Number of applications approved ('000s)	Approved value	Out-standing	Number of applications approved ('000s)	Approved value	Out-standing
		---(Rp. billion)---			---(Rp. billion)---	
1974	10	15	13	15	16	13
1975	17	28	22	24	29	18
1976	28	50	36	166	67	41
1977	40	74	50	322	115	62
1978	55	106	65	420	177	84
1979	72	163	99	644	305	154
1980	119	321	210	905	602	312
1981	173	540	380	1,272	1,124	647
1982	207	669	407	1,462	1,535	803
1983	231	812	393	1,633	1,884	856
1984	250	921	366	1,809	2,309	928
1985	266	1,015	328	1,996	2,768	885
1986	283	1,135	305	2,147	3,241	878
1987	295	1,269	297	2,278	3,781	903
1988	311	1,429	394	2,347	4,310	1,025

/a Cumulative as at end of period.

Source: Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Investment Credits by Economic Sector, 1980-1988 /a
(Rp. billion)

End of period	1980	1981	1982	1983	1984	1985	1986	1987	1988
Credits approved /b	1,675	1,906	2,679	3,900	4,509	5,898	7,966	9,814	13,500
Agriculture	277	340	467	734	809	1,402	2,274	2,584	3,393
Mining	5	40	54	57	179	229	363	382	495
Manufacturing industry	911	911	1,369	1,983	2,374	2,765	3,253	3,540	5,182
Trade	53	87	134	129	237	277	369	355	536
Service rendering industry	422	516	641	986	866	1,173	1,638	2,900	3,788
Others	7	12	14	11	44	52	69	53	106
Credits outstanding /b	1,296	1,436	2,099	2,861	3,802	4,802	6,167	7,338	9,770
Agriculture	137	202	322	477	555	877	1,233	1,644	2,193
Mining	2	26	34	49	178	224	367	342	363
Manufacturing industry	820	741	1,095	1,635	2,102	2,423	3,061	3,531	4,683
Trade	41	73	120	115	168	281	332	325	476
Service rendering industry	289	390	519	576	770	975	1,108	1,460	1,993
Others	7	4	9	9	29	22	66	36	62

/a Excludes investment credits from Bank Indonesia; includes State Development Bank and Local Developments Banks. Data with the same classification prior to 1980 are not available.

/b Excludes Small Scale Investment Credits, investment credits to the Central Government and foreign exchange components of project aid.

Source: Bank Indonesia.

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Time Deposits with State Banks, 1981-1988
(Rp. billion)

	1981	1982	1983	1984	1985	1986	1987	1988
24 months	748	849	566	280	411	519	786	1,909
12 months	82	79	886	1,721	2,795	3,867	4,213	4,555
6 months /a	107	122	549	721	726	950	716	1,531
3 months or less	42	45	679	673	1,307	1,323	3,496	3,521
Matured	103	126	143	10	11	13	14	14
Others	11	11	8	92	88	58	59	305
Total /b	1,093	1,231	2,831	3,497	5,337	6,730	9,283	11,835

/a Includes some 9 month deposits during 1984.
/b Includes interbank time deposits and residents' time deposits.

Source: Bank Indonesia.

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COUNTRY ECONOMIC REPORT

Interest Rates on Deposits at Commercial Banks, 1978-1989 /a
(% p.a)

End of Period	Demand Deposits /b	TABANAS Savings Deposits /c	TASKA Savings Deposits /d	Certificate of Deposits /e	Time Deposits: State Bank: Less than 3 mos /f	State Bank: 3 mos	State Bank: 6 mos	State Bank: 12 mos	State Bank: 24 mos	Private National Bank /a: Less than 3 mos /f	Private National Bank /a: 3 mos	Private National Bank /a: 6 mos	Private National Bank /a: 12 mos	Private National Bank /a: 24 mos
1978 /g	1.8-3	6-15	9.0	7.6	-	-	6.0	9.0	12-15	12.8	12.5	15.6	17.2	20.7
1979	1.8-3	6-15	9.0	9.8	10.6	5.1	6.0	9.0	12-15	16.2	16.7	18.3	19.6	19.6
1980	1.8-3	6-15	9.0	10.2	7.2	8.2	6.0	9.0	12-15	14.2	16.1	17.8	20.1	19.3
1981	1.8-3	6-15	9.0	10.9	12.1	10.2	6.0	9.0	12-15	15.4	17.4	17.9	19.4	19.0
1982	1.8-3	6-15	9.0	12.5	7.7	8.6	6.0	9.0	12-15	16.9	17.1	18.5	19.3	18.8
1983 /h	1.8-3	12-15	9.0	15.4	14.4	14.8	13.1	17.5	12.5	18.7	17.4	18.8	19.7	19.3
1984	1.8-3	12-15	9.0	16.5	15.1	17.1	17.2	18.7	17.2	19.8	20.7	20.7	20.4	21.0
1985	1.8-3	12-15	9.0	14.5	13.4	14.6	16.0	17.8	18.3	14.6	15.9	17.8	19.8	21.3
1986	1.8-3	12-15	9.0	14.0	13.3	14.2	14.7	15.2	16.0	14.8	15.5	16.2	17.3	20.1
1987	1.8-3	15.0	9.0	15.6	15.5	17.0	17.3	17.0	17.4	17.3	18.6	19.3	19.1	19.9
1988	1.8-3	15.0	9.0	15.9	15.8	18.1	18.4	18.7	18.8	20.2	20.1	20.3	20.2	20.9
1989	n.a	n.a	n.a	16.3	15.1	16.2	17.2	18.1	18.8	17.0	18.0	18.8	19.7	20.5

/a Weighted average rate of interest at selected banks.
/b From March 1983, 3% for amounts above Rp. 50 million, 1.8% for Rp. 1 to 50 million, and individually determined for amounts less than Rp. 1 million.
/c "TABANAS" or "Tabungan Pembangunan Nasional" (National Development Savings) is an ordinary savings account sponsored by "Bank Tabungan Negara" (State Seving Bank) and offered by all state owned and some private national commercial banks, and post offices. Until June 1, 1983: 15% for amounts of Rp. 200,000 or less; 6% above Rp. 200,000. From June 1983: 15% for Rp 1 million or less; 12% for more than Rp. 1 million. From July 1987 to November 1989 : 15% for all denominations. Thereafter left to banks' deacretion.
/d "TASKA" or "Tabungan Asuransi Berjangka " (Insured Time Deposits) is an ordinary time deposits sponsored by "Bank Tabungan Negara" and offered by the same institutions described in (c) above.
/e Midpoint of range for six months rates.
/f One month time deposits rate used as representative rate.
/g Effective January 1978: 15% for Rp. 2.5 million or less; 12% for more than Rp.2.5 million for 24 months State Bank time deposit.
/h Ceiling on time deposit interest rates at state banks removed on June 1, 1983.
12% legal minimum rate starting in June 1983 for 24 months State Bank time deposit.

Source: Bank Indonesia.

Statistical Annex
Table 7.1

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COUNTRY ECONOMIC REPORT

Principal Agricultural Products by Subsectors, 1978-1988
('000 tons)

Product	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /a
Food crops											
Rice /b	17,525	17,872	20,163	22,286	22,837	35,302	38,134	39,033	39,726	40,078	41,769
Corn	4,029	3,606	3,991	4,509	3,235	5,087	5,288	4,330	5,920	5,155	6,806
Cassava	12,902	13,751	13,726	13,301	12,988	12,103	14,167	14,037	13,312	14,356	15,280
Sweet potato	2,083	2,194	2,079	2,094	1,676	2,213	2,156	2,161	2,091	2,013	2,066
Soya beans (shelled)	617	680	653	704	521	536	769	870	1,227	1,161	1,254
Groundnuts (shelled)	446	424	470	475	437	460	535	528	642	533	565
Fisheries											
Saltwater fish	1,227	1,318	1,395	1,408	1,490	1,682	1,713	1,822	1,923	2,017	2,166
Freshwater fish	420	430	455	506	524	533	548	573	607	653	715
Meat and dairy											
Meat	475	486	571	596	629	650	742	808	860	895	928
Eggs	151	164	259	275	297	319	355	370	432	452	466
Milk /c	62	72	78	86	117	143	179	192	220	235	262
Cash crops											
Rubber	884	898	1,020	963	900	1,007	1,033	1,055	1,109	1,130	1,170
Palm oil	532	642	701	748	884	979	1,147	1,243	1,350	1,506	1,690
Coconut/copra	1,575	1,582	1,759	1,812	1,718	1,604	1,750	1,920	2,114	2,075	2,105
Coffee	223	228	285	295	281	305	315	311	339	380	398
Tea	91	125	106	110	94	110	126	127	136	126	156
Cloves	22	35	39	40	32	41	49	42	55	58	60
Pepper	46	47	37	39	34	46	46	41	40	49	52
Tobacco	81	87	116	118	106	109	108	161	164	113	119
Cane sugar	1,516	1,601	1,831	1,700	1,627	1,628	1,810	1,839	1,894	2,176	2,202
Cotton	1	1	6	10	13	14	12	45	53	48	78
Forestry /d											
Teakwood	475	495	613	578	692	718	758	777	798	689	725
Other timber	26,256	25,520	21,702	14,024	13,236	24,180	27,716	24,277	27,403	28,255	22,860

/a Preliminary figures.
/b Paddy production starting 1983.
/c In liters million.
/d In '000 cubic meters.

Source: Supplement to the President's Report to Parliament, August 16, 1989.

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COUNTRY ECONOMIC REPORT

Production of Major Crops by Type of Estate, 1978-1988
('000 tons)

Product	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988 /a
Smallholders											
Rubber	612	616	705	740	586	673	704	720	763	795	835
Coconut/copra	1,554	1,561	1,737	1,789	1,707	1,590	1,737	1,905	2,098	2,055	2,083
Coffee	206	209	266	276	262	287	291	288	316	359	375
Cloves	21	35	39	40	32	40	48	41	53	57	59
Tea	17	17	21	22	17	23	24	30	31	25	32
Sugar	485	498	749	1,364	1,373	1,249	1,397	1,450	1,417	1,744	1,743
Tobacco	68	73	101	103	97	100	104	156	159	110	116
Pepper	46	47	37	39	34	46	46	41	40	49	52
Cotton	1	1	6	10	13	14	12	45	53	48	78
Palm oil	0	0	0	0	0	0	0	0	0	0	0
Palm kernel	0	0	0	0	0	0	0	0	0	0	0
Private estates											
Rubber	110	112	111	114	125	133	121	124	150	135	135
Coconut/copra	21	21	22	23	11	14	13	15	16	20	22
Coffee	7	8	6	6	6	8	9	10	10	8	10
Cloves	0	0	0	0	0	1	1	1	2	1	1
Tea	15	16	17	18	16	17	18	17	18	21	40
Sugar	71	73	114	116	72	88	83	106	106	109	112
Tobacco	0	0	0	0	0	0	0	0	0	0	0
Pepper	0	0	0	0	0	0	0	0	0	0	0
Cotton	0	0	0	0	0	0	0	0	0	0	0
Palm oil	165	168	202	206	285	269	329	339	385	352	362
Palm kernel	22	23	36	37	47	68	69	71	73	76	77
Government estates											
Rubber	162	170	186	192	189	201	208	211	196	200	200
Coconut/copra	0	0	0	0	0	0	0	0	0	0	0
Coffee	10	11	13	13	13	10	15	13	13	13	13
Cloves	0	0	0	0	0	0	0	0	0	0	0
Tea	59	92	68	70	61	70	84	80	87	80	84
Sugar	960	1,030	968	220	182	291	330	343	371	323	347
Tobacco	13	14	15	15	9	9	4	5	5	3	3
Pepper	0	0	0	0	0	0	0	0	0	0	0
Cotton	0	0	0	0	0	0	0	0	0	0	0
Palm oil	367	474	499	542	599	713	818	904	965	1,154	1,328
Palm kernel	72	85	90	98	110	98	178	187	193	243	279
Total											
Rubber	884	898	1,002	1,046	900	1,007	1,033	1,055	1,109	1,130	1,170
Coconut/copra	1,575	1,582	1,759	1,812	1,718	1,604	1,750	1,920	2,114	2,075	2,105
Coffee	223	228	285	295	281	305	315	311	339	380	398
Cloves	21	35	39	40	32	41	49	42	55	58	60
Tea	91	125	106	110	94	110	126	127	136	126	156
Sugar	1,516	1,601	1,831	1,700	1,627	1,628	1,810	1,899	1,894	2,176	2,202
Tobacco	81	87	116	118	106	109	108	161	164	113	119
Pepper	46	47	37	39	34	46	46	41	40	49	52
Cotton	1	1	6	10	13	14	12	45	53	48	78
Palm oil	532	642	701	748	884	982	1,147	1,243	1,350	1,506	1,690
Palm kernel	94	108	126	135	157	166	247	258	266	319	356

/a Preliminary figures.

Source: Supplement to President's Report to Parliament, August 16, 1989.

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Rice - Area Harvested, Production and Yield, 1974-1988

Year	Area harvested ('000 ha)	Average yield (tons/ha)	Paddy output ('000 tons)	Rice output /a ('000 tons)
1974	8,509	2.64	22,464	15,276
1975	8,495	2.63	22,331	15,185
1976	8,368	2.78	23,301	15,845
1977	8,360	2.79	23,347	15,876
1978	8,929	2.89	25,772	17,525
1979	8,850	2.97	26,283	17,872
1980	9,005	3.29	29,652	20,163
1981	9,382	3.49	32,774	22,286
1982	8,988	3.74	33,584	22,837
1983	9,162	3.85	35,302	24,006
1984	9,764	3.91	38,134	25,933
1985	9,902	3.97	39,033	26,542
1986	9,988	4.00	39,726	26,784
1987	9,923	4.04	40,078	27,253
1988	10,090	4.14	41,769	28,403

/a Estimated on the basis of a conversion factor of 0.68 from paddy into rice.
/b Preliminary figures.

Source: Central Bureau of Statistics.

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BULOG Rice Program, 1978/79 - 1990/91
('000 tons)

	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90 /a	1990/91 /b
Beginning stock	459	708	886	1,242	1,623	1,045	1,49[illegible]	2,432	2,172	1,867	755	1,086	1,576
Domestic procurement	881	431	1,635	1,952	1,933	1,195	2,382	1,953	1,647	1,215	1,801	2,243	2,000
Import:	1,268	2,580	1,213	437	506	1,115	187	0	41	79	315	150	0
PL-480	304	353	101	46	0	65	54	0	0	0	0	0	0
Other food /c	15	327	198	48	0	140	0	0	41	79	315	150	0
Commercial	949	1,900	914	343	506	910	133	0	0	0	0	0	0
Total availability	2,608	3,719	3,734	3,631	4,062	3,355	4,066	4,385	3,860	3,161	2,871	3,479	3,576
Distribution /d	1,852	2,834	2,480	2,014	2,972	1,872	1,612	2,186	1,967	2,372	1,768	1,875	1,898
Government	608	666	649	806	1,320	1,373	1,368	1,414	1,498	1,525	1,512	1,542	1,560
State enterprises	106	90	89	95	105	89	59	77	94	97	106	100	114
Market operations /e	1,032	2,036	1,628	1,033	1,518	399	69	277	175	640	142	60	200
Other /f	106	42	114	80	29	11	116	418	200	110	8	173	24
Losses	46	8	12	26	45	28	22	27	26	34	17	28	28
End stock	708	806	1,242	1,591	1,045	1,455	2,432	2,172	1,867	755	1,086	1,576	1,650
Memorandum item:													
Rice production /g	17,325	17,872	20,163	22,286	22,837	24,006	25,933	26,542	27,014	27,253	28,340	29,106	28,902

/a Provisional figures.
/b Estimates.
/c In 1987/88, the figure shows repayment of rice loans.
/d Since June 1982, all regions have received rice in kind; formerly, surplus regions received food allowances in money.
/e Includes special sales at reduced prices of submarket standard rice of 130,000 tons in 1985/86 and 150,000 tons in 1986/87.
/f Includes export of 95,000 tons in 1984/85 and 400,000 tons in 1985/86, 173,750 tons in 1986/87 and 100,000 tons in 1987/88.
/g On calendar year basis.

Source: BULOG (Badan Urusan Logistic/State Logistic Board).

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COUNTRY ECONOMIC REPORT

Area Covered Under Rice Intensification Programs, 1974-1988
('000 ha)

Year	BIMAS /a	INMAS /c	Total	Of which INSUS /b
1974	2,676	1,048	3,724	0
1975	2,683	1,957	3,640	0
1976	2,424	1,189	3,613	0
1977	2,059	2,181	4,240	0
1978	1,960	2,888	4,848	0
1979	1,571	3,452	5,023	0
1980	1,374	4,142	5,516	1,060
1981	1,384	4,802	6,186	1,706
1982	1,296	5,047	6,343	2,945
1983	1,308	5,387	6,695	3,477
1984	434	6,936	7,369	3,806
1985	200	7,461	7,661	4,100
1986	258	7,533	7,791	4,480
1987	n.a	n.a	8,035	4,922
1988	n.a	n.a	8,114	4,971

/a BIMAS = Bimbingan massal (Mass rice planting guidance program).
/b INSUS = Intensifikasi khusus (Special intensification program).
/c INMAS = Intensifikasi massal (Mass intensification program).

Source: Supplement to the President's Report to Parliament, August 16, 1989.

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Index of Manufacturing Production by Selected Industry Group, 1986-1989 /a
(1983 = 100)

Code of Industry Group	Description /b	1986	1987	1988	1989 /c
31121	Condensed and dried milk, creamery and processed butter, fresh and preserved cream (6)	87.5	94.0	123.3	119.0
31330	Malt liquor and malt (5)	94.4	113.2	116.4	111.9
31420	Clove cigarettes (80)	147.4	166.5	177.7	195.9
31430	Other cigarettes (13)	78.8	81.9	79.2	82.1
32111	Yarn and thread (53)	129.9	130.5	6.0	187.8
32112	Weaving mills (except jute weaving products (409)	130.7	144.3	172.9	189.8
32114	Batik (65)	95.8	81.8	83.9	117.6
32130	Knitting mills (73)	219.2	233.3	239.8	338.8
32400	Footwear (32)	113.1	91.5	111.2	185.9
33113	Plywood (40)	139.3	192.7	242.1	273.3
34111	Paper manufacture (all kinds) (23)	159.2	159.7	242.0	246.6
35110	Basic chemicals (except fertilizer) (50)	119.0	156.4	139.0	152.6
35120	Fertilizer (10)	166.0	121.8	129.7	135.7
35210	Paint, varnish, and lacquers (25)	135.6	126.5	91.2	152.3
35232	Matches (8)	108.7	142.3	175.5	143.7
35510	Tyres and tubes (22)	109.5	79.2	109.7	157.7
36210	Glass and glass products (21)	178.0	149.3	124.6	148.4
36310	Cement (7)	144.4	150.9	149.8	187.5
37100	Basic iron and steel industries (16)	154.9	147.1	184.8	217.4
38130	Structural metal products (59)	110.2	118.7	125.7	175.8
38312	Drycell batteries (7)	123.9	115.5	158.6	202.2
38320	Radio, TVs, cassettes, other communication equipment and apparatus (23)	90.6	86.9	118.1	166.7
38430	Motor vehicles assembly and manufacture (23)	114.7	126.8	115.9	104.2
38440	Motor cycles and three wheel motor vehicles, assembly and manufacture (11)	98.0	81.3	76.8	106.0
	General index	127.0	146.4	169.0	187.2

/a The annual figures shown here are calculated as the average of quarterly indices.
/b Figures in brackets "()" indicate the number of establishments covered in that group.
/c Average of three quarters.

Source: Central Bureau of statistics.

Statistical Annex
Table 8.2

INDONESIA

COUNTRY ECONOMIC REPORT

Production of Minerals, 1974-1988

Year	Petroleum (mln bbls)	Tin concentrate	Copper ore concentrate	Nickel ore ('000 tons)	Bauxite	Coal	Iron sand concentrate	Gold /a (kg)	Silver /a (kg)	Natural gas (mcf)
1974	502.0	25.7	212.6	878.9	1290.1	156.2	365.2	265.3	6464.6	202.2
1975	477.0	25.3	201.3	801.1	992.6	206.4	353.0	330.7	4754.7	222.2
1976	550.0	23.4	223.3	1102.0	940.3	182.9	292.3	355.2	3397.5	312.1
1977	615 0	25.9	189.1	1302.5	1301.4	230.6	311.5	255.9	2831.9	542.8
1978	597.0	27.4	180.9	1256.5	1007.7	264.2	233.3	253.9	2506.4	820.1
1979	580.0	29.4	188.8	1551.9	1051.9	278.6	79.9	170.0	1644.6	998.4
1980	577.0	32.5	186.1	1537.4	1249.1	338.0	62.9	247.9	2196.0	1045.7
1981	584.8	35.4	188.5	1543.2	1203.4	392.8	86.6	183.1	2000.2	1123.8
1982	488.2	33.8	223.7	1640.9	700.2	588.0	144.5	222.7	3057.9	1111.9
1983	490.5	26.6	205.0	1278.0	777.9	648.2	132.9	2391.5	35473.1	1186.4
1984	516.5	23.2	190.3	1066.8	1003.2	1468.2	83.0	2247.1	38794.7	1506.7
1985	483.8	21.8	223.4	961.9	830.5	1491.7	130.9	2619.4	38327.3	1580.0
1986	507.2	24.0	251.2	1533.1	648.8	1725.4	152.3	3303.5	46596.0	1628.9
1987	479.0	26.1	259.8	1825.7	635.3	1887.0	194.0	3752.8	50485.4	1731.1
1988	484.7	30.6	294.7	1733.2	505.8	2854.5	202.8	4730.9	61538.0	1852.6

/a Since 1983, production of gold and silver including private enterprises.

Source: Central Bureau of Statistics.

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Crude Oil Production by Company, 1974-1989
('000 bbls)

	PERTAMINA	LEMIGAS	Contract of work			Subtotal	Production sharing contract	Total	Average daily output
			Caltex	C & T	Stanvac				
1974	40,143	362	329,907	1,959	16,626	348,492	112,840	501,837	1,375
1975	32,590	306	300,879	1,944	13,889	316,712	127,247	476,855	1,306
1976	31,333	268	304,616	1,803	12,787	319,206	199,512	550,319	1,504
1977	30,706	285	292,950	2,459	11,974	307,383	276,749	615,123	1,685
1978	31,271	195	275,349	2,266	11,853	289,468	275,763	596,697	1,635
1979	30,316	213	266,048	1,856	10,811	278,715	271,203	580,447	1,590
1980	29,891	205	258,325	2,046	11,578	271,949	274,971	577,016	1,577
1981	29,515	175	255,515	1,799	13,141	270,455	284,693	584,838	1,602
1982	27,375	195	175,928	1,422	13,214	190,564	270,055	488,189	1,338
1983 /a	26,947	233	191,307	1,411	11,766	204,484	286,384	518,048	1,419
1984	31,002	203	-	1,533	4,372	5,905	513,652	550,762	1,505
1985	30,071	170	-	1,358	5,130	6,488	453,190	489,919	1,342
1986	29,328	193	-	1,228	6,085	7,313	478,078	514,912	1,411
1987	26,775	210	-	1,236	8,354	9,590	475,854	512,429	1,404
1988	24,789	/b	-	1,368	13,413	14,781	451,941	491,511	1,343
1989	25567	/b	-	2,044	13,233	15,277	473,341	514,185	1,409

/a Since May 1983, contract of work data have been consolidated.
/b Since 1988, Lemigas data have been included in Pertamina.

Source: Ministry of Mines and Energy, Directorate General Oil & Gas.

INDONESIA

COUNTRY ECONOMIC REPORT

Petroleum Product Supply and Demand, 1978 - 1989
(million bbls)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Production of crude	596.7	580.4	577.0	584.8	488.2	518.0	550.8	489.9	514.9	512.4	491.5	514.2
Crude imports	31.1	30.5	32.9	37.0	22.0	25.7	34.2	32.1	27.7	30.2	31.2	28.1
Subtotal	627.8	610.9	609.9	621.8	510.2	543.7	585.0	522.0	542.6	542.6	522.7	542.3
Crude exports	472.0	410.8	378.8	383.4	320.9	336.2	354.6	295.1	327.4	291.9	276.6	291.5
Crude available for refineries	155.8	200.1	231.1	238.4	189.3	207.5	230.4	226.9	215.2	250.7	246.1	250.8
Changes in crude stocks (decrease = -)	-3.7	14.1	38.2	44.7	6.7	23.5	39.7	27.1	-2.3	16.9	0.3	3.2
Refinery input (including swaps)	159.5	186.0	192.9	193.7	182.6	184.0	190.7	199.8	217.5	233.8	245.8	247.6
Refinery consumption	9.4	13.0	13.5	6.5	6.5	7.2	9.2	13.1	13.3	13.0	13.0	14.3
Refinery output	150.1	173.0	179.4	187.2	176.1	176.8	181.5	186.7	204.2	220.8	232.8	233.3
Exports of refined products	40.3	49.3	53.4	49.9	39.0	43.3	66.0	47.3	55.2	62.4	63.7	55.4
Waxy residues	36.3	48.9	51.0	47.9	33.7	40.5	49.9	32.1	34.9	42	45.3	40.6
Bunker fuel, AVTUR, etc.	4.0	0.4	2.4	2.0	5.3	2.8	16.1	15.2	20.3	20.4	18.4	14.8
Available for domestic consumption	109.8	123.7	126.0	137.3	137.1	133.5	115.5	139.4	149.0	158.4	169.1	177.9
Product imports	16.9	15.0	22.0	42.6	28.0	23.5	5.0	2.7	5.4	10.3	13.3	21.3
Total supply	126.7	138.7	148.0	179.9	165.1	157.0	120.5	142.1	154.4	168.7	182.4	199.2
Domestic consumption	113.0	134.3	141.8	156.0	161.1	155.5	157.6	155.3	152.8	162.9	171.3	183.6
Changes in refined stocks	13.7	4.4	6.2	23.9	4.0	1.5	-37.1	-13.2	1.6	5.8	11.1	15.6

Source: Ministry of Mines and Energy, Directorate General Oil & Gas.

INDONESIA

COUNTRY ECONOMIC REPORT

Domestic Sales of Petroleum Products, 1978-19 , /a
('000 bbls)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Aviation gas	134	134	130	110	103	83	73	66	63	56	60	60
Aviation turbo	3,494	3,656	4,355	4,869	4,899	3,686	4,374	4,442	3,806	4,199	4,445	4,286
Premium gasoline	728	618	466	392	238	247	523	738	1,024	1,431	1,838	2,451
Regular gasoline	19,608	21,295	23,321	25,648	25,709	24,380	24,909	25,206	27,083	29,048	30,855	33,199
Kerosene	41,717	45,457	48,975	52,497	51,778	48,224	45,213	43,954	43,618	43,352	44,664	46,601
Motor diesel	31,709	34,595	40,116	44,737	48,918	49,790	48,567	47,682	47,421	54,075	59,143	64,508
Industrial diesel	6,744	7,581	7,829	9,391	9,311	9,978	10,285	10,329	8,855	8,319	8,809	9,515
Fuel oil	11,061	13,626	15,739	17,587	19,341	21,149	23,625	22,863	18,004	19,054	18,097	18,329
Total	115,195	126,962	140,931	155,231	160,297	157,537	157,569	155,280	149,874	159,534	167,911	178,949

/a Excluding lubricating oil and similar products.

Source: Ministry of Mines and Energy, Directorate General Oil and Gas.

INDONESIA

COUNTRY ECONOMIC REPORT

Consumer Price Index, 1979 - 1989 /a
(April 1977 - March 1978 = 100)

End of	Foodstuff	Housing	Clothing	Others	Total	Change (%)
1979	141.1	140.9	168.2	137.7	143.1	21.8 /b
1980	165.6	168.7	190.8	159.1	167.6	16.0
1981	179.3	182.3	198.2	168.8	179.8	7.1
1982	192.7	209.8	205.0	189.3	197.9	9.7
1983	212.7	238.1	214.0	221.5	221.5	11.5
1984	226.4	270.0	220.6	246.5	241.6	8.8
1985	230.9	289.4	228.0	259.7	252.2	4.3
1986	263.9	302.9	250.4	275.0	275.3	9.2
1987	296.1	321.4	270.4	297.9	300.8	9.3
1988	320.1	335.4	280.0	307.4	317.6	5.6
1989	342.0	356.5	293.5	321.9	337.0	6.1

/a The consumer price index for Indonesia has been used commencing March 1979 to replace the Jakarta cost of living index.

/b Percentage change of CPI for the period January through December 1979 using the rate of increase of the Jakarta cost of living index for period January through March 1979.

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Indonesia Wholesale Price Index, 1983-1989 /a
(1983 = 100)

Sectors /b	1983	1984	1985	1986	1987	1988	1989
Agriculture (44)	100	113	118	128	145	163	176
Mining & quarrying (6)	100	109	117	125	132	143	156
Manufacturing (140)	100	103	115	123	143	156	165
Imports (53)	100	113	119	129	158	164	178
Exports (38)	100	111	112	85	118	125	130
Excluding petroleum (34)	100	114	115	130	170	183	194
Petroleum (4)	100	112	113	73	103	108	112
General index (281)	100	111	116	116	142	151	161
General index excluding exports (243)	100	111	117	127	149	160	172
General index excluding exports of petroleum (224)	100	110	116	125	146	161	171

/a This new index replaces the previous WPI based on 1975. Figures show the average for year.
/b Figures within brackets "()" indicate the number of items represented in that sector.

Source: Central Bureau of statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Domestic Prices of Petroleum Products, 1978-1989
(Rp./liter)

	1978	1979	1980 /a	1981	1982 /b	1983 /c	1984 /d	1985 /e	1986	1987	1988	1989
Aviation gas	70	100	150	150	240	300	300	330	250	250	250	250
Aviation turbo	70	100	150	150	240	300	300	330	250	250	250	250
Premium gasoline	90	140	220	220	360	400	400	440	440	440	440	440
Regular gasoline	70	100	150	150	240	320	350	385	385	385	385	385
Kerosene	18	25	38	38	60	100	150	165	165	165	165	165
Motor diesel	25	35	53	53	85	145	220	242	200	200	200	200
Industrial diesel	22	30	45	45	75	125	200	220	200	200	200	200
Fuel oil	22	30	45	45	75	125	200	220	200	200	200	200

/a From May 1980.
/b Price increased on January 1.
/c Price increased on January 7.
/d Price increased on January 12.
/e Price increased on April 1, due to the application of 10% VAT.

Source: Ministry of Mines and Energy, Directorate General Oil and Gas.

INDONESIA

COUNTRY ECONOMIC REPORT

Approved Foreign Investment by Sector, 1977-1989 /a
(US$ million)

Sector	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Agriculture	21	3	16	56	25	9	10	0	9	126	117	8	122
Forestry	29	39	12	8	115	32	7	0	0	0	5	26	4
Fishery	3	23	21	3	22	3	21	0	11	4	12	46	47
Mining & quarrying	201	38	66	3	29	0	0	0	0	0	0	0	0
Manufacturing	327	276	1,158	771	834	1,120	2,615	1,002	687	537	852	3,828	4,246
Food	8	6	61	14	41	6	83	77	6	34	54	231	223
Textiles & leather	71	115	34	76	139	26	12	1	7	9	118	213	581
Wood & wood products	0	1	6	11	124	5	13	0	0	32	45	104	106
Paper & paper products	10	0	11	2	49	0	722	0	25	47	109	1,506	211
Chemicals & rubber	49	26	364	282	236	317	183	96	338	294	209	1,544	2,512
Nonmetallic minerals	98	20	77	222	20	57	50	0	3	0	251	30	184
Basic metals	18	10	561	0	85	3	836	609	65	39	7	61	106
Metal products	73	92	45	163	141	706	716	210	244	82	57	129	292
Others	0	7	0	1	0	0	1	9	0	0	3	10	30
Construction	1	5	1	8	49	11	44	17	122	65	42	2	16
Trade & hotels	7	10	3	39	0	17	78	84	0	0	196	405	98
Wholesale trade	0	0	0	0	0	0	0	0	0	0	0	0	0
Hotels	7	10	3	39	0	17	78	84	0	0	196	405	98
Transport & communications	0	0	0	25	0	0	0	4	0	70	213	3	5
Real estate and business services	20	4	44	0	18	204	108	0	29	25	20	117	181
Total	609	397	1,320	912	1,091	1,397	2,882	1,107	859	826	1,457	4,435	4,719

/a Intended Capital Investment. Amount represents original approvals plus expansions minus cancellations.

Source: Bank Indonesia and Investment Coordinating Board (BKPM).

INDONESIA

COUNTRY ECONOMIC REPORT

Approved Domestic Investment by Sector, 1977-1989 /a
(Rp billion)

Sector	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Agriculture, fisheries and livestock	49	100	39	30	60	62	681	277	899	1,879	2,885	2,698	3,418
Forestry	64	59	80	115	175	93	149	19	37	21	640	487	252
Mining	0	18	33	55	13	52	578	8	38	89	290	111	94
Manufacturing	401	531	580	1,093	1,306	1,419	3,792	1,332	1,632	1,842	5,518	9,747	12,931
Textiles	75	168	61	162	195	110	104	127	97	263	1,289	2,309	3,563
Chemicals	99	103	141	57	193	205	766	272	928	773	2,047	3,039	4,078
Electrical goods	0	0	0	0	0	0	0	0	0	0	0	0	0
Other manufacturing	228	261	378	874	918	1,104	2,922	933	607	806	2,183	4,399	5,291
Construction	0	3	5	4	8	16	195	67	270	74	50	31	146
Hotels	4	12	13	10	54	76	255	214	312	17	139	537	1,265
Real estate	35	15	6	16	5	74	204	31	267	169	174	846	936
Others /b	20	24	18	35	70	157	1,151	1	296	325	569	460	551
Total	574	762	774	1,358	1,691	1,949	7,005	1,949	3,750	4,417	10,265	14,916	19,594

/a Figures refer to intended capital investments, and represent original approvals plus approved expansion minus cancellations.
/b Includes transportation sector.

Source: Investment Coordinating Board.

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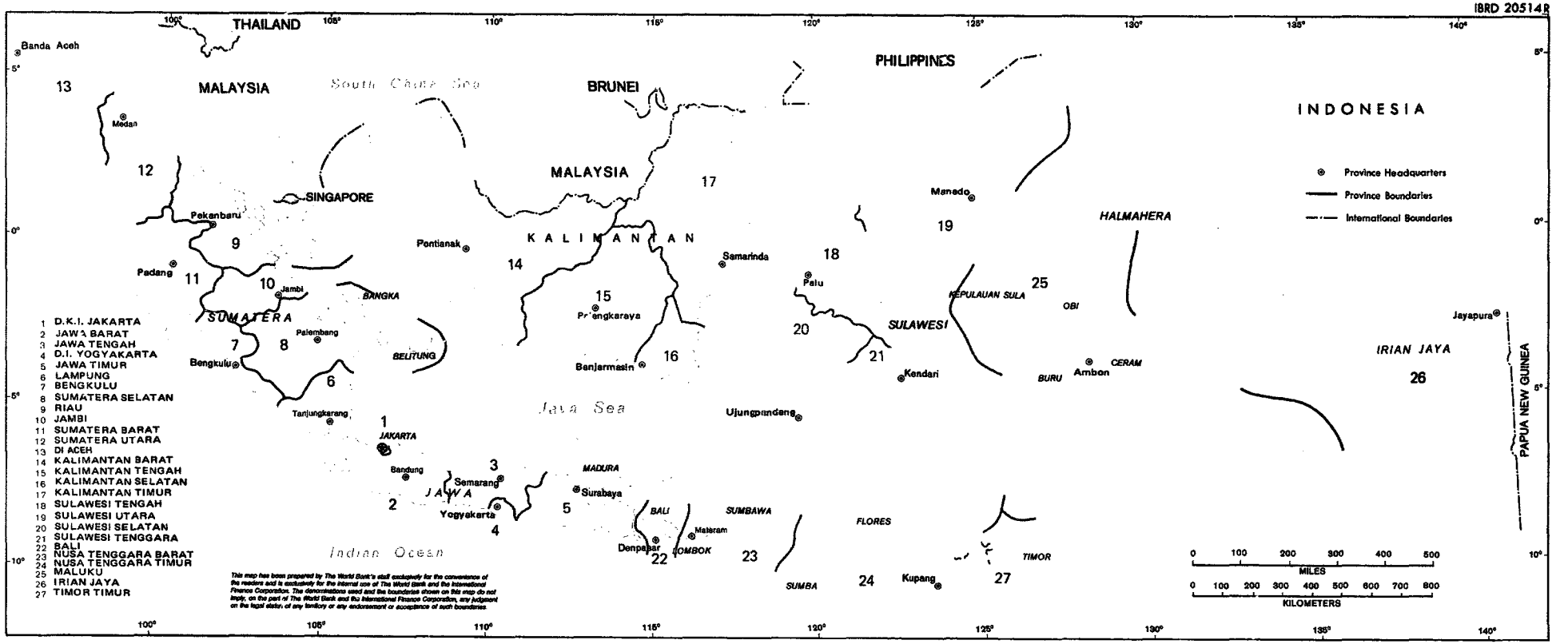

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