Report No. 16433-IND

Indonesia
Sustaining High Growth with Equity

May 30, 1997

Country Department III
East Asia and Pacific Region

Document of the World Bank

CURRENCY EQUIVALENTS

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

Annual Average:

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 [a]
1984	US$1.00 = Rp.1,026
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.1,686
1989	US$1.00 = Rp.1,770
1990	US$1.00 = Rp.1,843
1991	US$1.00 = Rp.1,950
1992	US$1.00 = Rp.2,030
1993	US$1.00 = Rp.2,079
1994	US$1.00 = Rp.2,160
1995	US$1.00 = Rp.2,249
1996	US$1.00 = Rp.2,340

FISCAL YEAR

Government	-	April 1 to March 31
Bank Indonesia	-	April 1 to March 31

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[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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MAIN ABBREVIATIONS, ACRONYMS AND DEFINITIONS

APEC	Asia Pacific Economic Cooperative
ASEAN	Association of Southeast Asian Nations
BAKN	State Civil Service Agency
BAPEPAM	Agency for Capital Market Supervision
BAPPEDA	Regional Development Planning Board
BAPPENAS	National Development Planning Board
BKPM	Investment Coordinating Board
BNI	Bank Negara Indonesia
BOT	Build, Operate and Transfer
BPD	Regional Developement Bank
BPN	National Land Agency
BPR	Rural Credit Bank
BPS	Central Bureau of Statistics
BULOG	State Logistical Agency
BUMN	State-Owned Company
CGI	Consultative Group on Indonesia
COLT	Commercial Offshore Loan Team (also see PKLN)
CPI	Consumer Price Index
DATI I	Provincial Level Government
DATI II	Local Level Government
DGAC	Director General of Air Communications
DGLT	Director General of Land Transport
DIP	List of Project Contents
DOD	Debt Outstanding and Disbursed
ETAM	Quarterly Automatic Adjustment (for PLN Tariffs)
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GENCOs	PLN Generating Companies (also see PJB)
GER	Gross Enrollment Rate
GOI	Government of Indonesia
IDT	Block grant program for left-behind villages
IHH	Forest Concession Fee
IMF	International Monetary Fund
INPRES	Instruction of the President
IPP	Independent Power Producer
JABOTABEK	Jakarta, Bogor, Tangerang, Bekasi Area
JAMSOSTEK	Social Security System
KABUPATEN	Regency
KEPPRES	Decision of the President
KOTAMADYA	Urban Municipalities
KSO	Joint Operating Scheme

KUD	Local Cooperative
KV	Kilovolt
KwH	Kilowatt Hour
LNG	Liquid Natural Gas
LPG	Liquid Natural Gas
M2	Broadly-defined Money Supply
M1	Narrowly-defined Money Supply
MLT	Medium- and Long-Term
MOC	Ministry of Communications
MOEC	Ministry of Education and Culture
MOF	Ministry of Finance
MOHA	Ministry of Home Affairs
MORA	Ministry of Religious Affairs
NGO	Non-Governmental Organization
PDAM	Regional State Water Company
PJB	PLN Power Generating Companies (also see GENCOs)
PKLN	Debt Ceiling (also see COLT)
PLN	State Electricity Company
PMA	Foreign Investment Approach
PMDN	Domestic Investment Approach
PPA	Power Purchase Agreement
PREMIX	High Octone Gasoline
PTP	Publicly-Owned Plantation
RDA	Regional Development Account
REPELITA	Five-Year Development Plan
RETRIBUSI	User Charge
SAKERNAS	Labor Force Survey
SBI	Bank Indonesia Certificate (Central Bank liability)
SBPU	Money market instrument (Central Bank asset)
SMK	Vocational/Technical Schools
SUPAS	Intercensus Survey
SUSENAS	Household Survey
VAT	Value Added tax
WHO	World Health Organization
WTO	World Trade Organization

INDONESIA
SUSTAINING HIGH GROWTH WITH EQUITY

CONTENTS

This report was prepared by a core team of Lloyd Kenward (Task Manager), James Hanson and Lloyd McKay. Key inputs were provided by Nisha Agrawal, Howard Barnum, James Douglas, Edward Dotson, Jorge Garcia-Garcia, Teresa Genta-Fons, David Hawes, Stephen Howes, Frida Johansen, Alain Locussol, John Newman, Haneen Sayed, Vincent Turbat and Joris Van der Ven. Magda Adriani, Basilius Bengoteku, and Edison Hulu provided research support, while Jessica Ardinoto, Inneke Herawati, Christina Setiadi and Endy Swastari were responsible for document processing.

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RINGKASAN EKSEKUTIF

A. Kebijaksanaan Ekonomi-Makro dalam Mengelola Keberhasilan dan Risiko

1. **Kinerja Umum**. Berdasarkan berbagai indikator makro, perekonomian Indonesia belakangan ini menunjukkan kinerja yang sangat baik. PDB meningkat sebesar 7,8% dalam tahun 1996 dan tingkat inflasi turun menjadi 6,47%. Investasi langsung dalam negeri dan luar negeri semakin marak. Surplus fiskal yang cukup besar berhasil dipertahankan dan meskipun berbunga tinggi percepatan pembayaran hutang luar negeri pemerintah terus dilaksanakan. Cadangan devisa resmi naik sebesar $4 milyar selama 1996/97.

2. Kendati prestasi yang dicapai cukup meyakinkan, namun perekonomian Indonesia masih menghadapi berbagai resiko. Di dalam negeri, inflasi dasar *(core inflation)* masih cukup tinggi dan harga berbagai komoditas yang diatur pemerintah dalam beberapa waktu tidak mengalami kenaikan. Deregulasi telah kehilangan momentumnya. Sektor perbankan masih tetap relatif lemah berdasarkan standar internasional dan konsentrasi di sektor properti kembali meningkat pesat.

3. Di bidang luar negeri, defisit transaksi berjalan semakin besar, kendati harga ekspor minyak Indonesia di pasar dunia tinggi; pertumbuhan ekspor non migas melambat; dan hutang luar negeri swasta meningkat pesat. Sampai tingkat tertentu, perkembangan sektor luar negeri ini mencerminkan tingginya investasi asing dan kasus khusus lainnya (seperti misalnya: penyempurnaan metodologi statistik; peningkatan pergerakan nilai kurs berbagai mata uang; dan harga komoditas ekspor primer yang rendah sekalipun mungkin bersifat sementara). Di masa datang, kondisi transaksi berjalan akan semakin memburuk, dan berbagai masalah yang dihadapi oleh negara-negara Asia Timur mungkin saja merembet ke Indonesia. Faktor-faktor yang mengandung risiko antara lain, arus modal masuk yang berbalik secara mendadak, risiko yang semakin besar akibat peningkatan hutang luar negeri Indonesia yang cukup besar, serta semakin pekanya arus modal global terhadap perubahan pada berbagai indikator ekonomi.

4. **Kombinasi Keterpaduan Kebijaksanaan Fiskal dan Moneter akan Membantu Perbaikan Kinerja.** Keterpaduan kebijakan fiskal dan moneter yang diterapkan saat ini turut menyumbang terhadap penyelesaian sebagian masalah diatas. Kebijakan fiskal tetap dijalankan penuh tanggung-jawab, sekalipun menjelang pemilihan umum. Akan tetapi, pendapatan minyak bumi yang lebih tinggi pada tahun fiskal 1996/97 belum sepenuhnya aman walaupun meningkat surplus anggaran, sehingga pengeluaran non-budgeter *(off-budget)* hampir tidak mengalami kontraksi. Secara keseluruhan, dampak kebijakan fiskal hampir identik dengan tahun fiskal 1995/96, kendati terdapat penerimaan minyak bumi yang jauh lebih besar. Instrumen utama yang digunakan untuk mengatasi suhu ekonomi *(overheating)* pada tahun 1996/97 ialah suku bunga riil. Dengan meningkatnya kepercayaan masyarakat, terutama setelah bulan Juli, suku bunga tersebut telah menarik arus modal masuk yang besar, yang cenderung mengapresiasi nilai riil rupiah, dan mengurangi daya saing Indonesia di luar negeri.

5. Dengan sedikit penurunan suku bunga dan sekaligus perimbangan dengan kebijakan fiskal yang lebih ketat lagi, akan mengurangi apresiasi, seraya mempertahankan stabilitas makro. Instrumen untuk melaksanakan kebijaksanaan ini juga akan bermanfaat bagi tujuan nasional lainnya, seperti, memperbaiki metode penilaian dan menaikkan pajak properti

(terutama terhadap pemukiman mewah) dari tarif yang saat ini berlaku, yakni 0,1% dari nilai objek pajak. Hal ini akan mengurangi *boom* di sektor properti, mendukung desentralisasi dan mengurangi tekanan prasarana perkotaan, serta memperbaiki pemerataan dengan memajaki pemilik properti. Menaikkan Iuran Hasil Hutan (IHH) akan memberikan kompensasi terhadap pengurasan sumber daya alam dan mendorong perbaikan penanganan hasil hutan yang lebih berkesinambungan. Harga bahan bakar yang lebih tinggi untuk menghapuskan subsidi fiskal akan memperbaiki pemerataan dengan mengurangi subsidi yang saat ini hanya dinikmati oleh 2 juta pemilik mobil, atau mereka sekitar 1% dari penduduk Indonesia. Menaikkan tarif listrik—dan penyesuaian struktur tarif—akan memperbaiki kondisi keuangan PLN dan mengurangi subsidi silang yang tidak efisien; hal ini juga akan memudahkan swastanisasi dan mendorong peningkatan produksi listrik di luar Jawa. Selain itu, masih ada peluang untuk menekan pengeluaran anggaran pembangunan di sektor telekomunikasi dan pembangkit listrik, dan lebih mendorong peran swasta di kedua-dua sektor tersebut.

6. **Memantapkan Daya Tahan Ekonomi.** Daya tahan ekonomi yang lebih baik juga akan memperkuat kinerja dan mengurangi resiko yang dihadapi oleh perekonomian. Melebarnya batas intervensi atas nilai tukar rupiah merupakan alat peredam pasar yang telah teruji pada tahun 1996. Pengaruh non-ekonomi dapat diredam, perubahan nilai tukar yang relatif kecil, tanpa kehilangan cadangan bank sentral, dan efek yang sangat minimal terhadap perekonomian domestik. Di masa lalu, kebijakan moneter juga telah bereaksi cepat terhadap goncangan dengan menaikkan suku bunga apabila pelarian modal ke luar negeri mulai terjadi. Meningkatkan cadangan devisa juga banyak berguna. Namun pengalaman berbagai negara menunjukkan bahwa jumlah cadangan yang besar saja tidak cukup; seyogyanya disertai oleh nilai tukar dan pasar uang harus diperkenankan untuk melakukan penyesuaian, dan insentif yang diberikan harus cukup kuat.

7. **Meningkatkan Insentif.** Kebijaksanaan deregulasi mendukung pertumbuhan pesat dari kegiatan yang berbasis padat karya telah melamban, dan untuk berbagai bidang tertentu bahkan telah berbalik arah. Telah terjadi kemunduran penjadwalan penurunan tarif. Masih banyak agenda deregulasi yang belum rampung, seperti regulasi domestik terus mengurangi efisiensi dan memperbanyak pemerataan antar-pulau. Besarnya kenaikan upah minimum yang cukup besar pada tahun-tahun terakhir mengurangi penciptaan lapangan kerja dan ekspor barang padat-karya. Kurangnya transparansi dan persaingan telah merugikan kinerja berbagai sektor seperti prasarana dan pengembangan sumberdaya alam. Intervensi *ad hoc* (yang semakin meningkat) dan berbagai praktek lainnya yang semakin disoroti dunia. Apabila momentum deregulasi tidak dipulihkan, Indonesia menghadapi risiko melambannya pertumbuhan dan memburuknya pemerataan, yang merupakan ciri khas di kebanyakan negara berkembang (bagian E).

8. **Pentingnya Bantuan Luar Negeri.** Prestasi perekonomian Indonesia pada tahun-tahun terakhir telah menarik arus masuk modal swasta yang besar. Prestasi ini, anatara lain mencerminkan keberhasilan strategi pembangunan yang secara eksplisit mengandalkan sektor swasta seperti yang disarankan oleh pihak donor. Meski demikian jumlah arus dana dari donor hanya dua-puluh persen dari dana yang masuk secara keseluruhan. Pembiayaan proyek oleh swasta pada umumnya hanya mampu untuk beberapa sektor prasarana saja. Pihak donor tetap merupakan satu-satunya sumber pembiayaan yang stabil, bersifat jangka panjang disertai dengan dukungan bantuan teknis dan penilaian proyek yang relatif cermat. Lagi pula,

persyaratan perolehan dana CGI memperpanjang rata-rata jatuh-tempo pinjaman serta meringankan profil kewajiban membayar kembali.

9. Memperhatikan faktor-faktor diatas, dan juga memperhatikan besarnya minat sektor swasta di Indonesia saat ini, sangat disarankan total komitmen CGI agar besarnya bantuan CGI tahun 1997 sama seperti pada tahun sebelumnya. Untuk masa-masa mendatang, pembiayaan swasta yang relatif memadai mempunyai implikasi penting pada bantuan dari donor untuk Indonesia. Terutama, peranan swasta menekankan betapa pentingnya bagi para donor untuk meningkatkan mutu dan efektivitas bantuan mereka.

B. Kesinambungan Pertumbuhan Tinggi dan Memperbaiki Pemerataan

10. **Lima Faktor Utama dalam Mempertahankan Pertumbuhan Tinggi dan Memperbaiki Pemerataan.** Memahami pengalaman di sekitar wilayah ini, banyak analis sepakat bahwa lima hal mendasar yang menentukan pertumbuhan tinggi dengan pemerataan di Asia Timur ialah:

- Dasar-dasar ekonomi-makro yang sehat, termasuk penyesuaian yang cepat untuk meredam terhadap goncangan;
- Tingginya Investasi dan tabungan dalam negeri, yang mencerminkan dasar-dasar ekonomi-makro yang sehat dan tingginya tingkat tabungan pemerintah;
- Kuatnya pengembangan sumber daya manusia yang kuat yang mendorong naiknya upah, berkurangnya laju pertumbuhan penduduk dan perbaikan kedudukan wanita;
- Lebih besarnya perhatian terhadap persaingan internasional dan berkurangnya campurtangan terhadap pasar dibandingkan dengan kebanyakan negara lain. dan,
- Perbaikan institusi dan lembaga, termasuk pemerintah.

11. Pengalaman di Asia Timur dan di tempat lainnya menunjukkan bahwa bila kinerja lima faktor utama ini menurun, maka pertumbuhan akan melamban, efisiensi menurun, dan pemerataan memburuk. Misalnya, di Korea dan Indonesia, investasi, tabungan dan pertumbuhan sangat rendah hingga saat stabilitas ekonomi-makro dipulihkan sekitar akhir tahun 1960-an. Di Korea pada paruh kedua tahun 1970-an, intervensi yang memprioritaskan industri padat-modal dan berteknologi tinggi menghasilkan pertumbuhan produktivitas yang rendah dan ketimpangan yang meningkat. Hal yang sama terjadi di Brazil, yang menerapkan proteksi yang tinggi, ketidakstabilan ekonomi-makro, dan memprioritaskan pendidikan tinggi—dan bukan pada pengembangan sumber daya manusia secara luas—turut memperburuk kinerja dan ketimpangan pada tahun 1980-an. Dengan demikian, untuk kasus Indonesia kelima faktor tersebut diatas memberi sumbangan besar dalam mempertahankan terhadap pertumbuhan ekonomi yang tinggi dan perbaikan pemerataan di masa datang.

12. Tentu saja, masa depan bisa berbeda dari masa lalu; tantangan-tantangan baru bisa mengancam kemampuan Indonesia untuk tumbuh pesat dan memperbaiki pemerataan. Tantangan-tantangan tersebut termasuk: globalisasi, langkanya ketrampilan, penduduk berusia lanjut, pengurasan sumberdaya alam, perusakan lingkungan, dan kurangnya prasarana untuk memelihara pertumbuhan pesat, terutama di daerah-daerah perkotaan. Dalam banyak hal, menghadapi tantangan-tantangan itu akan bergantung pada penyempurnaan pelaksanaan kelima faktor diatas, yang telah bermanfaat bagi Asia Timur dan Indonesia. Misalnya, globalisasi berarti bahwa lebih banyak negara yang akan bersaing untuk menguasai pasar dan investor asing, dan arus modal akan semakin peka terhadap "kabar buruk". Fondasi ekonomi-makro yang sehat,

penyesuaian cepat terhadap goncangan dan pengembalian momentum deregulasi masih belum mampu membantu menghadapi tantangan-tantangan tersebut diatas (bagian A dan bagian E). Perbaikan sumberdaya manusia akan sangat menentukan bagi peningkatan ketrampilan, bagi kenaikan penghasilan buruh, dan memenuhi kebutuhan penduduk Indonesia berusia lanjut atas jasa pelayanan kesehatan yang lebih baik (Lihat bagian C). Akan tetapi tantangan itu juga menyiratkan adanya peluang. Komitmen Indonesia didunia international seperti memantapkan suatu perekonomian yang lebih dapat diperkirakan, terbuka dan bersaing, dan memberikan lebih banyak kepastian bagi investor-investor yang potensial. Penduduk berusia lanjut juga berarti lebih banyak tabungan, apabila dapat dirancang skema pensiun yang cukup baik.

13. **Membangun Kelembagaan.** Perbaikan kelembagaan, terutama untuk mengelola hubungan pemerintah-swasta, sangat menentukan dalam mengatasi tantangan-tantangan baru terhadap pertumbuhan tinggi diiringi dengan pemerataan tinggi. Dalam artian pemberian insentif, Pemerintah dapat mendorong ekonomi kearah yang lebih efisien dan lebih merata. Hal ini bukan saja memperbaharui momentum terhadap deregulasi perdagangan, tetapi juga menerapkan peraturan yang lebih transparan dan kompetitif dalam berusaha, konsesi di bidang prasarana (bagian D), sumberdaya alam (bagian E), dan mengatasi kendala-kendala perdagangan domestik (bagian E). Lebih luas lagi, keinginan untuk menciptakan pemerintahan dan sistim hukum yang lebih baik akan mendorong penurunan ekonomi biaya tinggi dan penciptakan iklim kepastian dalam pemanfaatan sumberdaya masyarakat.

14. Penyempurnaan manajemen kerjasama antara publik-swasta termasuk peninjauan kembali pemanfaatan pengeluaran pemerintah. Bila minat swasta meningkat, maka peran pemerintah dapat dikurangi, dengan mengandalkan aturan main yang transparan dan bersaing untuk memastikan pelayanan jasa dengan harga wajar (misalnya, di bidang pembangkit tenaga listrik, telekomunikasi, dan jalan-jalan tol). Pada bidang di mana minat swasta terbatas, pemerintah dapat menyusun kembali cara pelaksanaannya dan menaikkan aanggaran supaya pelayanan semakin baik (misalnya, menyempurnakan pelayanan pendidikan dan kesehatan; bagian C). Kebutuhan prasarana fisik semakin besar, terutama di daerah perkotaan (bagian D). Tetapi mempertimbangkan tersedianya sumber dana diperlukan, dan konsisten dengan kebijakan fiskal yang lebih ketat. Contohnya: penerimaan dari swastanisasi dan pembayaran dari konsesi; perpajakan yang lebih baik (misalnya pajak properti yang lebih tinggi dan penilaian yang lebih baik); dan penghapusan subsidi baik secara eksplisit maupun secara implisit (penentuan harga masukan di bidang industri, konsumsi minyak tanah dan pupuk). Di samping itu, pemberian wewenang untuk pembelanjaan, pengenaan pajak dan tanggungjawab kepada pemerintah daerah dalam pengadaan barang-barang publik yang lebih responsif terhadap kebutuhan lokal.

15. **Skenario Pertumbuhan Tinggi dan Perbaikan Pemerataan.** Penekanan terhadap kelima faktor seperti disebutkan di atas, akan mempertahankan pertumbuhan pendapatan masyarakat dan penciptaan lapangan kerja, termasuk juga pertumbuhan di Kawasan Timur Indonesia. Hal ini nantinya akan mengurangi kepincangan pendapatan yang timbul karena perilaku mencari keuntungan berlebihan (*rent-seeking*) dan alokasi kekayaan yang tidak transparan dan bersaing. Seandainya Indonesia mengalami pertumbuhan rata-rata 7,5% per tahun sampai tahun 2005, maka PDB per kapita akan menjadi lebih dua kali lipat (lebih dari $2300). Indonesia akan termasuk salah satu dari 20 ekonomi terbesar di dunia. Sejalan dengan kecenderungan di seluruh dunia, pertumbuhan Indonesia akan berbasis perkotaan. Produksi barang primer akan terus

menurun sebagai proporsi PDB, dan sekitar separuh dari jumlah 220 juta penduduk Indonesia akan tinggal di wilayah perkotaan, dibandingkan dengan kurang dari sepertiganya pada tahun 1990. Investasi perkotaan dan aktivitas lingkungan akan lebih mendorong peranan Jabotabek sebagai motor pertumbuhan yang kuat. Dengan jumlah pendududuk sekitar 25-30 juta, Jabotabek akan merupakan sebagai salah satu wilayah metropolitan terbesar di dunia. Melanjutkan kecenderungan pertumbuhan dewasa ini, penghasilan buruh akan naik hampir sama cepatnya dengan PDB per kapita, dan hal ini tentu akan diikuti dengan pertumbuhan ekonomi di wilayah luar pulau Jawa.

16. Rezim perdagangan dan investasi yang tidak diskriminatif, bersamaan dengan peningkatan sumber daya manusia dan modal fisik, akan memacu ekspor. Sebagai konsekuensi dari kebijakan ini, Indonesia akan naik setingkat dengan menghasilkan barang ekspor dengan nilai-tambah lebih tinggi, kejenjang yang saat ini diduduki Thailand dan Malaysia. Tumbuhnya modal manusia dan barang modal serta ketrampilan bisnis—dan bukannya proteksi yang menyebabkan inefisiensi—akan dapat mendukung pertumbuhan teknologi dan kegiatan produksi padat-modal.

17. **Skenario Pertumbuhan 5%.** Sebaliknya, pergeseran kebijaksanaan yang dapat menurunkan produktivitas nasional, akan memperlamban pertumbuhan ekonomi sampai sepertiganya, yaitu sekitar 5% per tahun. Pertumbuhan yang jauh lebih rendah daripada ini untuk jangka panjang tampaknya tidak mungkin; mengingat pertumbuhan yang terjadi dewasa ini. Namun, pertumbuhan 5% per tahun tidaklah menggembirakan. Dengan pertumbuhan sebesar itu sampai dengan tahun 2005, pendapatan per kapita akan lebih rendah 20% dibandingkan pertumbuhan 7,5% per tahun, yang berarti dana yang tersedia untuk program-program sosial akan berkurang.

18. Pertumbuhan yang lamban kelihatannya mencerminkan ketidak-inginan pergeseran alokasi sumberdaya ke arah yang lebih padat-modal dan pemaksaaan substitusi impor seperti model yang dianut oleh sejumlah negara di masa lalu. Dalam kasus ini, program pemerataan tidak akan tercapai, karena hasil dari pertumbuhan ekonomi akan jatuh pada segelintir manusia dengan hak istimewa yang terlibat dalam industri yang diproteksi atau yang mempunyai akses terhadap dukungan Pemerintah. Dampak dari ketidaktepatan alokasi sumberdaya seperti itu akan menaikkan biaya dan mengurangi daya saing di berbagai sektor ekonomi, terutama untuk daerah-daerah di luar Jawa. Lambannya pertumbuhan permintaan tenagakerja akan memperlambat laju penyerapan tenaga kerja sektor formal dan mengurangi pemercepatan kenaikan gaji rata-rata. Melihat pengalaman negara lain, upaya-upaya untuk menyalurkan sumberdaya keuangan ke perusahaan-perusahaan yang tidak kompetitif dan berbiaya tinggi, dapat meningkatkan ketidakstabilan dalam sistem keuangan dan bahkan menyebabkan pembayar pajak enggan melaksanakan kewajibannya.

C. Mengatasi Tantangan Sumberdaya Manusia

19. Sektor swasta dan pemerintah sepakat bahwa peningkatan pengembangan sumberdaya manusia sangat penting artinya bagi pembangunan Indonesia. Pelayanan yang efektif atas jasa-jasa sumberdaya manusia penting artinya bagi program pengurangan kemiskinan dan pembangunan regional. Misalnya, pelayanan kesehatan dasar merupakan sarana yang sangat efektif untuk menyebarkan manfaat pembangunan sampai kepada kelompok termiskin dalam masyarakat. Pendidikan juga merupakan salah satu jalur penyelamatan terbaik dari kemiskinan, karena peningkatan pendidikan secara mendasar akan menaikkan pendapatan buruh.

20. **Program Lintas Sektoral Perbaikan Pelayanan Pendidikan dan Kesehatan.** Pertama, meningkatkan pelayanan dasar baik kualitas maupun kuantitas, terutama untuk daerah miskin dan daerah terpencil. Kedua, diperlukan lebih banyak pembiayaan, akan tetapi upaya menambah dana saja tidak cukup; disertai dengan perubahan penting dalam kelembagaan dan kebijakan, bahkan lebih penting lagi bagi tercapainya pembelanjaan yang efektif. Misalnya, pelatihan guru akan cenderung sia-sia tanpa adanya reformasi dalam pengaturan kelembagaan untuk penempatan dan tanggungjawab guru. Ketiga, sektor publik perlu meninjau sasaran pelayanan, ke arah pelayanan pokok bagi kelompok miskin dan menghindari pelayanan yang mampu disediakan pihak swasta. Keempat, salah satu alat yang cukup handal adalah desentralisasi tanggungjawab yang lebih besar lagi ke tingkat pemerintahan yang lebih rendah, didukung oleh perubahan dalam pengaturan fiskal dan kelembagaan secara seimbang baik wewenang dalam menyelenggarakan sendiri maupun tanggungjawab.

21. **Pendidikan.** Kemajuan Indonesia di bidang pendidikan hanya tertandingi oleh beberapa negara saja. Akan tetapi, sejak pertengahan 1980-an, laju prestasinya melamban. Yang sangat mengkhawatirkan adalah kualitas pendidikan yang tidak berubah atau cenderung menurun. Hal ini dapat dilihat dari menurunnya jumlah pendaftaran murid sekolah lanjutan tingkat pertama pada akhir tahun 1980-an, yang menimbulkan keraguan mengenai pencapaian tahap perkembangan selanjutnya. Pada tingkat sekolah lanjutan, pertumbuhan partisipasi pihak swasta perlu mendapat respon pemerintah yang lebih mendalam lagi.

22. Peningkatan mutu yang bernas merupakan prioritas utama, terutama pada tingkat pendidikan dasar. Sekolah dasar mendidik mayoritas penduduk. Sekolah-sekolah itu merupakan sarana terbaik dalam menyentuh orang miskin, dan masalah-masalah pada tingkat dasar berkembang terus ke atas melalui sistem yang ada. Unsur-unsur penting di sini yaitu mencakup peningkatan pola pengajaran dan alokasi guru. Lagi pula, hambatan-hambatan perlu diatasi untuk penambahan waktu belajar di ruang kelas bagi kelas 1 dan 2, dikoordinir dengan program penyediaan makanan di sekolah untuk meningkatkan rentang waktu perhatian dan memperbaiki pemerataan.

23. Program-programpemerintah mengenai pendidikan dasar 9-tahun memberi harapan akan peningkatan kualitas pendidikan di masa depan. Namun untuk itu sangat diperlukan sumberdaya yang jauh lebih banyak, dan bahkan membutuhkan peran sektor swasta yang semakin besar. Untuk membatasi biaya dan memaksimalkan pemerataan, pilihan kebijaksanaan pendidikan dipastikan dapat menjangkau daerah-daerah miskin dan terpencil, dan menghindari ketidak-efisienan. Selain itu, sangat diperlukan upaya untuk mengurangi jumlah siswa putus-sekolah pada tingkat dasar.

24. Kelemahan kelembagaan dapat dikurangi dengan mengalihkan lebih banyak tanggungjawab dan pertanggungjawaban kepada tingkat pemerintahan yang lebih rendah, dan mendefinisikan secara tegas peran dari badan pemerintah pusat. Beberapa prinsip pemerintah yang sudah dilaksanakan untuk tingkat pendidikan tinggi, dapat diterapkan pada tingkat pendidikan dasar.

25. Dalam jenjang pendidikan menengah, pemerintah merencanakan untuk meninjau kembali peranannya. Peran swasta diharapkan akan menjadi semakin penting, dan prinsip-prinsip "paradigma baru" Pemerintah dirancang untuk memanfaatkan perkembangan ini. Pemerintah perlu melaksanakan rencana-rencana tersebut dengan tegas. Di sekolah kejuruan dan sekolah teknik, Pemerintah juga perlu memberi peluang kepada sektor swasta,

dan meningkatkan perannya sendiri sebagai sumber informasi/peraturan, mengurangi biaya program-programnya.

26. Sejumlah perbaikan-perbaikan tersebut memerlukan biaya yang mahal. Akan tetapi-dengan keberlanjutan pertumbuhan ekonomi yang tinggi—perbaik-
an akan terjangkau melalui upaya prioritas dan pentahapan kegiatan. Seandainya pertumbuhan ekonomi mengalami penurunan yang cukup besar, maka program ini akan dijadikan sebagai prioritas tinggi yang diberikan pada pengeluaran sektor pendidikan.

27. **Kesehatan**. Pertumbuhan ekonomi yang pesat, banyaknya penduduk lanjut usia, dan kebijakan-kebijakan baru pemerintah, mengakibatkan meningkatnya permintaan akan pemeliharaan kesehatan, pembiayaan kesehatan, pengeluaran dan pelayanan jasa. Pada umumnya, kebijakan-kebijakan sektoral telah bergerak ke arah yang benar, akan tetapi kebijakan-kebijakan itu perlu diperkuat dan dipercepat. Untuk itu sangat diperlukan inovasi dalam keuangan sektor publik dan insentif, serta perbaikan mutu jasa pelayanan sektor publik maupun sektor swasta.

28. Prioritas utama perlu diberikan pada pelayanan pengobatan dasar kepada orang miskin. Dalam kasus umumnya, jasa publik merupakan sarana utama pelayanan kesehatan masyarakat dalam waktu yang akan datang. Pengeluaran pemerintah untuk pelayanan-pelayanan dasar sebagai persentase PDB perlu ditingkatkan. Akan tetapi, seperti halnya dalam banyak sektor lain, peningkatan pengeluaran saja tidak akan cukup. Perubahan kelembagaan sangat diperlukan untuk mencapai pengelolaan secara umum dan penyelenggaraan pelayanan yang lebih baik; untuk meningkatkan insentif dan ketrampilan para profesional kesehatan di sektor publik, dan pelayanan yang lebih berkualitas di Puskesmas-Puskesmas.

29. Pelayanan kesehatan oleh swasta dapat berperan lebih besar dengan didukung oleh kebijakan-kebijakan pemerintah yang disempurnakan. Permintaan akan pelayanan ini akan terus tumbuh pesat sebagai akibat dari naiknya penghasilan rumahtangga dan arus urbanisasi. Pemerintah perlu memprakarsai kebijakan-kebijakan untuk mendukung pelayanan bermutu tinggi oleh swasta; dukungan keuangan pemerintah sebaiknya minimal, karena pengguna jasa ini mampu membayar sendiri. Desentralisasi yang terus dilanjutkan (misalnya, mencakup keputusan perencanaan dan kepegawaian) juga diperlukan untuk meningkatkan efektivitas dan mutu pembelanjaan sektor pemerintah. Tanggungjawab yang jelas dan insentif yang lebih kuat diperlukan untuk semaksimal mungkin memanfaatkan wewenang yang lebih luas di daerah yang lebih luas dan fasilitas pengambilan keputusan manajemen yang lebih besar.

D. Membangun Prasarana Fisik

30. Prasarana fisik yang lebih baik merupakan kunci lainnya bagi masa depan Indonesia. Ada tiga bidang yang terpenting, adalah pembangkit listrik, prasarana perkotaan (pengadaan air dan penyaluran imbah, drainase dan pengelolaan limbah padat), dan transportasi.

31. **Masalah-masalah Lintas Sektoral.** Mengandalkan lebih banyak lagi pada sektor swasta akan memberikan banyak keuntungan. Namun keuntungan tersebut tergantung pada penerapan kerangka yang transparan dan kompetitif untuk penjualan aset dan konsesi. Kegagalan dalam menangani masalah ini mengandung risiko biaya-tinggi (misalnya, dalam pembangkit tenaga listrik dan jalan tol). Potensi kenaikan biaya akan sulit diserap, dan akan memperlamban pertumbuhan serta mengurangi daya saing internasional.

Pengalaman di seluruh dunia menyimpulkan bahwa tidak adanya transparansi, kurangnya persaingan, tidak-adilnya transaksi, dan pilih-kasih (*favoritism*), akan mengurangi manfaat bagi masyarakat, serta mengancam proses swastanisasi, dan bahkan menggerogoti proses-proses reformasi pada umumnya.

32. Re-regulasi tampak meningkat, terutama di bidang transportasi. Berbagai keluhan timbul berkaitan dengan keterlambatan di pelabuhan pada pelayanan bea cukai, bahkan terjadi sebelum penyerahan jasa pemeriksaan pra-pengapalan. Ada saran untuk menyalurkan semua muatan luar negeri melalui Batam. Mulai ada tekanan untuk melakukan re-regulasi pelayaran, dan pembatasan impor kapal yang diperlunak pada pertengahan 1996 telah berbalik dengan cepat.

33. Kelemahan kelembagaan pada perencanaan strategik, sumberdaya manusia, pengadaan dan pembuatan kontrak merupakan masalah yang umum ditemui. Di bidang perencanaan strategik, lembaga-lembaga Pemerintah RI telah memperagakan bahwa mereka efektif dalam hal proyek-proyek tambahan *(incremental)*, akan tetapi lemah dalam perencanaan jangka panjang dan perencanaan investasi, khususnya yang mempunyai implikasi lintas-sektoral. Masalah-masalah ini kebanyakan disebabkan oleh fragmentasi kelembagaan antara wewenang pemerintah dan badan-badan pemerintahan, yang seringkali mempunyai mandat yang tumpang-tindih dan tanggung jawab yang kurang jelas.

34. Desentralisasi wewenang yang lebih besar kepada pemerintah daerah atau kepada badan-badan pemerintahan, diiringi oleh semakin lebih besar peran sektor swasta, dalam peningkatan pelayanan jasa. Dalam kebanyakan hal, pemerintah pusat perlu untuk lebih memusatkan perhatian pada penetapan kerangka kebijakan, paket anggaran, standar penilaian hasil dan petunjuk pelaksanaan. Kemudian rincian perumusan dan pelaksanaan kebijakan dapat diserahkan kepada pemerintah daerah. Otonomi keuangan yang lebih besar akan dapat membantu kemampuan pemerintah daerah untuk menyampaikan pelayanan. Hibah dan pinjaman yang lebih besar akan membantu, akan tetapi kuncinya ialah dasar penerimaan berkelanjutan yang lebih besar melalui pajak properti yang lebih tinggi, peningkatatn penerimaan daerah dan biaya penggunaan fasilitas. Undang-Undang baru tentang Pajak dan penerimaan daerah merupakan langkah baik ke arah itu.

35. **Sektor Pembangkit Tenaga Listik: Tarif; Kelebihan Kapasitas Pembangkit Listrik; dan Pengelolaan Partisipasi Swasta.** Sejak tahun 1980-an, PLN telah meraih sejumlah keberhasilan. Penjualan meningkat dengan 14-15% per tahun, mutu pelayanan telah diperbaiki, dan listrik desa telah tersebar luas. Kapasitas pembangkit tenaga swasta dalam jumlah besar (sama dengan kapasitas PLN sendiri) akan mulai beroperasi beberapa tahun lagi, dan saat ini sedang berlangsung persiapan untuk swastanisasi parsial. PLN tidak lagi merupakan badan usaha yang merugi, walaupun keterlambatan dalam penyesuaian tarif belum lama ini mengurangi kesehatan keuangannya.

36. Perkembangan sektor ini, ditambah isu yang dalam struktur tarif, menimbulkan sejumlah masalah yang mendesak. Kenaikan tarif diperlukan semata-mata untuk memulihkan profitabilitas PLN pada tingkat yang wajar, untuk menghindari krisis likuiditas dan injeksi dana baru dari publik serta menghindari pinjaman, dan mempersiapkan dalam rangka swastanisasi PLN. Mekanisme penyesuaian tarif secara mutlak perlu diperbaharui, agar dapat menutup biaya. Kebijakan tarif kebijaksanaan yang seragam secara nasional menaikkan biaya listrik bagi pemakai jaringan Jawa-Bali untuk mensubsidi silang pemakai listrik di luar pulau Jawa. Subsidi pemerintah untuk tujuan nasional ini jelas akan

meningkatkan daya saing Indonesia, membantu swastanisasi dan memberikan insentif yang lebih besar pembangkit tenaga listrik di luar pulau Jawa.

37. Kapasitas pembangkit tenaga sudah jauh melebihi beban puncak jaringan Jawa-Bali dan faktor muatan kapasitas *(capacity load factor)* telah menurun. Keadaan ini antara lain mencerminkan kekurangan investasi di bidang transmisi dan distribusi, yang menyebabkan pemadaman listrik total dan pemadaman listrik sebagian (*brown-out*) sehingga banyak konsumen terpaksa memilih pembangkit tenaga sendiri. Pembangkit "*Super-Crash Program*" PLN hampir selesai, namun biayanya akan tinggi selama kontrak pengadaan gas belum dinegosiasikan. Kapasitas swasta dalam jumlah besar segera akan beroperasi, kebanyakan *unsolicited*, dan melibatkan negosiasi perjanjian *take-or-pay* dengan harga di atas tarif rata-rata PLN saat ini. Akibatnya, kenaikan tarif akan diperlukan untuk menutup biaya kapasitas dan mungkin akan perlu mengurangi sebagian kapasitas PLN yang relatif murah demi untuk menampung kontrak-kontrak swasta.

38. **Mengelola Kerjasama Pemerintah-Swasta.** Dengan memperhitungkan proyek-proyek yang sudah disetujui belakangan ini dan yang sedang dalam tahap negosiasi, kenaikan kapasitas tenaga listrik diperkirakan akan memenuhi permintaan hingga tahun 2006. Dengan demikian, kapasitas pembangkit baru baik oleh pemerintah maupun swasta, sebaiknya dibatasi. Kerjasama dengan perusahaan swasta perlu mempertimbangkan resiko kelebihan kapasitas. Setiap proyek baru sebaiknya dipersiapkan dengan cermat, untuk memaksimalisasi efisiensi, baik dilihat dari kebutuhan bahan kabar maupun permintaan jaringan, dan proyek baru tersebut haruslah transparan, melalui prosedur tender yang bersaing sejalan dengan pelaksanaan pengumuman pemerintah baru-baru ini. Pengeluaran pemerintah untuk pembangkit tenaga listrik sebaiknya dikurangi, pembangunan pembangkit tenaga listrik baru sebaiknya ditunda, untuk menghemat dana pembangunan. Dengan deregulasi gas alam memungkinkan mempercepat penyediaan bahan bakar yang bersih lingkungan, menghemat penggunaan cadangan minyak, dan untuk pembangkit tenaga listrik. Dilihat dari kelebihan kapasitas yang ada, listrik tenaga nuklir pada saat ini tidak diperlukan, dan mungkin dalam jangka panjang, dan karena mengandung ketidakpastian dan bahaya pada lingkungan yang ditimbulkannya. Pada pihak lain, peningkatan anggaran pemerintah pada transmisi dan distribusi akan membuahkan banyak keuntungan. Upaya dalam kegiatan ini dapat dilakukan dengan melibatkan parsipasi pihak swasta.

39. Jasa prasarana perkotaan semakin tidak memadai. Pembelanjaan pemerintah di bidang ini terus menurun dibawah target. Dengan tingkat urbanisasi yang tinggi, kemacetan lalu lintas dan masalah-masalah lingkungan hidup, mendorong naiknya biaya dan menghambat pertumbuhan. Sementara itu, pengadaan pelayanan jasa perkotaan yang memadai adalah mutlak diperlukan untuk terus mengurangi kemiskinan. Masalah dalam pengadaan air bersih di perkotaan juga merupakan masalah sangat menonjol ditemui. Indonesia masih tertinggal jauh dibanding negara-negara lain yang setara tingkat ekonominya, dan beresiko menghadapi isu-isu kesehatan, terutama kesehatan bagi penduduk miskin.

40. Pembiayaan yang lebih banyak merupakan prioritas untuk menghindari masalah prasarana perkotaan. Akan tetapi, seperti di kebanyakan sektor lainnya, uang yang lebih banyak saja tidak cukup; kebijakan yang lebih baik dan pengaturan kelembagaan yang diperbaiki juga diperlukan. Desentralisasi digabung dengan peningkatan sumberdaya (pajak properti yang lebih tinggi, tarif konsumen dan hibah) akan menyediakan padanan biaya dan manfaat yang lebih baik dan penyampaian pelayanan yang lebih baik.

Sebagaimana telah disebut, Undang-Undang baru mengenai Pajak dan Pendapatan Daerah merupakan awal baik ke arah ini. Dengan sumber penerimaan berkelanjutan yang lebih tinggi, maka tiap pemerintah daerah akan mampu memperoleh pinjaman untuk pembelanjaan barang modal.

41. Pengadaan yang lebih bersaing, dengan insentif untuk penghematan biaya, akan menghemat dana. Perusahaan-perusahaan Air Minum Daerah perlu dikonsolidasi atau dikelompokkan ke dalam suatu konsorsium untuk mencapai skala ekonomis dan untuk menyempurnakan pengelolaan sumber waduk air. Kenaikan tarif dan pengurangan kerumitan tarif akan membantu perusahaan dalam pengadaan air dan menghilangkan non-transparansi yang menaikkan harga pemakaian air oleh konsumen. Kerugian akibat dari penagihan dan kebocoran air perlu diperbaiki perusahaan dapat menyediakan sumberdaya lebih besar dan melayani lebih banyak konsumen. Partisipasi swasta dalam bidang ini perlu dapat ditingkatkan, walaupun manfaatnya hanya akan dinikmati masyarakat apabila pengusahaannya melalui kerangka usaha yang bersaing dan transparan.

42. **Transportasi.** Sampai saat ini, total kapasitas transportasi telah mengimbangi permintaan yang meningkat, walaupun kemacetan lalu lintas mulai menimbulkan masalah di daerah-daerah yang telah mengalami pertumbuhan ekonomi pesat. Biaya di sektor pengangkutan terus didorong oleh pengadaan yang tidak bersaing dan tidak transparan oleh Badan Usaha Milik Negara dan oleh keterlambatan pembayaran kepada kontraktor (yang mereka imbangi dengan menaikkan penawaran). Biaya-biaya juga terdorong naik oleh peraturan tentang pengadaan yang mencegah pemakaian pemasok dengan biaya rendah dan oleh sejumlah tarif resmi dan tidak resmi—yang dibebankan dalam perpindahan barang.

43. Untuk pembangunan jalan perkotaan khususnya konstruksi dan pengoperasian jalan tol yang memerlukan jasa pelayanan swasta, sangat perlu dilakukan proses tender yang transparan dan bersaing. Seperti halnya di sektor lain, peran sektor swasta dapat lebih besar, jika proses kontrak dan konsesi dapat diperbaiki. Langkah penting lainnya adalah kebijakan penentuan harga yang lebih baik, misalnya penentuan harga untuk mengurangi kemacetan dan penetapan biaya parkir yang lebih tinggi di kota-kota besar untuk menutup seluruh biaya pemeliharaan dan pengoperasian jalan. Pelaksanaan penghapusan bertahap pemakaian bensin yang mengandung timah di seluruh Indonesia akan memperbaiki kesejahteraan dan mengurangi biaya kesehatan. Deregulasi lebih lanjut untuk pelayanan transportasi bus umum juga akam sangat membantu. Akhirnya, pengelolaan lalu-lintas yang disempurnakan dan pemusatan investasi pemerintah untuk mengatasi hambatan yang paling gawat akan membantu mengurangi biaya kemacetan dan polusi.

44. Untuk jalan-jalan antar kota, pemecahannya lebih konvensional, yaitu: pendanaan lebih banyak; memperluas peran sektor swasta secara lebih transparan; dan kapasitas penyerapan kelembagaan yang lebih baik, terutama tender yang lebih bersaing dan integrasi pelayanan jasa (misalnya, jaringan jalan tol dan bukan tol dan jasa pelayanan kereta-api yang bersaing). Di bidang perkereta-apian, yang mempunyai masa depan cerah mengingat kepadatan penduduk di Jawa, pemerintah telah melancarkan suatu program reformasi, yang memerlukan pelaksanaan yang kuat. Usulan-usulan yang tidak diminta *(unsolited)* dari pihak-pihak yang mempunyai koneksi baik jangan sampai menggagalkan rencana pelaksanaan. Untuk transportasi laut, yang masih menjadi keprihatinan adalah re-regulasi dan hambatan birokrasi; pemantauan cermat akan keberhasilan sistem bea cukai yang baru memerlukan perhatian khusus. Fasilitas

dan peraturan pelabuhan, di samping peraturan pelayaran dan pembatasan impor kapal, cenderung menaikkan biaya pelayaran antar-pulau, dengan demikian memperlambat proses integrasi nasional dan membatasi prospek pembangunan di luar Jawa.

E. Membangun Prasarana Non Fisik

45. Kelanjutan perbaikan prasarana non-fisik (yaitu kebijaksanaan dan kelembagaan dalam bidang lingkungan) adalah mutlak diperlukan dalam persaingan internasional, pertumbuhan pesat dan pemerataan yang meningkat. Perhatian akan prasarana lunak ini antara lain mencakup: kerangka insentif yang mendorong persaingan antara para produsen; perjanjian kerjasama dan konsesi yang transparan; dan masalah-masalah kinerja pemerintah serta sistem hukum. Selain itu, dalam peraturan perdagangan internasional dan domestik, ketidakpastian iklim usaha dan kerangka hukum, serta intervensi *ad hoc* oleh pemerintah, bertentangan dengan efisiensi, persaingan internasional dan pemerataan.

46. **Memulihkan Momentum Deregulasi Perdagangan Internasional.** Tampaknya besarnya perhatian menarik kebijakan Mobil Nasional sangat erat kaitannya dengan deregulasi di bidang perdagangan internasional yang diumumkan pada tahun 1996. Di antaranya, yang paling penting adalah Paket Tarif bulan Juni. Juga pada tahun yang sama, ada kelonggaran impor kedelai, kapal penangkap ikan bekas, dan sembilan kode tarif lainnya. Sayangnya telah terjadi penyimpangan dalam pelaksanaan sebagian kebijakan ini. Misalnya, sekitar 800 di antara pemotongan tarif yang diumumkan tidak dilaksanakan sesuai rencana. Demikian pula beberapa bulan setelah pengumuman pembatasan impor kapal nelayan bekas, regulasi kandungan lokal yang tinggi diberlakukan.

47. Untuk dapat memanfaat momentum yang ada, pelaksanaan penurunan tarif sebaiknya disesuaikan dengan jadwal yang sudah direncanakan, dan memang, terlihat tanda-tanda menggembirakan mengenai hal ini yang diharapkan akan diumumkan sekitar pertengahan tahun 1997. Apabila pelaksanaan pemotongan tarif sudah sesuai dengan jadwal, langkah selanjutnya adalah mempersiapkan pelaksanaan pemotongan tarif sampai tahun 2003—tanpa menyerah terhadap tekanan untuk penangguhan selektif atau pengecualian—hal ini akan mempunyai arti penting bagi persaingan dunia internasional dan kepastian investor.

48. Kelanjutan agenda deregulasi perdagangan yang belum rampung juga akan membantu memperbaiki daya saing dan pendapatan. Misalnya, masih ada pembatasan kuantitatif yang cukup berarti terhadap impor, termasuk sejumlah produk pertanian. Cukup banyak jenis ekspor non-migas yang dikenakan berupa pajak atau pembatasan. Bila hal tersebut dihapuskan, ekspor non-migas dan efisiensi akan lebih terpacu. Harga yang lebih rendah bagi sejumlah produk pertanian, seperti gula dan gandum, akan menyediakan masukan (input) yang lebih murah bagi agro-industri dan meningkatkan upah riil dan pemerataan. Di samping itu, pengurangan tarif terhadap produk kendaraan, bahan kimia, produk-produk logam dan komoditi pertanian akan meningkatkan efisiensi dan pertumbuhan produktivitas. Akhirnya, pemajakan barang yang digunakan oleh konsumen berpenghasilan tinggi—seperti mobil atau barang yang dari segi sosial kurang diinginkan, seperti alkohol, akan lebih efektif jika pajak ditingkatkan, bukan tarif. Tujuan sosial lainnya juga merupakan hal yang tidak kalah pentingnya jika barang itu diproduksi di dalam negeri.

49. **Memacu Deregulasi Domestik.** Meskipun berbagai upaya telah dilakukan, namun masih kurang besar hasil yang dicapai akibat pembatasan perdagangan, tarif dan pungutan di pasaran domestik. Usaha untuk memperbaiki masalah rumit ini dapat dimulai melalui menghapus pembatasan perdagangan

antar-pulau, yang cenderung menurunkan harga ekspor di kawasan Indonesia yang lebih miskin. Demikian pula, *retribusi* pajak dan pembatasan perdagangan pertanian mengakibatkan harga-harga yang diterima oleh petani menjadi lebih rendah dan harga konsumen menjadi lebih tinggi, yang mengurangi penghasilan riil para petani dan di luar pulau Jawa.

50. Mengelola sumberdaya alam Pemerintah menghadapi sejumlah tantangan. Ancaman kekurangan, kerusakan sumberdaya alam, seperti minyak bumi, hutan dan air. Perusakan lingkungan hidup telah menjadi masalah. Pemerintah juga bertanggungjawab untuk memastikan bahwa masyarakat pada umumnya, termasuk generasi-generasi yang akan datang—bukan segelintir manusia pribadi—memperoleh manfaat dari sumberdaya-sumberdaya milik bangsa ini. Pemerintah telah memberi respon dengan sejumlah kebijakan, antara lain pelelangan yang cukup transparan bagi konsesi dalam hal minyak bumi, hingga pajak dan iuran *(royalties)* sebesar kurang lebih 10% dalam hal kehutanan dan pertambangan, kebijakan yang cukup liberal di bidang sumberdaya air, pembentukan suatu badan perlindungan lingkungan hidup yang menggunakan beragam instrumen untuk memperbaiki lingkungan hidup. Walaupun telah ada banyak kemajuan, masih diperlukan upaya lebih lanjut untuk menghadapi tantangan pengelolaan sumberdaya alam. Upaya itu mencakup antara lain, perbaikan hak-hak properti (misalnya, hak atas tanah), pelelangan lebih transparan dan bersaing bagi konsesi sumberdaya alam, iuran lebih tinggi (misalnya, IHH), dan *performance bond* untuk melindungi lingkungan hidup dalam konsesi kehutanan.

51. **Memperkuat Lembaga-Lembaga Keuangan.** Kemajuan telah dicapai dalam memperkuat sistem keuangan selama beberapa tahun terakhir ini. Misalnya, sejumlah bank telah dapat meningkatkan modal mereka; jumlah aset bermasalah yang terus menurun dibandingkan dengan pinjaman total kredit; beberapa bank telah memperbaiki manajemennya; dan sumber baru (misalnya, reksa dana atau *open-ended mutual funds*) juga semakin terbuka pilihan dipasar modal semakin besar persaingan pada sektor moneter. Meskipun demikian, berdasarkan standar baku internasional sektor keuangan Indonesia masih relatif lemah, yang menambah biaya perantara keuangan. Ada kekhawatiran bahwa sistem keuangan, yang ada sekarang ini tidak berfungsi sebagai alat peredam yang memadai dikala terjadi goncangan ekonomi-makro.

52. Berdasarkan perbaikan yang dicapai belakangan ini, berbagai strategi baik dapat membantu mengatasi kelemahan sistem keuangan. Di pihak Bank Indonesia, pengawasan yang lebih ketat sangat diperlukan, termasuk batasan-batasan dalam rangka intervensi Bank Indonesia terhadap bank-bank (misalnya, untuk dukungan likuiditas berjangka pendek dan untuk mempermudah merger, pengambilalihan, dan penutupan). Bagi bank-bank pemerintah, diperlukan dukungan politik tingkat tinggi untuk membantu penagihan kredit-kredit bermasalah, maupun sanksi yang lebih efektif terhadap kreditur bermasalah. Akhirnya, satu-satunya penyelesaian nyata ialah swastanisasi total bank pemerintah; swastanisasi sebagian sudah merupakan langkah maju, namum tidak dapat diharapkan banyak perbaikan yang berarti. Langkah-langkah sementara lain mungkin akan diperlukan untuk meningkatkan pengelolaan dan kinerja bank-bank pemerintah, misalnya, tutup, merger dan penciutan, mungkin digabung dengan "penguraian" dan penjualan sejumlah kegiatan.

53. Bagi bank-bank swasta, diperlukan ketegasan hukum (misalnya, sangsi otomatis keuangan bagi bank yang kekurangan persyaratan dan pemberian pinjaman berlebihan kepada pihak-pihak tertentu, dsb). Bank yang tidak memiliki cukup modal (setelah diperhitungkan kredit-kredit bermasalah) harus ditutup sebelum mengalami kebangkrutan.

Peningkatan kewajiban modal bagi bank-bank non-devisa akan dipaksakan melalui konsolidasi. Konsolidasi langsung dapat dipermudah melalui peningkatan modal baru, baik asing maupun domestik, maupun membeli bank non-devisa domestik yang sedang mengalami masalah.

54. **Kerangka hukum.** Pemerintah menyadari masalah-masalah yang ditimbulkan akibat rendahnya kredibilitas dan prediktabilitas sistem hukum sebagai sarana untuk penyelesaian sengketa—termasuk masalah dalam melindungi mereka yang kurang beruntung—dan reformasi sedang dalam persiapan. Prioritas untuk upaya reformasi antara lain: i) memberdayakan komitmen nasional terhadap aturan hukum dan sistem peradilan yang efektif dan independen; ii) reformasi kelembagaan, seperti sistem penyaringan yang disempurnakan, badan-badan akreditasi dan standar-standar profesional bagi tenaga hukum profesional; iii) memodernisasikan undang-undang, dengan partisipasi luas dari pihak-pihak yang berminat; dan iv) meningkatkan sumberdaya manusia.

55. **Persoalan "Governance".** Hasil survai diantara pelaku bisnis mencerminkan bahwa Indonesia memperoleh angka yang cukup tinggi untuk kriteria seperti "kecilnya resiko pengambil-alihan tanpa kompensasi". Namun demikian, survai yang sama secara konsisten menempatkan Indonesia dalam peringkat yang rendah untuk "kelambanan birokrasi" dan "mentaati kontrak". Faktor-faktor seperti ini meningkatkan ketidakpastian dan risiko. Pelaku-pelaku bisnis itu cenderung memilih menggunakan koneksi dari pada mengutamakan effisiensi. Mereka membengkakkan biaya. Perbuatan mereka itu menimbulkan sikap sinis dan persepsi tidak jujur. Dan mereka mempersulit diri dalam melakukan bisnis yang benar. Persepsi ini belum menghambat pertumbuhan investasi asing selama tahun-tahun terakhir. Namun demikian, agar dapat mengimbangi negara-negara sukses lainnya, dan untuk memperbaiki citra bisnis, Indonesia cepat atau lambat perlu mengatasi masalah.

56. Negara-negara lain telah menemukan beberapa pemecahan parsial, misalnya: lembaga peradilan independen; struktur penggajian pegawai negeri yang memberi imbalan berdasarkan prestasi dan kejujuran; hukuman yang setimpal terhadap penyelewengan; reformasi kebijakan untuk membatasi kewenangan pejabat pemerintah; mengurangi tanggung jawab bagi mereka yang menyalahgunakan; dan cepat mengambil tindakan terhadap mereka yang berprestasi rendah atau yang menyalahgunakan kekuasaan. Pengalaman Bank Dunia menganjurkan bahwa pemerintahan yang lebih baik meningkatkan kinerja pemerintahan bergantung pada dukungan luas dan komitmen pada semua tingkat—baik dalam kepemimpinan maupun tindakan.

Executive Summary

A. Macroeconomic Policies for Managing Success and Risk

1. **Overall Performance.** On the basis of broad macro indicators, Indonesia's economy has performed very well recently. GDP increased by 7.8% in 1996 and inflation dropped to 6.6%. Local and foreign direct investment have been increasingly buoyant. A sizable fiscal surplus was maintained and large prepayments of high-interest, public external debt have continued. Official international reserves rose by $4 billion during 1996/97.

2. Despite this strong performance, significant risks remain. Domestically, core inflation is still high and key administered prices have not been increased in some time. Deregulation has lost momentum. The banking sector remains relatively weak by international standards, and its exposure to the property sector is again on the rise.

3. Externally, the current account deficit widened, despite high international prices for Indonesia's oil exports; non-oil exports slowed noticeably; and private external debt is increasing rapidly. To some extent, these external developments reflect higher foreign investment and some special circumstances (*e.g.*, improved statistical methodology; large cross-currency movements; and lower commodity prices that may be temporary). Looking ahead, the current account is likely to worsen further next year, and problems in other East Asian economies could spillover into Indonesia. These factors, *inter alia*, risk a reversal of capital inflows, a risk that is magnified by Indonesia's large external debt and the increasing sensitivity of global capital flows to changes in indicators.

4. **A Better Mix of Fiscal and Monetary Policies Would Help.** The current mix of fiscal and monetary policy contributes to some of these problems. Fiscal policy continues to be run responsibly, even in the run-up to elections. However, the higher oil earnings in FY1996/97 were not fully sterilized by an increased fiscal surplus and (net) off-budget spending looks a bit less contractionary. Overall, the impact of fiscal policy was virtually identical to FY1995/96, despite significantly higher oil revenues. The main instrument used to limit overheating in 1996/97 was real interest rates. With improved confidence, especially after July, these rates attracted large inflows, which tended to appreciate the rupiah in real terms, and reduce external competitiveness.

5. Allowing interest rates to fall somewhat further and concurrently offsetting this with still tighter fiscal policy would reduce the appreciation, while maintaining macro stability. Instruments to carry out this approach would also serve other national objectives, for example, improving assessments and raising the property tax rate (especially for luxury urban residences) from its current 0.1% of assessed values. This would dampen the property sector boom, support decentralization and urban infrastructure, and improve equity by taxing property owners. Raising forestry royalty (IHH) rates further would help compensate the nation for depletion of its resources and encourage more sustainable forestry practices. Higher fuel prices to eliminate the fiscal subsidy would improve equity by reducing the subsidy that now goes to the 2 million or so car-owners, who comprise about 1% of the nation's population. Raising power tariffs—and adjusting their structure—would improve PLN's finances and reduce inefficient cross subsidies; it would also make privatization easier and encourage power production in the outer islands. Moreover, substantial room remains in the development

budget for cutting back spending on telecommunications and power generation and relying more on the strong private interest in these sectors.

6. **Improving Economic Cushions.** Better economic shock absorbers would also enhance performance and reduce risk to the economy. The wider buy-sell band of the rupiah is a market-based shock absorber that served Indonesia well in 1996. Non-economic shocks were absorbed with only small, transitory exchange rate movements, no central bank loss of reserves, and minimal effect on the domestic economy. In the past, monetary policy also has responded quickly to shocks by allowing interest rates to rise when outflows begin; continued responsiveness would provide an important, additional cushion. Maintenance of higher foreign exchange reserves also would be helpful. But evidence from many countries suggests that even large reserves are not enough; exchange and financial markets need to be allowed to adjust, and the incentive regime needs to be strong.

7. **Strengthening Incentives.** The strong deregulation that supported rapid, labor-based growth has slowed, and even reversed in some areas. There has been slippage in scheduled tariff cuts. Little progress has been made on the unfinished deregulation agenda and domestic regulations continue to hurt efficiency and inter-island equity. The large minimum wage increases of recent years could dampen job creation and labor-intensive exports. The lack of transparency and competition have hurt performance in sectors such as infrastructure and natural resource development. *Ad hoc* interventions (which are on the rise) and other common local practices are coming under increasing global scrutiny. Unless momentum is restored to deregulation, Indonesia risks slower growth and deteriorating equity, which characterizes many developing countries (Section E).

8. **The Importance of Foreign Assistance.** Indonesia's strong economic performance in recent years has attracted large private capital inflows. In part, this reflects the success of an explicit, private sector-led development strategy that has been supported by the donor community. But donor flows still represent one-quarter of gross flows. Private project financing is generally available only for a few infrastructure sectors. The donor community continues to provide virtually the only source of stable, long-term financing with relatively strong project appraisals and technical assistance. Moreover, the terms of the CGI funds strengthen the average maturity of debt and the debt service profile.

9. Bearing in mind these factors, as well as the strong private sector interest in Indonesia at the moment, total 1997 CGI commitments similar to last year's would be very supportive. Looking further ahead, the relative abundance of private financing has important implications for Indonesia's aid donor community. In particular, it underscores the importance of donors' increasing the quality and effectiveness their aid.

B. Sustaining High Growth with Equity

10. **Five Key Factors in Maintaining High Growth With Equity.** Looking at experience around the region, many analysts agree that five common factors were critical in East Asia's high growth with equity:

- Sound macroeconomic fundamentals, including rapid adjustment to shocks;
- High investment and domestic saving, which reflected sound macroeconomic fundamentals and high public saving rates;
- Strong human resource development that led to higher wages, lower population growth and improvement in

the status of women;

- More attention to international competitiveness and less interference with markets than most countries. And,

- Improved institutions, including government.

11. Experience in East Asia and elsewhere suggests that when performance declines in these areas, growth slows, efficiency drops, and equity deteriorates. For example, in Korea and Indonesia, investment, savings and growth were low until macroeconomic stability was restored around the end of the 1960s. In Korea in the latter half of the 1970s interventions to favor capital-intensive, technological-advanced industry were associated with low productivity growth and increased inequity. Similarly, in Brazil, high protection, macroeconomic instability, and emphasis on higher education—instead of broad-based human resource development—contributed to poor performance and inequity in the 1980s. Thus, Indonesia's continued, strong emphasis on these five factors would contribute greatly to high growth with equity in the future.

12. Of course, the future may differ from the past; new challenges could threaten Indonesia's ability to grow rapidly and increase equity. These challenges include: globalization; scarcity of skills; an aging population; natural resource depletion; environmental degradation; and lack of infrastructure to maintain rapid growth, especially in urban areas. In many cases, meeting these challenges will depend on improved implementation of the five factors that have served East Asia and Indonesia well. For example, globalization means that more countries are competing for markets and foreign investors, and that capital flows are increasingly sensitive to "bad news". Sound macroeconomic fundamentals, quick adjustment to shocks and renewed momentum in deregulation will go a long way to meet these challenges (Sections A and E). Improved human resource development will be critical to improving skills, raising labor incomes and meeting the demands of Indonesia's aging population for better health services (See Section C). But the challenges also represent opportunities. Indonesia's sound international commitments lock-in a more predictable, open, competitive economy and provide more certainty for potential investors. The aging population will also mean more savings, if a sound public pension scheme can be designed.

13. **Stronger Institutions.** Improved institutions, especially to manage the public/private interaction, will also be critical to meeting the new challenges to high growth with equity. In terms of the incentive framework, the Government could push the economy towards more efficient, equitable solutions. This would mean not only renewing the momentum on trade deregulation, but implementing more transparent, competitive arrangements for sales and concessions in infrastructure (Section D) and natural resources (Section E), and reducing internal trade barriers (Section E). More broadly, it means a commitment to better governance and an improved legal system, that would reduce the cost of doing business and ensure the benefits of public resources are equitably shared among all Indonesians, including future generations.

14. Improved management of the public/private interface also will entail realignment of government spending. Where private interest is strong, government could cut back, relying instead on a transparent, competitive framework to ensure delivery of good services at reasonable prices (for example, in power generation, telecoms, and toll roads). In areas of limited private interest, government can realign its approach and increase spending to deliver better services. (*e.g.*, upgrading basic education and health

services; Section C). Physical infrastructural needs will be very large, especially in urban areas (Section D). But the financial resources are available, and they are consistent with tighter fiscal policy. For instance: privatization revenues and returns from concessions; better taxation (e.g. higher property taxes and better assessments); and the elimination of explicit and implicit subsidies (input-pricing in industry, petroleum consumption, and fertilizer). In addition, delegation of more spending, tax authority, and accountability to sub-national governments would make the provision of (local) public goods more responsive to local needs.

15. **A High Growth with Equity Scenario**. Emphasis on the five factors, noted above, would maintain rapid growth in incomes and jobs, including in the Eastern Islands. It would also reduce inequalities arising from rent-seeking behavior and non-transparent, non-competitive allocations of assets. If Indonesia were to average 7.5% p.a. growth through 2005, GDP per capita would more than double in US dollars (to over $2300). The country would become one of the world's 20 largest economies. In line with world-wide and Indonesian trends, growth would be urban-based. Primary production would continue to decline as a proportion of GDP and about half of Indonesia's 220 million population would live in urban areas, compared to less than a third in 1990. Urban investments and environmental actions would sustain greater Jabotabek's role as a strong engine of growth. With population of 25-30 million, it would be one of the largest metropolitan areas in the world. Continuing current trends, labor incomes would rise about as fast as per capita GDP and the outer islands' growth would be strong.

16. A non-discriminatory trade and investment regime, in conjunction with increases in human and physical capital, would boost exports. As a consequence of these policies, Indonesia would move up the ladder of higher-value-added exports, onto the rungs now occupied by Thailand and Malaysia. The growth of (human and physical) capital and business skills--not protection of inefficiencies--will lead to natural growth of technology- and capital-intensive production.

17. **A 5% Growth Scenario**. In contrast, shifts in policy could lower national productivity, and slow growth by a third, to 5% per year. Much lower than this for an extended period seems unlikely, owing to the momentum of growth at present. Nonetheless, 5% p.a. growth would be disappointing. By the year 2005, income per capita would be some 20% less than under the 7.5% p.a. scenario, with proportionately less resources available for social programs.

18. Such slower growth would most likely reflect an undesirable shift toward the more capital-intensive, forced import-substitution model followed by many countries in the past. In that case, equity would suffer, as the benefits of growth would go to those privileged few who are involved with the protected industries or have access to Government support. The costs of such resource misallocation would raise costs and reduce competitiveness in the rest of the economy, notably off-Java. Slower growth in labor demand would slow formal sector employment growth and reduce average wage increases. Judging from other countries' experience, attempts to channel financial resources to uncompetitive, high-cost firms could heighten instability in the financial system and even lead to taxpayer supported bailouts.

C. Meeting the Human Resource Challenge

19. The private sector and Government agree that increased human resource development is critical to Indonesia's development. Effective delivery of basic

human resource services is important for poverty alleviation and regional development. For example, basic health services are a very effective means of spreading the benefits of development to the poorest of society. Education is one of the best escape-routes from poverty, as broad-based increases in education raise labor incomes.

20. **Cross-Sectoral Themes in Improving Education and Health.** First, basic services need higher quality as well as increased quantity, especially to the poor and remote regions. Second, more financing is needed, but more resources alone will not suffice; significant changes in institutions and policies are even more important, to make spending effective. For example, teacher training will be largely wasted without reforms in the institutional arrangements for the allocation and accountability of teachers. Third, the public sector needs to re-focus, towards basic services for the poor and away from those services that can be provided by the private sector. Fourth, one promising instrument appears to be further decentralization of responsibility to lower levels of government, supported by changes in fiscal and institutional arrangements that balance autonomy with accountability.

21. **Education.** Indonesia's progress in education has been matched by few countries. However, since the mid-1980s, improvement has slowed. Of particular concern has been the stable—if not declining—quality of education. Also, junior secondary enrollments declined in the late 1980s, which has raised doubts about achieving the next phase of expansion. At the post-basic level, the rapid rise of the private sector calls for a refocusing of the role of the state.

22. Significant quality up-grading is a high priority, particularly at the primary level. Primary schools educate the vast majority. They are the best means to reach the poor, and problems at the primary level are transmitted upwards throughout the system. Important elements here include improved teaching and teacher allocation. Also, hurdles must be overcome to increase time in the classroom for grades 1 and 2, coordinated with a school feeding program to increase attention spans and improve equity.

23. Government's plans for 9-year universal basic education offer promise for improving quality. However, significantly more resources will be needed, even allowing for a strong private sector role. To limit costs and maximize equity, a premium will be placed on options that ensure affordability, reach the poor and isolated regions, and ensure that existing inefficiencies are not replicated. Moreover, a prerequisite is a reduction in drop-outs at the primary level.

24. Institutional weakness could be reduced by devolution of more responsibility and accountability to lower level governments, and by tightly defining the remaining role of central agencies. Several of the Government's principles that are being implemented for higher education, could be applied to basic education.

25. In post-basic education, the Government has plans for refocussing its role. The private sector is expected to become increasingly important, and the Government's "new paradigm" principles are designed to take advantage of this development. The Government needs to firmly implement these plans. In vocational and technical schools, it also needs to make room for the private sector, upgrade its informational/regulatory role, and reduce the cost of its own programs.

26. These many improvements will be expensive. However—with continued strong economic growth—they are affordable with some prioritization and phasing of activities. Should economic growth slow appreciably, affordability depends upon high priority being

assigned to educational spending.

27. **Health.** Rapid growth, an aging population, and new government policies are changing demands for health care, health financing, expenditures and service delivery. In general, sectoral policies are moving in the right direction, but they need to be strengthened and accelerated. Further innovation in public sector finance and incentives, and improved quality of both public and private sector services, are needed.

28. A top priority should be improved basic medical services to the poor. In the majority of cases, public services will be the only option for some time to come. Government spending on basic services needs to increase as a percentage of GDP. But, as with many other sectors, increased spending will not be enough. Institutional change is needed to achieve better public sector management and organization of services; to improve the incentives and skills of public sector health professionals; and to deliver better quality services in *puskesmas*.

29. Private health care, with support from improved government policies, can play a larger role. The demand for this service will continue to grow rapidly as household incomes and urbanization expand. The Government needs to initiate policies to support high quality private services; public financial support should be minimal, as these will be self-financing. Continued decentralization (*e.g.*, to encompass planning and personnel decisions) is also needed to increase the effectiveness and quality of public sector spending. Clear responsibilities and stronger incentives are needed to make the most of increased authority of district and facility management decision-making.

D. Building "Hard" Infrastructure

30. Better physical infrastructure is another key to Indonesia's future. Three of the most important areas are power, urban infrastructure (water supply & sewerage, drainage and solid waste management), and transport.

31. **Cross-Sectoral Themes.** Greater reliance on the private sector would pay dividends, but the gains depend on establishing transparent, competitive frameworks for the sale of assets and concessions, and for the sectors themselves. Failure to address this issue risks high-cost infrastructure (*e.g.*, in power generation and toll-roads). The potential rise in costs would be difficult to absorb; it would slow growth and reduce international competitiveness. Worldwide experience suggests that non-transparency, lack of competition, unfair dealing and favoritism reduce the benefits to the public; they can also undermine privatization and other reform processes.

32. Reregulation is increasing, notably in transport. Complaints have arisen concerning port delays even before the handover of pre-shipment inspection to the local (post-shipment) customs service. Proposals have been made to channel all foreign cargo through Batam. Pressure is developing for reregulation of shipping and the easing of restrictions on vessel imports in mid-1996 was effectively reversed quickly.

33. Institutional weaknesses in strategic planning, human resources, procurement and contracting is another common theme. On strategic planning, GOI institutions have demonstrated that they are effective at incremental projects. But their effectiveness is lower with longer-term, strategic investments, especially those with cross-sectoral implications. These problems are largely attributable to institutional fragmentation of authority across government levels and agencies, which often have overlapping mandates and unclear accountability.

34. Decentralization of more authority to

sub-national governments or to agencies, along with greater reliance on the private sector, offer promise of improved service delivery. In most cases, the central government needs to focus more on setting policy frameworks, budget envelopes, best-practice standards and implementation guidelines. The details of policy formulation and implementation would then be left to sub-national governments. Greater financial autonomy would help these government's ability to deliver services. Larger block grants and loans would help, but the key is a larger sustainable revenue base through higher property taxes, increased local fees and user charges. The new Law on Local Taxes and Fees is a good step in this direction.

35. **The Power Sector: Tariffs; Overcapacity in Generation; and Managing Private Participation.** Since the 1980s, PLN (the public power company) has had many successes. Sales have increased by 14-15% p.a., service quality has improved, and village electrification has spread widely. Large private generation capacity (roughly equal to PLN's own capacity) is coming on-line over the next several years, and preparations are underway for partial privatization. PLN is no longer a loss-making entity, although recent lags in adjusting tariffs are reducing its financial viability.

36. These developments, plus on-going issues of the tariff structure, are raising a number of pressing issues. Tariff increases are needed simply to restore PLN's profitability to reasonable levels, to avoid liquidity crises and new injections of public funds and borrowings, and to prepare PLN for privatization. The automatic tariff adjustment mechanism also needs overhaul, to better cover costs. The uniform national tariff policy raises power costs for users of the Java-Bali grid to cross-subsidize power in the outer islands; a clear public subsidy for this national goal would increase Indonesia's competitiveness, help privatization, and provide better incentives for more power generation in the outer islands.

37. Generation capacity already is well in excess of peak load in the Java-Bali grid and the capacity load factor has declined. These developments partly reflect lagging transmission & distribution investment, which is also largely responsible for the outages and "brown-outs" that lead many large users to opt for self-generation. PLN's "Super Crash Program" plants will be nearing completion, but their costs will be high until gas supply contracts are negotiated. Large private capacity also is coming on line, most of which was unsolicited and involves negotiated take-or-pay agreements at prices above PLN's current average tariff. Consequently, additional tariff increases will be needed to cover the costs of the capacity and it may be necessary to back-down some of PLN's relatively low-cost capacity to accommodate the private contracts.

38. **Managing the Public/Private Interface.** The projected increases in generation capacity would meet anticipated demand through 2006, only taking into account projects currently approved or under negotiation. In this situation, new generation capacity, public or private, should be limited. Contracts with private plants should entail their bearing more of the risk of overcapacity. Any new projects should be carefully prepared, to maximize their efficiency in terms of fuels and grid demands, and they should be subjected to transparent, competitive bidding procedures through implementation of the Government's recent announcements. Public spending on generation should be reduced, and new plants be postponed, thereby saving development budget funds. Natural gas deregulation would make this clean fuel available, save dwindling oil reserves, and allow plants to be built with less lead time. In the context of this excess capacity, nuclear power is not needed at this time, particularly given long lead times, corresponding uncertainties and environmental risks. By contrast, increased public spending

on transmission and distribution would pay large dividends. Efforts also could be made to involve private participation in these areas.

39. Urban infrastructure services are increasingly inadequate. Public spending in this area has consistently fallen well short of targets. With rapid urbanization, congestion and environmental problems are pushing up costs and hindering growth. In addition, an adequate supply of urban services is vital to further reductions in poverty. In urban water supply, such problems are particular acute. Indonesia is well behind comparator countries and risks to health could become an issue, particularly among the poor.

40. More financing is a priority to avoid urban infrastructure bottlenecks. But, as in most other sectors, more money is not enough; better policies and improved institutional arrangements are also needed. Decentralization combined with increased resources (higher property taxes, user fees, and bloc grants) would provide a better match of costs and benefits and a better delivery of services. As mentioned, the new Law on Local Taxes and Fees represents a good start in this direction. With higher, sustainable revenue sources, municipalities would be able to borrow for capital expenditures.

41. More competitive procurement, with incentives for cost saving, would save funds. The water companies need to be consolidated or grouped into consortia to achieve economies of scale and to improve management of water basin resources. Tariff increases and a reduction in tariff complexity would help to provide resources for the companies and to remove the non-transparencies that raise costs to users. Billing, collection, and high water losses could be improved substantially, again providing greater resources while serving more consumers. In all these areas, private participation could be increased, but significant benefits to the public would come only from a more transparent, competitive framework.

42. **Transportation.** To date, overall transport capacity has kept pace with increasing demand, although bottlenecks and traffic congestion are becoming problems in areas that have experienced rapid economic growth. Costs in the transport sector continue to be pushed up by non-competitive, non-transparent procurement by state entities and by late payments to contractors (which they offset by raising bids). Costs also are raised by regulations on procurement that prevent use of low cost suppliers and by various fees—legal an illegal—that are charged for movement of goods.

43. For urban roads, the top priority is a transparent, competitive bidding process for private services, notably for toll road construction and operation. As in other sectors, there are wide possibilities for improving service through an expanded private sector role, if the processes for contracts and concessions can be improved. Another important step would be better pricing policies, for example, congestion pricing and higher parking fees in the larger cities and user charges to cover the full cost of road maintenance and operations. Implementation of the phase-out of leaded gas throughout the country would improve welfare and reduce health costs. More deregulation of bus service would also be helpful. Finally, improved traffic management and focussing public investments to relieve the most critical bottlenecks would contribute to reducing the costs of congestion and pollution.

44. For inter-urban roads, the solutions are more conventional: more funding; an expanded, transparent role for the private sector; and better institutional absorptive capacity, notably more competitive bidding and integration of services (*e.g.*, the toll and non-toll arterial road network and competing rail services). In railroads, which have a bright

future because of Java's high population density, the Government has embarked on a program of reforms, which needs strong execution. Unsolicited proposals from well-connected parties should not be allowed to de-rail implementation. For maritime transport, important concerns are reregulation and bureaucratic obstructionism; careful monitoring of the success of the new customs system is of special concern in this regard. Port facilities and regulations, as well as shipping regulations and restrictions on vessel imports, tend to raise costs of inter-island shipping, thereby slowing national integration and limiting prospects of off-Java development.

E. Building "Soft" Infrastructure

45. Continued improvement of soft infrastructure (the policy and institutional environment) is critical to international competitiveness, rapid growth and improved equity. This concern for soft infrastructure includes: an incentive framework that encourages competition among producers; a competitive, transparent framework for government contracts and concessions; and issues of performance of the government and the legal system. International and domestic trade regulations, uncertainties related to the business environment and the legal framework, and *ad hoc* government interventions work against efficiency, international competitiveness, and equity.

46. **Re-establishing Momentum in Deregulation of International Trade.** Despite attention attracted by the National Car policy, significant announcements of deregulation in international trade were made in 1996. Of these, the most important was the June tariff package. Also in 1996, controls were eased on imports of soybean cake, used fishing vessels, and nine other tariff codes. Unfortunately, there has been slippage in implementation of some of these measures. For example, about 800 of the announced tariff cut were not implemented on schedule. Likewise, within a few months of lifting the ban on imports of used fishing vessels, costly local content regulations were effectively put in place.

47. To restore momentum, the tariff cuts need to catch-up with their announced schedule and, indeed, there were encouraging signs in this regard just before mid-1997. Once the announced cuts are back on-schedule, next steps will entail implementation of announced cuts through 2003—without succumbing to pressures for selective delays or exemptions, which will be important for international competitiveness and investor certainty.

48. Progress on the unfinished trade deregulation agenda would also help to improve competitiveness and income. For example, there are still significant quantitative controls on imports, including many agricultural products. A large number of non-oil exports are subject to some form of tax or restriction. Lifting these would boost non-oil exports and efficiency. Lower prices of some agricultural products, such as sugar and wheat, would provide cheaper inputs for agro-industry and increase real wages and equity. In addition, reducing protection on sectors such as vehicles, chemicals, metal products and agricultural commodities would encourage efficiency and productivity growth. Finally, taxation of goods used by high income consumers—such as cars—or socially undesirable goods like alcohol, would be more effective if taxes, rather than tariffs were used. The social goals are of no less importance if the good is produced locally.

49. **Making Progress on Domestic Deregulation.** Despite efforts, only modest improvements have been made in the complex web of domestic restrictions, fees and levies. Disentangling this web could usefully begin with lifting restrictions on intra-island trade, which often reduce prices of exports from the poorer regions of Indonesia. Similarly,

retribusi taxes and restrictions on agricultural trade result in lower farmgate prices and higher consumer costs, which reduce real incomes of the farmers and in the outer islands.

50. Managing natural resources presents many challenges to the Government. Depletion has become a threat in areas like oil, forestry, and water. Environmental degradation has become a problem. Government also is responsible for ensuring that the public at large, including future generations—not a few private individuals—benefits from public ownership of the nation's resources. The Government has responded with a variety of policies, ranging from fairly transparent auctioning of concessions in the case of oil, to moderate taxes and royalties in the case of forestry and mining, to a largely hands-off policy for water resources, to setting up of an environmental protection agency that uses a variety of instruments to improve the environment. Although progress has been made, further efforts are needed to meet the challenges of managing natural reserves. These include, improvements of property rights (for example, land titling), more transparent, competitive auctioning of natural resource concessions, higher royalties (for example, IHH), and performance bonds to protect the environment in forestry concessions.

51. **Strengthening Financial Institutions.** Progress has been made in strengthening the financial system during the past year or so. For instance, many banks have significantly increased their capital; reported classified assets continue to decline in relation to total credits; management has changed at several banks; and important new products (*e.g.*, open-ended mutual funds) have entered the markets. Also, the open capital market continues to add significantly to the competitive nature of the sector. Nevertheless, by international standards Indonesia's financial sector remains relatively weak, which contributes to the high cost of financial intermediation. There is continuing concern that the financial system, in its present state, would not act as an adequate shock absorber in the event of some macroeconomic shock.

52. Building on recent improvements, a different strategy would help to address the financial system's weaknesses. On the side of Bank Indonesia, stricter supervision is needed, including a series well-defined thresholds for progressive intervention by Bank Indonesia in weak banks (*e.g.*, for temporary liquidity support and to facilitate mergers, takeovers and closures). For the state banks, high-level political support is needed to assist with collection of their bad debts, as well as more effective sanctions against bad debtors. Ultimately, the only real solution will be full privatization of the state banks; partial privatization is a step forward, but—on it's own—is unlikely to lead to significantly improved performance. Other, interim measures are likely to be necessary to improve state banks' corporate governance and performance, e.g., closures, mergers and downsizing, perhaps in conjunction with "unbundling" and sale of some activities.

53. For the private banks, stricter enforcement is needed of key prudential regulations (for instance, automatic, stricter penalties for under-capitalization and excessive loans to related parties, etc.). Banks that do not maintain sufficient capital (after adequate provisioning for bad debts) should be closed-down before insolvency occurs. A sizable, phased increase in capital requirements for non-foreign exchange banks would force consolidation. Spontaneous consolidation would be facilitated by clarification of the circumstances under which new capital, foreign and domestic, can buy into troubled domestic non-foreign exchange banks.

54. **The Legal Framework.** The Government recognizes the problems created by the legal system's low credibility and

predictability as a means of dispute resolution—including the problems in protecting the underprivileged—and reform efforts are underway. Priorities for the reform effort include: i) strengthening national commitment to the rule of law and an effective, independent judicial system; ii) institutional reform, such as improved screening, accreditation boards and professional standards for legal professionals. iii) modernizing laws, with widespread participation of interested parties; and iv) strengthened human resources.

55. **Governance Issues.** In surveys of businessmen, Indonesia gets high marks for criteria such as little "risk of expropriation with no compensation". However, the same surveys consistently rank Indonesia low on "bureaucratic delays" and "contract enforceability". Such factors increase uncertainty and risk. They favor the well-connected over the efficient. They inflate costs. They engender cynicism and perceptions of unfairness. And they make it difficult to do legitimate business. To be sure, these perceptions have not impeded growth or foreign investment in recent years. Nonetheless, to keep pace with other successful countries, and to improve its image in this regard, Indonesia will need to address this issue sooner or later.

56. Other countries have found some partial solutions, for instance: an independent judiciary; a civil service pay structure that rewards merit and honest effort; credible penalties for malfeasance; policy reforms to reduce the discretionary authority of government officials; and greater accountability for poor performance or abuse of power. The World Bank's international experience suggests that improved governance will depend on widespread local support and commitment—at all levels—both in terms of leadership and actions.

1
MACROECONOMIC DEVELOPMENTS AND POLICIES: MANAGING SUCCESS AND REDUCING RISK

A. Overview

1.1 On the basis of broad macro economic indicators, the Indonesian economy is currently performing very well. Real growth continues strong; overall inflation is down; external confidence is high; foreign direct investment is robust; the external current account continues to be financeable; the external value of the rupiah has been little changed in almost a year; and international reserves are up sharply. Continued sound macro policies have played an important role in achieving these results.

1.2 More careful scrutiny of the data gives reason for pause. Core inflation remains high; certain administered price adjustments are being delayed; private external debt is increasing rapidly; the growth of non-oil exports has declined markedly; and high international oil prices have been masking weakness in the current account. Also, adverse developments in neighbouring countries could spillover into Indonesia; there is increasing dependence upon volatile capital flows; common local practices are coming under increasing international scrutiny; and financial markets continue to assign high risk to rupiah-denominated assets. In the meantime, time-tested policies (such as deregulation) are losing their edge, while the quality of growth—including fairness—remains a concern for the great majority of the nation.

1.3 This Chapter looks at some of these issues from a macroeconomic perspective. Three basic points emerge. First, overall demand management is sound, but the mix of fiscal and monetary policies is contributing to several of the problems noted above. In particular, reliance upon monetary policy to maintain macro stability has attracted capital inflows that have tended to appreciate the currency. This has contributed to reduced external competitiveness. This problem could be reduced by easing monetary policy while concurrently compensating with tighter fiscal policy to keep the pace of economic expansion under control. Second, several of the options for raising fiscal revenues would be of assistance in achieving other important objectives (*e.g.*, improved equity and human resource development, decentralization, regional development, and stronger institutions; Chapters 2-5). Third, strengthening many other policies (for instance, deregulation policy, debt management, wage policy, and financial regulation) would support this process.

1.4 The remainder of this Chapter begins with a review of economic developments (domestic and external developments in Sections B and C, respectively). These Sections identify the sources of some of the risks in the present economic situation, and look at possibilities for reducing the riskiness of the current environment. After examining some details specifically related to fiscal (Section D) and monetary policy (Section E), the overall outlook for policies is summarized in the Section F. The Chapter ends with a brief review of the short-term outlook, including comments on donor assistance (Section G).

B. Domestic Economic Developments

B.1 Real Output and Expenditure

1.5 Real output increased by 7.8% in 1996, a moderate slowdown from 8.2% in 1995. The driving force behind the on-going robust growth continues to be the private, urban economy (that is, GDP excluding oil & gas, agriculture and public administration; see Table 1.1). This sector, which now represents more than two-thirds of the economy, has been

expanding at double-digit rates for almost a decade.

1.6 Among the industrial components of GDP, construction slowed in 1996 as evidenced, for example, by lower growth of cement consumption and by credit extended for property development (Section E). Manufacturing also slowed, reflecting weaker growth in several non-oil exports (Section C) and a decline in auto sales.

1.7 Among the primary sectors, agriculture growth declined—despite another good harvest—compared to the unusually high rate of expansion recorded in 1995. In the mining sector, the level of Oil & Gas production recovered in 1996. The LPG industry had a new refinery (Sumbagut) come on-stream as well as major expansion at an existing (Arar) refinery. Oil production continues essentially flat. Non-oil & Gas mining (especially copper and coal) slowed appreciably from the rapid pace of the past several years, although gold production expanded robustly. In tertiary industry, private services continued to increase rapidly, driven by strong growth in financial services, the hotel and restaurant category, and new services, such as franchising; all reflect the strong external interest (*e.g.*, tourism and business travel) in Indonesia at the present. (Further discussion of the financial services industry is provided in Chapter 5.)

1.8 Several factors appear to account for the lower growth in GDP. The growth of non-oil exports declined (Section C), and the stimulative impact of the 1995 tax cuts was wearing-off. Also, uncertainty occasioned by the development of a national car may have caused auto sales to drop early in the year. In addition, market signals probably contributed to a temporary slowdown in property development (Box 1.1). Monetary policy also played a role; increased capital requirements and continued high real interest rates helped to slow lending, supported by Bank Indonesia's "moral suasion" (Section E).

Table 1.1: Real Growth in Output
(1993 prices, change in % per annum)

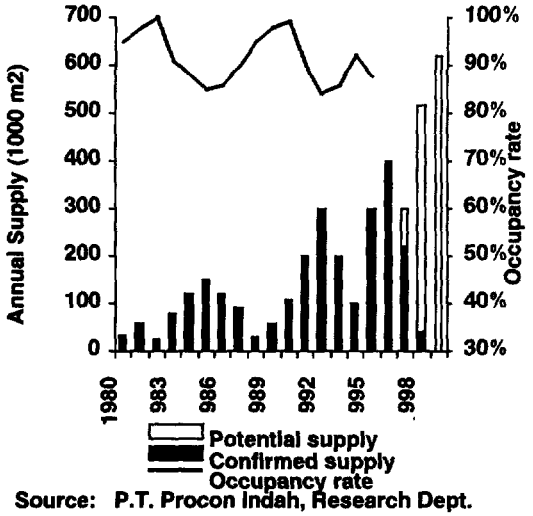
	Share in 1995	*1988-91*	*1991-94*	*1995*	*1996*
GDP	100.0	9.0	7.3	8.2	7.8
Agriculture	16.1	3.6	2.8	4.2	1.9
Oil & Gas	8.7	6.7	0.8	-1.4	0.9
Public Admin.	6.0	4.5	2.1	1.3	1.1
Other	69.2	12.0	10.3	11.3	10.7
of which:					
Manufacturing	21.3	12.0	12.6	13.0	12.0
Construction	7.6	15.0	13.9	12.9	12.4
Utilities	1.1	13.7	10.8	15.5	12.6

Box 1.1: The Property Market

The property market in and around Jakarta has been booming for several years (Box 1.2 in World Bank 1995a). The extended nature of the boom has raised concerns of sustainability. There is a risk that a reversal could hit Indonesia's still-weak banking sector (Chapter 5), and be the trigger for an economic downturn.

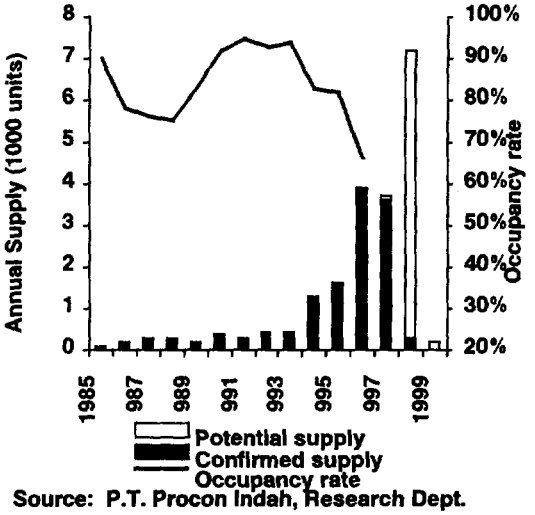
Occupancy rates are already on the decline in key parts of the property market,[1] and much more capacity is projected to come on-stream in the next few years. Rental rates in prime locations are under downward pressure, leaving them little changed in real terms over the course of the past half decade or so.

Market Indicators for Prime Office Space



Source: P.T. Procon Indah, Research Dept.

Market Indicators for Rental Apartments



Source: P.T. Procon Indah, Research Dept.

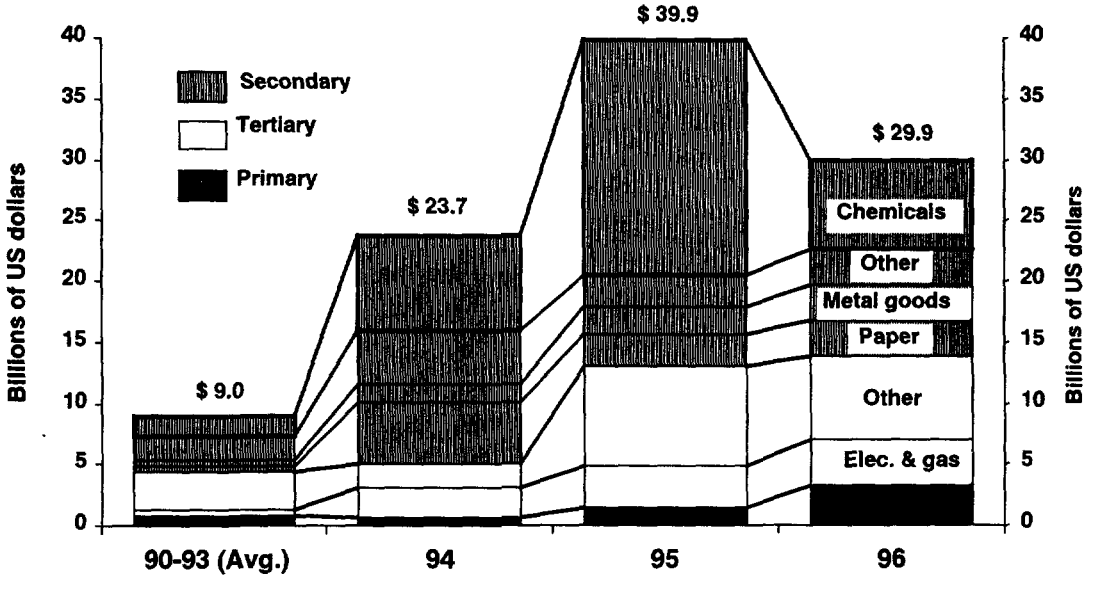
Implications for Policy. To keep this boom under control, the central bank has kept lending rates high, stepped-up supervision of banks' exposure to the property sector, and strengthened "moral suasion" (Section E). For its part, the Ministry of Finance has introduced taxes (and recently raised the rate) on transfers of land and building titles, and on luxury residences. Also, the Government has stopped issuing new land licenses for housing projects in the greater Jakarta area. Nonetheless, credit extended to this sector has picked-up since mid-1996, and banks' exposures continue to increase. Other measures could be taken to reduce risks, as has been done elsewhere in the region (Malaysia, Singapore, Hong Kong and the Philippines). For example, the Government could also increase property taxes of one form or another, preferably by a substantial margin. Two other steps would also be helpful in this context: i) initiate stronger actions (Chapter 5) to strengthen the banking sector; and ii) reiterate at every opportunity that responsibility for private sector debts will not be assumed by the public sector in the event of a downturn.

[1] There are no official data on occupancy rates for the property market. These data are available courtesy of the Research Department of P.T. Procon Indah, property consultants and analysts based in Jakarta.

1.9 On the expenditure side of the national accounts, growth of consumer demand declined, especially consumer durables. For example, motor vehicle sales were down 15% compared with an increase of 18% in 1995. Among the other categories of expenditure, exports also slowed (Section C, below), while investment spending continued very strong.

1.10 **Future Investment Indicators.** Foreign (PMA) investment approvals —excluding chemicals—continued to rise in 1996, by 10% in US dollars (by 26% in number of projects). The 1995 data for the chemicals sector were inflated by some large petro-chemical projects that were known to have dim prospects for implementation (paras 1.44 and 1.45 of World Bank, 1996). The average size of projects has fallen markedly in 1996, to around $30 million compared with over $50 million in the past two years. There were only 3 very large projects approved through 1996, versus 11 in 1995 and 6 in 1994. As indicated in Figure 1.1, there was a good distribution of projects among economic sectors, and their export intensity seems roughly unchanged (after allowance for the petro-chemical projects noted above). By major country of origin, more investment is being made by Japan, Singapore and Korea, whereas the value of approvals originating in the United States and the United Kingdom is down.

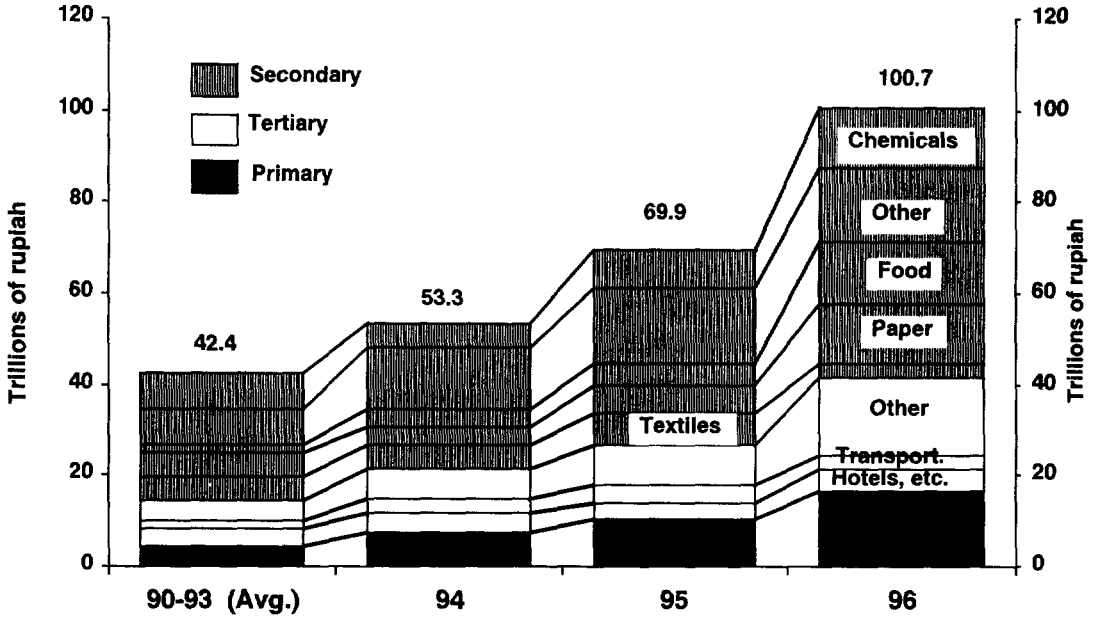
Figure 1.1: Approvals of Foreign Investment by Sector



Sources: BKPM.

1.11 Domestic (PMDN) investment approvals also expanded robustly in 1996, by almost 40% in real terms (Figure 1.2). Export intensity surged; the number of projects was up about 5%; and the average size was up nearly 40%. Expansion was especially strong in Plantations (up more than 120%); Pulp and Paper (110%); Food (165%); Electricity & Water (460%); and Housing (85%). Of these, Pulp & Paper and Food are heavily export-oriented. Among industries not doing well in 1996, the value of approvals for Fisheries, Wood Products and Textiles are all down about 50% while Forestry attracted virtually no new projects in 1996, compared with almost Rp.1.5 trillion in 1995.

Figure 1.2: Approvals of Domestic Investment by Sector



Sources: BKPM.

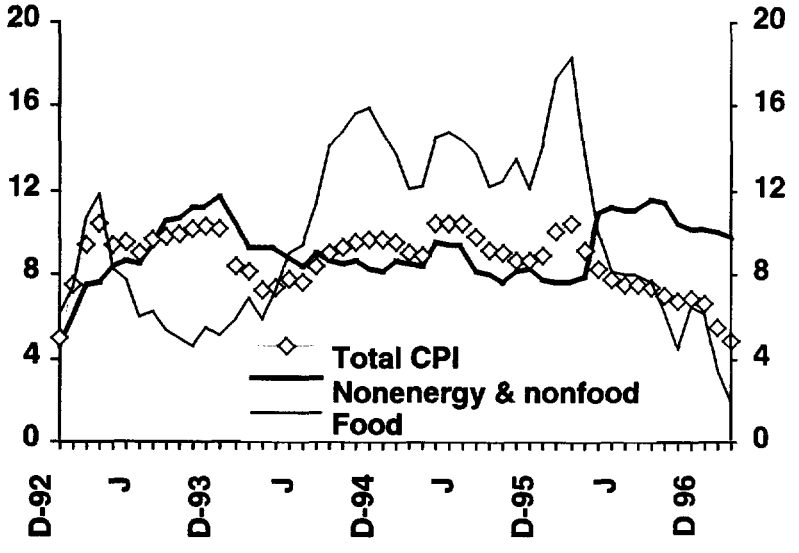
1.12 Investment approvals are only a leading indicator of economic activity; real activity depends upon investment realizations (Box 1.2 in World Bank, 1996a). Historically, only about 40-50% of approvals are ever realized and, in the next few years, this percentage is likely to be lower owing to the petro-chemical projects mentioned earlier. Sustaining high levels of investment approvals and realizations will entail several inter-related steps that are discussed elsewhere in this Report: maintaining macroeconomic stability; further deregulation, particularly as regards non-tariff barriers and domestic restrictions (Chapter 5); introducing a more transparent framework for private provision of infrastructure (Chapters 2 and 4); and addressing economic issues related to governance (Chapter 5).

B.2 Inflation

1.13 **Consumer Prices.** Inflation as measured by the overall consumer price index, came down significantly during 1996, and it dropping further in the early months of 1997 (Figure 1.3). In December 1996, the 12-month increase was 6.6% compared with 9% a year earlier. (On this measure, inflation is slightly higher than on the measure normally used by the Indonesian authorities. They use the sum of monthly increases, which excludes compounding. On this basis the increase was 6.5% during 1996.)

1.14 Several characteristics of this decline suggest that it may be temporary. First, food prices were the major factor accounting for the decline; they slowed sharply from more than 14% during 1995 to 6% during 1996. Second, overall inflation is being held down by electricity and domestic fuel prices, which are overdue for a price adjustment (Section D and Chapter 4). And third, the core rate of inflation (*i.e.*, excluding food and energy) actually rose during 1996 (Figure 1.3), owing

Figure1.3: Consumer Price Index
12-month % Change



in part to an increase in administered prices of transportation fares in April.

B.3 Labor Markets

1.15 **Update on Labor Markets.** Issues in this sector were discussed in detail in Chapter 3 of World Bank, 1996a. This Section provides an update of recent developments together with some policy implications.

1.16 **Labor Supply and Demand.** Indonesia has begun to experience major changes in the factors underlying labor supply. Most importantly, the rate of growth of population—and population of working age—has slowed markedly since the 1970s (Table 1.2). Nevertheless, the growth rate of the labor force has increased, reflecting an increase in estimated participation by women in the work force. Regionally, there are sharp differences in the rates of labor supply growth between Java and the Outer Islands. On Java, during the 1990s, the population growth rate has declined to 1.3%, and the working age population growth rate to 2.1%. In the Outer Islands, the demographic transition has been slower: the corresponding rates are 2.1% and 3.0%.

1.17 On employment, three trends have been important during the 1990s (Table 1.2). First, there has been an absolute decline in employment in agriculture, which is often interpreted as an important indicator of labor market tightening. Second, employment in the services sector has rebounded in the 1990s. And third, there has been relatively slow growth of manufacturing employment in the 1990s. Within manufacturing, the slower growth reflects a change in the composition of output and investment away from the more labor-intensive industries—especially the textile, clothing and footwear industries —towards more capital-intensive industries (chemicals and non-metallic minerals). This

trend seems likely to continue as evidenced by the pattern of recent investment approvals (see preceding sub-section).

Table 1.2: Labor Market Trends
(% change, at annual rates)

	1971-80	*1980-90*	*1990-95*
Total Pop.	2.3	1.9	1.7
Working Age Pop.	2.8	2.5	2.4
Employment:	3.0	3.2	2.2
Of which:			
Agriculture	1.2	2.1	-0.6
Manufacturing	4.7	5.6	4.1
Trade	4.9	4.6	5.3
Transport	4.9	5.8	5.4
Services	6.3	2.7	4.9

Source: BPS.

1.18 While the trend of unemployment is difficult to determine (Box 1.2), all data sources provide a fairly consistent picture of the structure of unemployment. Unemployment rates in Indonesia are higher, on average, for the young, the educated, females and workers off-Java, especially in Sumatra and Sulawesi. Overall, this structure of unemployment has remained remarkably stable over time. Nevertheless, during the mid-1990s, there has been a rise in unemployment rates among primary and lower secondary graduates aged 15-24 years, especially among the females. It is precisely this group that would have been drawn into the labor market by the prospect of higher wages in the manufacturing industries. It is also likely to be most affected by the slow-down of growth in investment and employment in the labor-intensive sectors, as discussed above.[1]

1.19 **Wages.** Two major shifts occurred in the 1990s. First, real wages began to rise in a number of sectors; and second, Government intervention rose, especially to increase (and enforce) minimum wages. The higher real wages primarily reflect the labor market tightening and transitions mentioned above. This said, it is likely that in certain regions and certain industries, the minimum wage hikes have contributed to the rapid rise in average wages.

1.20 Between 1989-95, minimum wages on average tripled in nominal terms and doubled in real terms. In 1996, they effectively increased by another 30%, in a manner that led to confusion in implementation.[2] Labor-intensive sectors were particularly hard hit by this hike and the trade Associations for various manufacturing sectors—shoes, textiles, toys, wooden panels, and so forth—appealed for delays and exemptions. In the end, the Ministry exempted 215 companies from the minimum wage regulations in 1996. However, the circumstances contributed to greater labor unrest—some 800 labor disputes were reported in the Greater Jakarta area alone, many of them caused by the refusal of factory management to implement the new minimum wage regulations. The number of labor strikes and demonstrations increased by 22% between 1995 and 1996, partly due to the minimum wage issue.

1.21 In early 1997, the Government announced a 10% increase in (average unweighted) minimum wages. In the heavily industrialized areas of West Java, the increase was only slightly higher, 10 1/2%. By recent historical standards (see above) this is moderate; in itself, this increase should be approximately off-set by productivity increases and inflation. However, this year's announcement seems to have extended minimum wages to daily casual workers, which were previously a safety-valve for some companies.

Box 1.2: Measuring Unemployment in Indonesia; Sources and Issues in Interpretation

In mid-1996, new survey data (SUPAS) indicated an unemployment rate for 1995 that was significantly higher than previous estimates (Table A). This triggered concern in some quarters that there had been a sharp rise in unemployment and that special "employment-generating" initiatives were needed to alleviate the situation. For others, the survey results were difficult to believe because they would have implied that the unemployment rate had tripled between 1990 and 1995, a period of rapid economic growth. The evidence (see below) favors this latter, skeptical view; subsequent data (SAKERNAS and SUSENAS, 1996) confirm that SUPAS is a statistical aberration.

There are four sources of unemployment statistics in Indonesia: i) SAKERNAS, the National Labor Force Survey conducted annually with a sample size of about 65,000; ii) SUSENAS, the National Socio-Economic Survey of Households conducted annually with a sample size of about 200,000; iii) the Population Census, done every 10 years at the beginning of a decade (with a 5% sample taken of more detailed data, including labor force statistics); and iv) SUPAS, the Intercensus Survey, done every 10 years at the mid-point of a decade with a sample of 200,000. Each produces different estimates of unemployment (Table A).

There are several good reasons why these surveys produce different estimates of unemployment. First, as noted, the sample size is different for each survey. Second, there are differences in training and quality of surveyors. For example, SAKERNAS and SUSENAS generally use trained statisticians or employees of the National Bureau of Statistics; the Census and SUPAS often rely on temporary workers (who are trained for the task and let go after the task is completed). Third, there are differences in the timing of the Surveys (SAKERNAS is undertaken in August; the Census and SUPAS in September/October; and SUSENAS In January/February). This is important because evidence indicates that unemployment in Indonesia is largely transitional in nature, consisting primarily of school-leavers who are looking for their first job.

Table A: Unemployment Rates from Alternative Sources (in % of labor forces)

	SAKERNAS	*SUSENAS*	*CENSUS*	*SUPAS*
1986	2.6			
1987	2.6			
1988	2.8			
1989	2.8			
1990	2.5		3.2	
1991	2.6			
1992	2.6	4.6		
1993	2.8	4.6		
1994	4.4	5.2		
1995		5.4		7.2
1996	4.9	5.1		

More importantly, some of the surveys have asked significantly different questions regarding both labor force participation and unemployment. The Census and the early years of SAKERNAS ask a tightly focussed question that implies a narrow definition of unemployment (Table B). This yields unemployment rates that are appreciably lower than the more general question asked by the other sources.

Table B: Survey Questions

Asked of Those Looking for Work	**Data Source and Years**
1. Did you look for work last week?	1990 Population Census; 1986-93 SAKERNAS
2. Are you looking for work?	1995 SUPAS, 1992-96 SUSENAS, 1994,96 SAKERNAS

continued ....

continuation

Which is more reliable? Despite its relatively small size, SAKERNAS has much to recommend it. It is a narrowly focussed survey, with only 20 questions, all of which concern labor market statistics. Of these 20 questions, 6 are devoted to determining, probing and confirming the unemployment status of the respondent. By contrast, the other three surveys are much longer (*e.g.*, SUSENAS records expenditures on more than 300 items, but only 1 question concerns unemployment); none probe any further.

Its clear from the above that data from different sources are not comparable. To examine trends, it is important to look at data from the same source over time. For many years, SAKERNAS provided this, with a known break in 1994 (when the question changed; see Table B). It is unfortunate that SAKERNAS was not undertaken in 1995, a SUPAS year, as this would have provided a base for comparability.

Policy Implications. The high estimate of the unemployment rate implied by the 1995 SUPAS is not consistent with other recent estimates of unemployment nor other indicators of economic activity. In addition, the implied jump in the unemployment rate in 1995 results from lack of comparability with other sources. Subsequent data confirm that it is a statistical abnormality.

This is not to imply that Indonesian policymakers do not need to worry about unemployment. It is well understood that if economic growth--especially in the formal sector--were to slow significantly for an extended period, open unemployment would become a serious social problem. But this should not be confused with quirks of data and changing methodologies in collecting data.

1.22 **Labor Markets Policies.** The most effective policies for generating more jobs would be further deregulation of labor-intensive industries as well as industries that provide inputs into labor-intensive industries (Chapter 3 of World Bank 1996a). In the short-term, rises in the real minimum wage should be limited to productivity increases, especially in the labor-intensive sectors, as Indonesia is likely to need low-skilled labor intensive manufacturing jobs for some time (Chapter 3). Over the medium-term, direct government intervention needs to be replaced by a better means for giving workers a stronger voice in wage and employment negotiations (Box 1.3 and World Bank, 1996a, Chapter 3).

C. External Economic Developments

C.1 Balance of Payments

1.23 **Pressures for a Larger Current Account Deficit were Dampened by Higher Oil Prices.** The current account deficit increased to $8.1 billion (3.5% of GDP) in 1996/97, as unexpectedly high oil and gas prices offset half of a rise of $2.3 billion in the non-oil deficit (Table 1.4). Oil and gas exports rose to $12.6 billion, reflecting high international prices. However, the non-oil & gas current account deficit widened from $10.5 billion in 1995/96 to $12.8 billion in 1996/97. The trade surplus fell by $400 million, to $1.4 billion in 1996/97 as higher oil prices were offset by weaker prices for other export commodities and slower growth of non-oil exports (paras 1.25 to 1.27). Net factor payments increased by $700 million as continued growth in tourism receipts was insufficient to offset high profit remittances and continued large interest payments.

1.24 A net capital account surplus financed the $8.1 billion current account deficit plus a

Box 1.3: The Costs of Delay in Building Institutions for Improved Labor Relations: The Case of Korea

International experience in developing and developed countries alike suggests that--after a certain level of development is reached--countries need to put in place a modern system of industrial relations. Failure to do so at a relatively early stage can lead to serious costs later on. The Republic of Korea is an example of this experience.

After years of tight government control, the number of strikes in Korea began to increase enormously in 1987 at great cost to the economy. Disappointingly low growth in 1989 was attributed to appreciation of the currency and to large wage increases, workplace stoppages, and labor productivity declines attributable to labor strife. The surge in workforce militancy after 1987 pushed up labor costs much faster than competitors' (Table A). Despite relatively low income per capita, by 1990 labor costs in Korean manufacturing had risen to the point where they were virtually identical to Singapore and Taiwan, China and much higher than Hong Kong.

Table A: Hourly Compensation Costs in Manufacturing
(US dollars)

Year	USA	Japan	Rep. of Korea	Hong Kong	Singapore	Taiwan, China
1986	13.25	9.31	1.34	1.88	2.23	1.73
1987	13.52	10.83	1.65	2.09	2.31	2.26
1988	13.91	12.80	2.39	2.40	2.67	2.82
1989	14.31	12.63	3.29	2.79	3.15	3.53
1990	14.77	12.64	3.82	3.20	3.78	3.95

The cost of these wage increases far outstripped productivity increases leading to a dramatic increase in unit labor costs. Korea's performance in the late 1980s compares unfavorably with its two most important competitors, Japan and Taiwan, China (Table B).

Table B: Unit Labor Costs in Manufacturing
(1986 = 100)

Year	Nominal Wages			Labour Productivity			Unit Labour Costs		
	Korea	Japan	Taiwan, China	Korea	Japan	Taiwan, China	Korea	Japan	Taiwan, China
1987	112	103	110	103	109	111	109	94	100
1988	134	104	122	110	116	116	121	90	105
1989	167	110	140	110	121	127	151	91	110
1990	201	115	159	120	125	138	168	92	115

Source: "Involving Workers in East Asia's Growth: Regional Perspectives on World Development Report 1995," The World Bank 1996.

$3.9 billion increase in reserves. Foreign direct investment (FDI) in projects rose to $6.5 billion (though about 70% of this is estimated to be private sector borrowing). Debt prepayments, combined with modest disbursements, have resulted in negative net external borrowing by the central government ($-0.7 billion). Portfolio inflows (of $3.1 billion) plus Net Other Capital (the residual; also $3.1 billion), amounted to $6.2 billion, up from $4.4 billion in 1995/96. Official reserves rose to $20 billion (equivalent to 4.7 months of merchandise imports).

1.25 **Merchandise Trade.** Non-oil & gas export growth and import growth both fell quite sharply from the relatively high rates of 1994/95 and 1995/96. On the basis of Bank Indonesia's Balance of Payments data, import

Table 1.4: Balance of Payments
(US$ billion)

	1992-93	*1993-94*	*1994-95*	*1995-96*	*1996-97*
Merchandise Exports (FOB)	35.3	36.5	42.6	47.8	52.2
Oil & Gas Exports	10.5	9.3	10.5	10.6	12.6
Non-Oil & Gas Exports	24.8	27.2	32.2	37.1	39.6
Merchandise Imports (CIF)	-30.2	-32.3	-38.8	-46.0	-50.8
Oil & Gas Imports	-3.8	-4.8	-4.0	-4.3	-4.8
Non-oil & Gas Imports	-26.4	-28.1	-34.8	-41.7	-46.0
Trade Balance	5.1	4.2	3.8	1.8	1.4
Interest Payments (M&LT)	-3.8	-4.1	-4.3	-4.9	-5.3
Transfers and Other Services	-3.9	-3.0	-3.8	-3.9	-4.2
Net Services and Transfers	-7.7	-7.1	-8.1	-8.8	-9.5
Current Account Balance	-2.6	-2.9	-4.3	-7.0	-8.1
Oil & Gas Account	4.2	2.6	4.0	3.5	4.7
Non-Oil & Gas Account	-6.8	-5.5	-8.2	-10.5	-12.8
Capital Account Balance	7.4	3.2	4.9	9.6	12.0
Net Disbursements of Public M&LT Debt	1.8	1.4	0.1	-0.2	-0.7
Disbursements	7.1	7.0	5.7	5.7	5.4
Amortization [b]	-5.3	-5.6	-5.5	-5.9	-6.1
Foreign Direct Investment	1.7	2.0	2.6	5.4	6.5
Portfolio Investment [a]	n.a.	n.a.	2.3	3.3	3.1
Net Other Capital (residual)	3.9	-0.2	0.1	1.1	3.1
Change in Official Reserves (- = increase)	-4.8	-0.3	-0.6	-2.7	-3.9
Memo Items:					
Current Account Balance/GDP	-1.8	-1.8	-1.9	-3.3	-3.5
M&LT Debt Service [b]/Exports (GNFS)	29.1	31.6	28.2	30.0	31.1
Terms of Trade (1993=100)	101.0	100.0	104.9	106.5	108.4[c]
Official Reserves - (US$ billion)	12.0	12.7	13.3	16.0	19.9
- Months of Imports	4.8	4.7	4.2	4.3	4.7

[a] Includes sales of public asset being privatized offshore.
[b] Includes prepayments.
[c] The improvement in oil prices in 1996 was partly offset by a decline in the non-oil terms of trade.

Source: Bank Indonesia, Biro Pusat Statistik, and World Bank staff estimates.

growth slowed from 18.6% to 10.4%, while non-oil & gas export growth slowed from 15.2% to 6.6%, when measured in US dollars. This slowdown is not unique to Indonesia, but has been common throughout much of East Asia. In Indonesia's case, it stems from a number of factors, including weaker prices for copper, other minerals, coffee, seafood and vegetable oil. On average Indonesia's non-oil export prices fell by almost 4% in 1996/97; volumes rose by a respectable 10.5%. Wage pressure, loss of momentum for deregulation and a real appreciation of the Rupiah, may have weakened export growth.

1.26 On the basis of BPS data, non-oil export growth in dollars was 9.0% in 1996 (down from 15.1% in 1995) while oil & gas exports rose by 9.7% (Table 1.5)[3]. The volume of oil & gas exports continued its decline of recent years, but this was more than offset by higher prices. Among non-oil exports, the most rapidly growing categories were electrical goods (which experienced a rise in growth to 28% versus a fall in much of Southeast Asia), plastic and plastic products, vegetable oil, processed food, "other manufactured goods", and copper. These items alone accounted for 75% of the total increase in non-oil exports. Plywood exports increased by 4% due to a price recovery that more than offset a decline of about 4% in volume. Textile, clothing and footwear exports all grew slowly, at 5-7%. Seafood suffered a decrease due to a fall in the price and quantity of shrimp exports following infestations in some "farms". Three items stand out in terms of consistently strong export growth in each of the last three years—mining (copper and coal), electrical goods, and "other manufactured goods". This growth is broadening the export base and reducing reliance on oil & gas, forest-based goods, and textiles, footwear and clothing.

1.27 BPS data indicate a very sharp drop in import growth, from 27% in 1995 to 6% in 1996.[4] The growth of intermediate good imports, which account for about 70% of imports, fell to 2.3%,[5] to some extent reflecting demand management policies. Consumer good imports continued to grow rapidly, but they are still a relatively small share of total imports (10%). Passenger vehicle imports (part of consumer goods) rose sharply, partly reflecting the national car policy. Imports of machinery and equipment grew 13%. This is consistent with the rise in FDI and is not necessarily a matter of concern. Much of growth in capital good imports is due to FDI in the free trade zones and hence is export oriented and would not occur without concurrent FDI financing.

1.28 **The Widening Current Account Deficit and Economic Policy.** Indonesia's widening deficit increases the risks of a sudden shift in volatile foreign finance. However, this risk is lessened by the extent to which the current account deficit is investment induced, rather than consumption driven. So far Indonesia's widening deficit seems largely to reflect increased investment, especially FDI. The increase in the current account deficit over the past two years is roughly the same as the increase in FDI. With much of the imports accompanied by FDI financing, and with investors motivated in part by projects' international competitiveness, potential adjustment problems are reduced.

1.29 Containing the risks will involve, first, keeping the current account deficit within reasonable limits by using tighter macroeconomic policy to offset and dampen any boom in private spending. This will automatically free-up goods for export and contain imports to roughly the increase in exports plus foreign direct investment. Second, use of shock absorbers (*e.g.*, a wider exchange rate band and adroit monetary policy) will dampen volatile flows. Third, a different mix of macroeconomic policy—less reliance on high interest rates, more reliance on tight fiscal

Table 1.5: Export Growth

Sector/Commodity	*Growth (% in $s)*			*1996 Exports*
	1994	*1995*	*1996*	*($ billion)*
Oil & Gas Exports	-0.5	8.0	9.7	11.7
Non-oil & Gas	12.1	15.1	9.0	38.1
Mining	23.6	48.8	11.6	3.1
o/w: Copper	23.5	79.3	13.7	1.7
Coal	27.6	26.1	8.5	1.1
Agriculture	22.7	2.5	0.9	2.9
o/w: Seafood	8.3	6.0	-1.0	1.4
Manufacturing	10.3	14.1	9.5	32.1
Plywood	-12.0	-6.9	3.9	3.6
Pulp & other wood products	16.6	27.9	0.1	2.0
Gold & mineral products	53.5	6.3	5.1	2.3
Chemicals (incl. fertilizer)	27.1	50.2	-0.6	0.8
Plastic & plastic products	8.7	85.6	27.7	0.6
Paper & paper products	34.7	22.0	-5.6	1.0
Rubber products	30.9	57.5	1.6	2.2
Vegetable oil	60.3	-7.4	32.5	1.4
Processed food	10.1	0.7	17.5	1.0
Garments	-8.1	5.0	5.5	3.6
Other textiles	-3.7	9.0	5.7	2.9
Footwear	13.7	8.8	6.8	2.1
Furniture	17.0	10.2	10.0	0.9
Electrical goods & computers	40.6	19.1	28.4	4.0
Other manufacturing	7.4	24.1	29.0	3.7

Source: Biro Pusat Statistik.

policy—would cut back on volatile capital inflows and tend to reduce the related real exchange rate appreciation that discourages exports and encourages imports. Fourth, exports—and general competitiveness—would benefit from more deregulation and cuts in "invisible costs" (Chapter 5). Such deregulation would ensure that investments are forced to produce internationally competitive products and thereby generate foreign exchange directly or indirectly. Finally, to ensure that investors and foreign capital inflows are not excessively encouraged by lack of downside risk, the Government needs to reiterate its policy of not taking over private debts, and to continue to avoid debt guarantees (explicit or implicit), and bailouts of bad debts in the financial system.

C.2 External Debt and Reserves

1.30 At end-1995, Indonesia's total external debt stood at $107.8 billion, up from $96.5 billion a year earlier. Of this amount, roughly 60% was public & publically guaranteed (medium- and long-term debt). On the basis of preliminary indicators, total debt increased by about $2 billion during 1996. Favorable valuation effects (due to cross-country exchange rate movements) reduced the stock of public debt by about $4 billion. When combined with negative net disbursement due to prepayments, this lead to a sharp drop of some $5 billion in public debt, but this was more-than-fully offset by an expansion in private debt by about $7 billion.

Table 1.6: Import Growth

Sector/Commodity	*Growth (% in $s)*			*1996 Imports*
	1994	*1995*	*1996*	*($ billion)*
Total Imports	12.9	27.1	5.6	42.9
Consumer Goods	20.2	52.2	21.3	3.7
Food and Beverages	77.6	99.8	40.3	1.6
Passenger vehicles	3.8	26.0	30.5	1.2
Other durables	14.3	34.5	-3.4	0.8
Other	-24.0	94.3	-38.1	0.1
Intermediate Goods	15.6	28.1	2.3	29.6
Food and Beverages	22.1	38.7	26.6	2.1
Raw Materials	13.6	29.3	-2.9	16.8
Fuels and Lubricants	12.7	25.4	19.4	2.6
Parts and Accessories	19.9	24.2	3.7	8.1
Capital Goods	3.7	17.3	11.0	9.7
Machinery and Equipment	-0.5	20.5	13.2	9.0
Other	58.5	-9.0	-12.8	0.6

Source: Biro Pusat Statistik.

1.31 These movements during 1996 highlight two important trends in Indonesia's external debt in recent years. First, the great bulk of the increase is accounted for by private, non-guaranteed debt, which has increased by about $17 billion over the last 2 years. Several factors are behind this rapid growth in private debt. First, rapid investment-led growth of the private sector generates a large demand for private credit. Second, strong external confidence in Indonesia has made large amounts of off-shore funding available at relatively low interest rates. And third, continued high domestic interest rates have pushed more creditworthy borrowers off-shore.

1.32 The second important trend in external debt is low net disbursements of public debt. Net disbursements of public debt have been on the decline for several years, and have been negative (including prepayments) since 1994/95. The Government continues to prepay large amounts of its foreign debt, and the pace of prepayment increased with $1.6 billion prepaid in 1996/97. This brings total debt prepayment since late 1994 to some $3.2 billion (roughly one-third debt to the World Bank; the rest to the Asian Development Bank), or more than 5% of total outstanding public debt. With these prepayments, debt with interest rates over 9% has been eliminated. This is a major accomplishment.

1.33 After prepaying $460 million in February (from privatization receipts), the Government delivered on its commitment in the FY1996/97 Budget Speech to use budgetary surpluses for debt prepayment. It prepaid some $570 million in official debt that carried interest rates of 9% or more in May and another $540 million in October. In mid-December, the Government announced that the proceeds of privatization of an additional 4.15% of PT Telkom would be used to prepay further debt and an additional $533 million was prepaid in the first quarter of 1997.

1.34 **Debt Ceilings**. To assist with external debt management, Indonesia maintains certain quantitative restrictions on foreign borrowings. These ceilings (referred to as PKLN or the COLT in English), which were originally introduced in October 1991 to improve

management of commercial public debt,[6] expired in March 1996. In FY1996/97, they were replaced by ceilings only on foreign borrowings by state and private banks and by state-owned companies; the ceiling on private companies—which was only indicative—was eliminated.[7]

1.35 Near the end of March 1997, Bank Indonesia further tightened short-term external borrowing by banks. Banks were required to limit short-term (two years or less) offshore borrowings, to a maximum of 30% of their capital (the limit on the Net Open Position remains at 25% of capital and the ceilings noted above remain in place). In addition, banks are to report their annual off-shore borrowing plans to Bank Indonesia, and to extend at least 80% of their off-shore loans (except short-term bilateral loans of up to $20 million) as export credits (which are defined fairly broadly). The ruling also provided for certain fines: 0.5% of new debt, if banks fail to report plans to borrow; 0.01% of a bank's total offshore debt if that bank fails to report its schedule to enter foreign financial markets; and, for banks' borrowings exceeding 30% of their capital, 0.5% of that excess.[8] These regulations are primarily intended to reduce banks' offshore borrowings and reduce financial sector risk. They will, of course, direct borrowing off-shore, and raise borrowing costs for customers that cannot go off-shore (primarily small- and medium-sized businesses).

1.36 **Public Debt Management.** The Government appears to have public debt under firm control. Its policies of debt prepayment have achieved impressive results to date, and there are indications of more prepayments to come. Three options might be considered to strengthen this program (also see Box 2.7). First, a specific line item might be added to the annual Budget for debt prepayment. Second, a explicit target might be announced for debt prepayment over REPELITA VII, say $15 billion, which is well within range considering possibilities for privatization and desirable fiscal surpluses. Third, GOI could begin using budget surpluses and proceeds from privatization to cover unfunded pension liabilities, which are large (Chapter 5 and Leechor). Some aid donors are considering waiving prepayment penalties, as the Asian Development Bank has already done.

1.37 **Dealing with Private Capital Flows.** Policies to deal with private debt flows are different from those for public debt. They are more indirect, mainly involving the maintenance of macroeconomic stability and narrowing of the scope of public activities to make room for the private sector. Indonesia has been following these policies. Macroeconomic stability has been maintained. Debt "headroom" was created by prepayments out of portfolio inflows from offshore privatizations. And any fluctuations in confidence among the holders of shares in offshore markets will primarily affect stock prices, not Indonesia's balance of payments. More importantly, Indonesia's local shock absorbers—stock market prices and the wider buy/sell exchange rate band (see the next subsection)—reduce the incentives for destabilizing "hot money" flows. Beyond this, other policies would also be of assistance. For instance, economic policies can act as a brake on special sectors (such as property development; Box 1.1). Stronger local capital markets would ease the pace of off-shore borrowing. Moreover, as mentioned above, the Government needs to reiterate at every opportunity that debt of the private sector will not become a liability of the public sector in the event of default.

1.38 **Official Reserves.** Indonesia maintains large stocks of international reserves, which is desirable. At end-1996/97, these amounted to almost $20 billion (equivalent to 4.7 months of total imports; Table 1.4), up from $16 billion a year earlier. In addition to official

transactions (for example, on account of sales of oil or servicing of foreign debt), Bank Indonesia accumulates official reserves by buying (or selling) foreign exchange on the spot market for one hour (from 2 to 3 PM) each working day, if sales or purchases are needed to keep the spot rate of the rupiah within its pre-determined exchange rate band (see following sub-section). During 1996, there were large spot purchases in June and in the final three months of the year. For the first time in many years, Bank Indonesia was not called upon to sell foreign exchange in defense of the value of the rupiah at any time during 1996.

1.39 In addition to its official reserves, Bank Indonesia holds other net foreign assets (estimated at approximately $5 billion) and maintains large (roughly $2 billion at end-1996) revolving stand-bys. The stand-bys can be activated at short notice without adding to debt outstanding or debt service (as long as they remain undrawn). As liquidity backup, Bank Indonesia also maintains repurchase agreements with several other central banks in the region; in April, these agreements were extended to include Japan.[9]

C.3 Exchange Rates

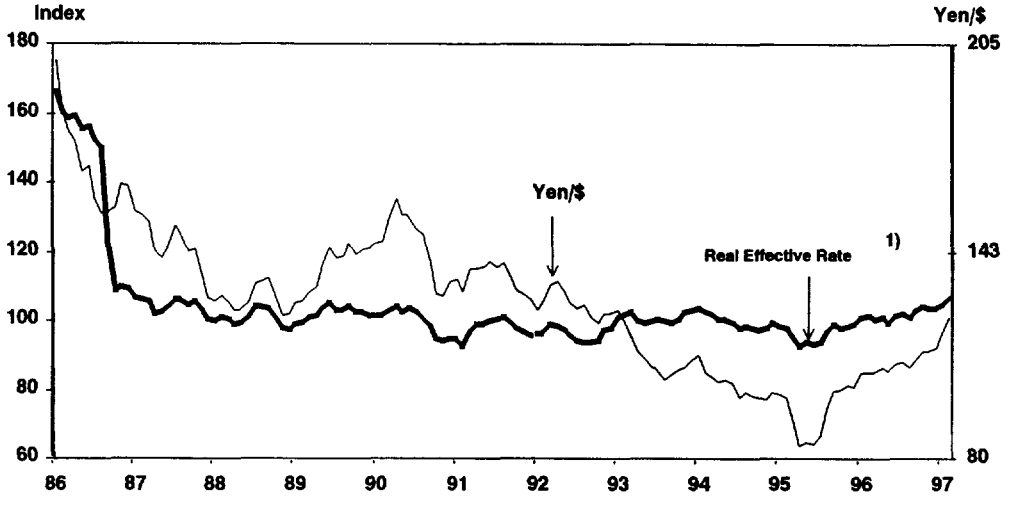
1.40 Since 1986, the Indonesian Government has followed a policy of roughly maintaining the real effective exchange rate of the rupiah (Figure 1.4).[10] During 1996, the real value of the rupiah rose almost 5% and it surged again in early 1997. These increases are largely accounted for by third currency movements—for example, the appreciation of the US$ dollar versus the Japanese yen, the deutsche mark and the Korean won. However, a further part stems from market pressures that strengthened the rupiah versus the US dollar within the wider buy/sell band (see below); during 1996 the spot value of the rupiah depreciated by only 3 1/4%. This depreciation is among the smallest in many years, and half occurred during the final 2 months of the year when Bank Indonesia speeded-up the pace of depreciation of the bands (Figure 1.5 and para. 1.42).

1.41 Under the current system of exchange rate management, the rupiah is allowed to fluctuate within an intervention band (Figure 1.5) whose mid-point is set on a daily basis by the Central Bank. The upper/lower edges of the intervention band define the rates at which Bank Indonesia is prepared to intervene to sell/buy US dollars. Since 1992, the Central Bank has widened the intervention band in stepwise fashion, to give more room for price fluctuations to absorb shocks.

1.42 The band was widened twice during 1996 (Figure 1.5). In mid-June, it was widened from 66 to 118 rupiah, and in mid-September to 192 rupiah, which is equivalent to approximately 8% of the value of the rupiah. On both these occasions (and the previous, end-1995 widening), the bands were widened slightly asymmetrically to allow a bit more room on the weaker side of the band. It should also be noted that there was a perceptibly faster pace of depreciation of the band in the final months of the year; during the final two months of the year the mid-point of the intervention band depreciated by 7 1/2% at an annual rate versus 6% during the first 10 months.

1.43 As can be seen from Figure 1.5, the wider band was very effective in absorbing sizable, temporary shocks during 1996. Most notably, nervousness in early July regarding the health of the Republic's President and the social disturbances of late July were easily absorbed without loss of reserves. The ease

Figure 1.4: Exchange Rate Indicators
(Jan 1986 - Feb 1997)



1) January 1990=100, break in series at end-1991.
Source: IMF.

with which the markets shrugged-off these developments is also indicative of the strength of external confidence in Indonesia in 1996.

1.44 Indonesia's current band is much wider than in the past (Figure 1.5). However, some other countries maintain even wider bands. For instance, Colombia maintains a band of 14%; Chile's is 25% (widened from 20% in January 1997); and most countries in the EMS maintain 30% bands.

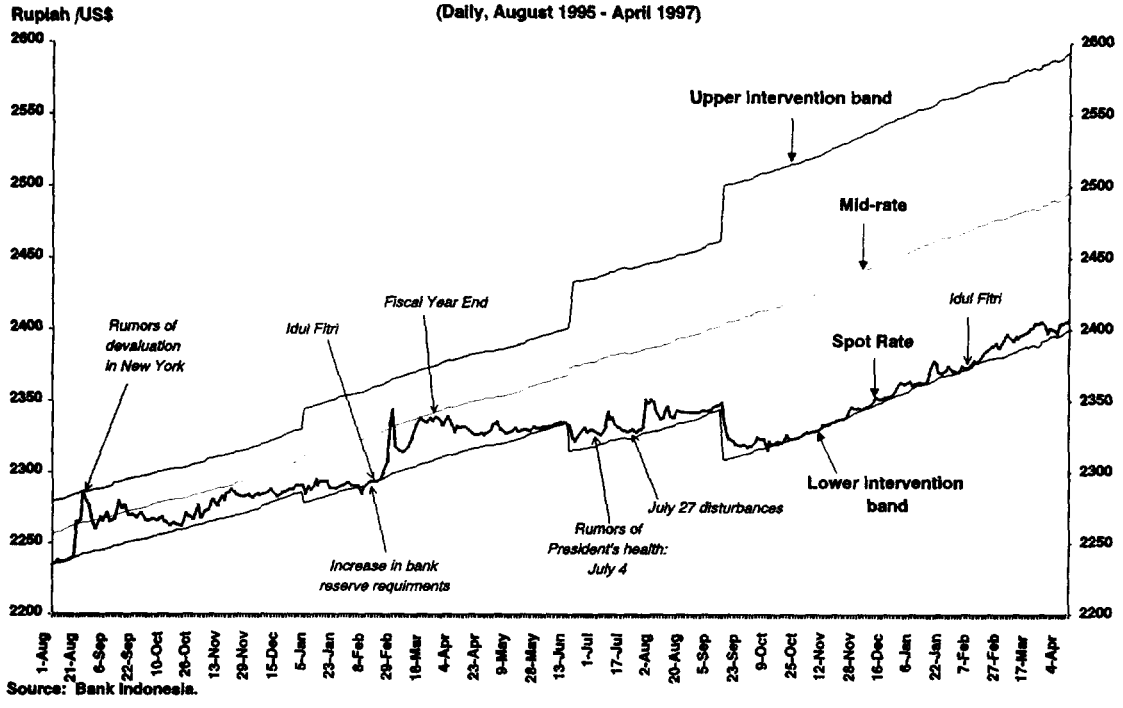
1.45 International experience underscores the importance of putting-in-place an adequately-wide band prior to the onset of any crisis. By way of recent regional examples in this regard, the Korean won, which floats relatively freely, dropped in value by almost 9% (relative to the US dollar) during 1996, without creating any apparent difficulties for the economy. By contrast, the Thai baht, which is managed within a very tight band, was under pressure for much of 1996.

D. Macro Policies: Fiscal Policy

1.46 **The Outturn for FY1996/97.** The overall fiscal position for FY1996/97 is estimated to be in small surplus, as measured on an IMF/World Bank basis (Table 1.7). This overall fiscal position (that is, including estimated net off-budget spending) is virtually unchanged from the previous year. At first glance, this may seem surprising considering the high level of international oil prices (an average of nearly $21/bbl versus less than $17.50/bbl in 1995/96). However, almost half of the revenues from high international oil prices were eaten-up by subsidies to maintain domestic prices at relatively low levels.[11] In addition, off-budget spending was a bit less contractionary, perhaps reflecting the run-up to national elections.

1.47 On the revenue side, the main characteristic of this outturn is oil & gas revenues that are some Rp.6 trillion above budget, owing to much higher-than-budgeted international oil prices. A substantial proportion of this seems to have been saved (especially in the early months of 1997), which is reflected in a build-up of government deposits in the financial system (see "domestic financing" in Table 1.7). Total non-oil tax revenues were approximately in line with budgeted amounts; income tax exceeded

Figure 1.5: Rupiah Exchange Rate: Spot Rate and Intervention Bands
(Daily, August 1995 - April 1997)



Source: Bank Indonesia.

budgeted amounts while sales tax and import duties were less than expected. Non-tax revenues were below-budget, owing to the relatively low level of domestic oil prices that eliminated the surplus on oil & gas operations (footnote 11).

1.48 On expenditures, current and capital spending were approximately on-budget, apart from (unbudgeted) payments to Pertamina for domestic pricing subsidies (see footnote 12). Net off-budget operations (as measured by total official financing that is not accounted for by on-budget revenues and spending) looks less contractionary than last year; as mentioned this may reflect the run-up to elections. There is also debt prepayment of some $1.6 billion, which is counted as (negative) financing in IMF/World Bank format.[12]

1.49 **The Budget for FY1997/98.** In January of 1997, the Government brought down a tight Budget for FY1997/98. The Budget (measured on an IMF/World Bank basis) was projected to be in small deficit (less than 1/4% of GDP) compared with virtual balance in the previous year's Budget (Table 1.7). However, the revenue targets (set in relation to the Budget of the previous year) were very conservative and total spending was budgeted to grow in line with revenues, both expanding a little slower than nominal GDP.

1.50 According to the Budget, total revenues for FY1997/98 would decline in relation to GDP. This reflects a projected slowdown in Oil & Gas revenues, which were set on the basis of international oil prices of $16.5/bbl. Non-oil taxes were budgeted to remain constant relative to GDP, while non-tax revenues dropped-off a little due to sharply lower profits on domestic fuel sales and returns on public enterprises. No new revenue measures were announced in the Budget.

1.51 Current expenditures are budgeted to decline slightly in relation to GDP. There were external interest savings stemming from debt prepayments (Section C) and favorable third currency movements (Section C). These savings were largely offset by continued rapid increases in (foreign and domestic) materials expenditures.[13] Personnel expenditures, which stayed constant in relation to GDP, appear to include an allowance for a modest real increase in general civil service salaries. As was the case in the previous year, the exact size of the general pay increase for the civil service was left to be discussed with Parliament.

1.52 On-budget capital spending declined a little relative to GDP (Table 1.7). According to the Budget, priority was to be accorded to, *inter alia*, poverty alleviation programs, regional allocations (INPRES), and various health programs; education received mid-range priority. Somewhat lower priority was given to power generation and to telecommunications, both of which are benefitting from large private investment. More details concerning the development expenditures are included in Chapter 2.

1.53 **Fiscal Policy Issues.** The Budget for 1997/98 is striking evidence of Indonesia's continuing commitment to macroeconomic stability, even in an election year. In the course of the year, strong implementation will be important, supplemented by strict control over off-Budget spending. In addition, certain follow-up policies will also be important. For example, "windfall" revenues—such as those accruing from further privatizations or higher-than-expected international oil prices—could be used to prepay more external public debt. If such revenues are spent, they could increase inflation and imports.

1.54 Looking further ahead, the foundation of fiscal policy should be generation of more revenues by means that increase efficiency and equity. Improved tax administration will be a key in this regard, and the newly passed laws on Non-Tax Revenues and Tax Courts are important steps towards this goal (also see Section F). Among the priorities, the most important steps concern non-budgetary, quasi-public revenues and expenditures which are believed to be very large in Indonesia.[14] For purposes of transparency, accountability and budgetary discipline, more of these should be brought on-Budget,[15] as envisaged in legislation passed by Parliament in early 1997. Two prominent examples are monies gathered under re-forestation fees and the now-compulsory 2% surcharge on high income earners for poverty alleviation. Restructuring of some expenditures would also be important. On the side of current spending, real increases in personnel spending should go to re-structuring civil service salaries, rather than increasing the size of the civil service and "wage creep" (for development spending, see Chapter 2).

E. Macro Policies: Monetary Policy

1.55 Increased globalization of financial flows (Chapter 2) has important implications for economic policy-making in Indonesia. One of the most important is the reduced effectiveness of monetary policy in influencing real developments (*e.g.*, Box 1.3 in World Bank, 1996a) under fixed exchange rate regimes. Concerns in this regard appear to be one consideration behind the authorities' move towards more flexible exchange rate arrangements. However, when the spot exchange rate is at one edge of the intervention band (Section C), the economy is effectively operating under a "fixed regime". For the time being, the authorities appear to set interest rates roughly in line with (risk-adjusted) international rates. Instruments are: changes in reserve money, which are geared to targeting interest rates; moral suasion; statutory reserve requirements; and regulatory policy. Moral suasion and regulatory policy are sometimes

Table 1.7: Indonesia: Central Government Fiscal Operations[a)]
(Rp.trillions)

	1994/95	1995/96	1996/97 Budget	1996/97 Estimate	1997/98 Budget
Revenue & Grant	60.1	69.0	78.2	83.6	88.1
Oil & LNG taxes	13.4	14.8	14.1	19.9	14.9
Non-oil taxes	40.7	48.4	56.0	55.8	64.7
Non-tax revenues	5.5	5.2	7.6	7.3	7.9
Grants[b)]	0.5	0.5	0.6	0.6	0.6
Current Expenditure	35.3	43.6	48.3	51.7	55.3
External Interest	6.5	6.9	7.8	7.7	7.5
Subsidies[c)]	0.5	0.2	0.1	1.8	0.1
Other, of which:[d)]	28.4	36.5[h)]	40.3	42.2	47.7
Personnel[e)]	19.8	23.2	27.8	27.3	32.2
Capital Expenditure (on-budget)	25.3	26.0[h)]	30.2	28.9	34.0
Total Budget Expenditure	60.6	69.6	78.5	80.6	89.4
Overall Budget Balance	-0.5	-0.5	-0.3	3.0	-1.3
Estimated Off-Budget (net)[f)]	-1.7	-4.3	...	-2.1	...
Overall Fiscal Balance	1.3	3.8	-0.3	5.1	-1.3
Financing					
External (net)	-0.7	-0.1	-0.3	-2.3	0.7
Disbursements	11.6	13.0	11.8	12.1	12.4
Amortization	12.3	13.1	12.1	14.4	11.7
Domestic (net financial drawdown)	-2.3	-5.5	0.5	-4.1	0.6
Exceptional: privatization receipts	1.7	1.8	0.0	1.4	0.0
	(as % of GDP)				
Revenue & Grants	15.0	14.7	14.4	15.2	13.8
Current Expenditures	8.8	9.3	8.9	9.4	8.7
Capital Expenditure (on-budget)	6.3	5.5	5.5	5.3	5.3
Overall Fiscal Balance (incl. off-budget)	0.3	0.8	-0.0	0.9	-0.2
Memo item:					
Oil prices ($/bbl)[g)]	16.6	17.3	16.5	20.8	16.5

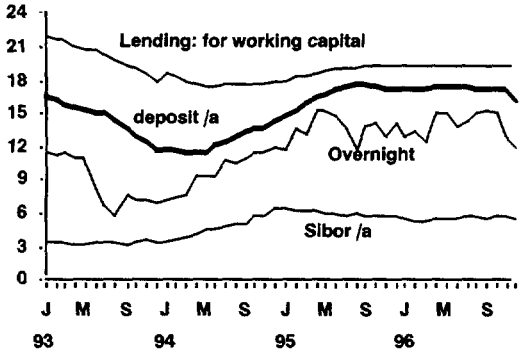
a) This table presents Central Government fiscal accounts in the format of the IMF's Government Financial Statistics, which differs from Government of Indonesia's Budget format, presented in the Annex.
b) Estimated grant component of external financing.
c) Includes fertilizer and petroleum subsidies.
d) Includes estimated spending of a current nature classified as development expenditure in the Government's Budget (defence expenditure, operations and maintenance expenditure).
e) Central Government's personnel spending plus transfers to regional governments for personnel expenditure.
f) Derived as the sum of government saving (revenues less current expenditures) and net financing (external plus domestic), less estimated on-budget capital spending.
g) Indonesian crude, annual average for the fiscal year or projection at Budget.
h) Includes re-classification of pre-shipment import-inspection fees from capital to current expenditure.

Source: Ministry of Finance, Bank Indonesia, and World Bank staff estimates.

used to influence the timing of interest rate changes, the growth of aggregate credit, and the composition of credit (for example, lending to the property sector).

1.56 **Interest Rate Developments.** Offshore rates and rupiah-denominated interest rates were little changed during most of 1996 (Figure 1.6). Beginning around the end of November, deposit rates at many banks came down some 50-100 basis points, as Bank Indonesia eased rates on its monetary instruments. But lending rates were little changed, probably reflecting banks' attempts to maintain margins in the face of higher reserve requirements, to be effective in April 1997 (Box 1.4). Despite this stability in domestic and foreign rates, the covered differential (*i.e.*, the interest rate spread less the forward swap premium)[16] displayed considerable volatility (Figure 1.7), owing to marked fluctuations in the swap premium. In late 1996, confidence was on the rise, which reduced swap costs and widened the covered differential (Figure 1.7). This accounts for the strong capital inflows during this period.

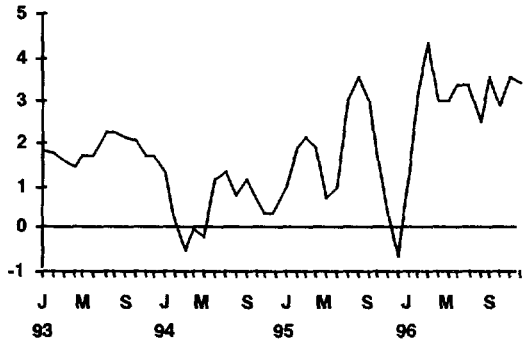
Figure 1.6: Interest rates (% p.a.)



/a 3-month.

Source: Bank Indonesia.

Figure 1.7: Covered differential a) (% p.a.)



a) Rupiah deposit rate less SIBOR less swap premium (all 3-month maturity).

Source: Bank Indonesia.

1.57 **Reserve Money.** Policy towards reserve money was run tight during most of 1996 (Table 1.8). Higher commercial bank reserve requirements led to a sharp rise in the demand for reserve money in February 1996 (which was a tightening of policy, despite the resulting jump in reserve money; see Box 1.4). After the increase in reserve requirements took hold, expansion in reserve money was quite restrained. During the last 9 months of the year, reserve money rose by 14 1/2% at annual rates, and almost two-thirds occurred in December when Bank Indonesia eased interest rates. This compares with 16 3/4% during 1995.

1.58 The sources of expansion of reserve money illustrate the conduct of monetary policy during 1996 (Table 1.8). The main factor exerting an expansionary influence on reserve money was external in origin (*i.e.*, Bank Indonesia's purchases of foreign exchange), especially during October through December, when the exchange rate was crawling along the stronger edge of the intervention band and Bank Indonesia was buying large amounts of foreign exchange (Figure 1.5). Liquidity credits (which are low-cost credits from the central bank for special programs) were also expansionary during 1996, continuing the pattern begun in 1995. During 1996, the bulk

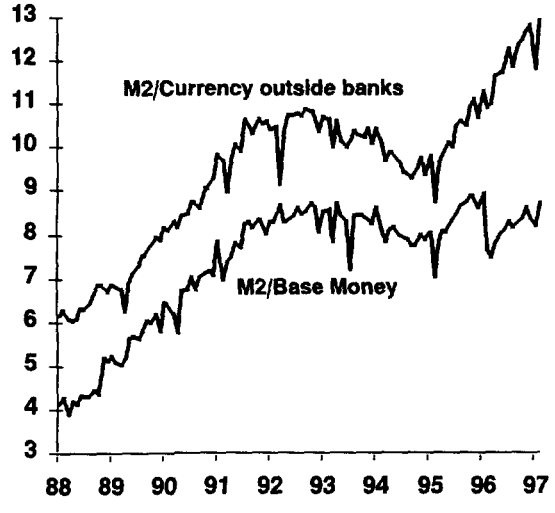
of additional credits were extended to Bulog, in part for financing of flour. Their on-going expansion during the past two years is a marked departure from previous years and a source of concern. To offset these expansionary factors, Bank Indonesia made active use of its money market instruments (SBIs and SBPUs). Government deposits, which had been highly contractionary in the two previous years, were only mildly contractionary during 1996 as a whole. Late in the year (and in early 1997) when oil prices were relatively high, government deposits were more contractionary; effectively, government saving of its oil revenues automatically sterilized increases in net foreign assets.

Table 1.8: Sources of Reserve Money Expansion
(Rp. trillions during the indicated period)

	1994	*1995*	*1996*	*1996 (Mar-Dec)*
External Factors	-1.5	5.2	17.1	12.3
plus: Policy Factors	8.6	0.2	-8.7	-9.3
Claims on government	-3.1	-6.9	-1.4	-2.1
Liquidity credits	0.9	3.9	3.5	2.9
Money market instruments	10.8	3.7	-10.8	-10.1
plus: Other	-2.6	-2.2	0.3	0.4
equals: Reserve Money	4.6	3.7	8.6	3.4
(Growth rate, % per year)	(25.9)	(16.7)	(33.1)	(14.4)

Source: Bank Indonesia.

Figure 1.8: Broad Money Multiplier
(Jan. 1988 - Feb. 1997)



Source: Bank Indonesia.

1.59 **Monetary Aggregates & Credit Developments.** Broadly-defined money supply rose by almost 30% during 1996, up moderately from the previous year (Table 1.9). This acceleration occurred despite the relatively restrained growth in reserve money, mentioned above. Consequently, the growth of broadly-defined money supply (M2) continues to outpace reserve money by a considerable margin, indicating a continuing rise in the money multiplier (apart from the once-only drop in the M2-multiplier in February, when reserve requirements increased; Box 1.4 and Figure 1.8). Relatively rapid growth in M2 occurred in all major components of quasi-money (that is, foreign currency deposits, and rupiah time and savings deposits).

1.60 Shifts in the money multiplier[17] (Figure 1.8) are an on-going source of frustration for monetary policy. Policy-makers see themselves as maintaining reasonable control over the growth of reserve money, and an adequate spread between domestic interest

rates with foreign rates. Nevertheless, the growth of overall money supply (and credit) remains higher than desired, thereby potentially fueling excessively rapid economic growth and inflation. In addition, these shifts are not easily explained by conventional factors (such as rising interest rates, financial innovation or increased financial intermediation). Trying to regain more control over this key economic variable seems to be one objective of increasing commercial bank reserve requirements (Box 1.4). However, this is awkward with an open capital account like Indonesia's, as long as the spot exchange rate is at one edge of the intervention band (Box 1.4 and World Bank 1996a, Box 1.3). These complications argue in favor of increased reliance upon fiscal policy, and on setting conservative targets for reserve money and credit expansion.

Table 1.9: Indonesia: Developments in Money and Credit
(change over year earlier, trillions of Rp.)

	1993	*1994*	*1995*	*1996*
Net Foreign Assets	-0.9	-4.4	7.4	18.0
Net Domestic Assets	32.5	32.7	41.3	53.7
Lending to Business	30.2	37.8	47.4	56.4
Other Assets (net)	-5.4	1.1	-0.6	-5.7
Broad Money (M2)	26.1	29.3	48.1	66.0
Narrow Money (M1)	8.0	8.6	7.3	11.4
Quasi-money	18.1	20.7	40.8	54.6
Memo Items: (% change)				
Reserve money	19.5	25.8	16.7	33.1
Broad Money	22.0	20.2	27.6	29.6
Narrow Money (M1)	27.9	23.3	16.1	21.6
Quasi-money	20.1	19.1	31.6	32.1
Lending to Private Sector	22.7	23.2	23.6	21.7

Source: Bank Indonesia.

1.61 On the asset side of the monetary accounts, credit expanded by around 22%, down a little from previous years, but still well above Bank Indonesia's target of 17 1/4%.[18] The main factors accounting for this credit slowdown are: i) Bank Indonesia's higher capital requirements for foreign exchange banks; ii) slower growth in lending by state banks, probably accounted for by only a few of them and, perhaps, iii) Bank Indonesia's higher reserve requirements. Bank Indonesia also attempted to strengthen moral suasion during 1996,[19] but it does not appear to have been a significant factor. Among the major sectors, expansion of credit was especially rapid for Services (35%) and Trade (25%); Agriculture and Manufacturing were the slowest-growing sectors, expanding by 15% and 10%, respectively.

1.62 Looking at the Property Sector (Box 1.1),[20] which constitutes almost one-quarter of total bank credit, banks' exposure to this sector continues to rise. After a marked slowdown during 1995, the pace of expansion of lending to the property sector began to pick-up again in 1996 (although it remains moderate by recent standards; see Figure 1.9). The

Box 1.4: Reserve Requirements as an Instrument of Monetary Policy In Indonesia

In February 1996, Bank Indonesia (BI) re-activated reserve requirements as an instrument of monetary policy. This instrument was last changed in 1988, when it dropped sharply from an effective rate of about 8% to 2% as part of the October 1988 de-regulation package. There were three components to the 1996 change. First, required reserves (that is, the amount of cash held by commercial banks or the amount of their deposits in the central bank) were raised from 2 to 3% of deposit liabilities. Second, the definition was changed so as to exclude cash held by the banks. Third, the frequency of the calculation was changed from a weekly average to a daily basis, and BI (not the commercial banks) makes the calculation (using data submitted to BI within 6 days versus 2 weeks previously).

In September 1996, Bank Indonesia announced another increase in reserve requirements. On this occasion they were raised to 5%, effective mid-April 1997. According to official announcements, eight months of lead-time was needed to give banks adequate advance notice and to avoid complications stemming from seasonal instability in the demand for reserve money in early 1997 (reflecting the occurrence of the New Years, Idul Fitri, and fiscal year-end within 3 months).

What are the implications of these changes? Conventional economic analysis treats reserve requirements like a tax on banks, acting as a wedge between deposit and lending rates. An increase in reserve requirements widens the wedge; whether lending or deposit rates adjust more, depends upon the relative degree of competitiveness in these two markets. In Indonesia's highly open economy, the adjustment will tend to fall on side of lending rates, because of the highly competitive nature of funds mobilization.

What is likely to happen in the wake of further increases in reserve requirements? Higher reserve requirements will lower the money multiplier (the ratio of money supply to reseve money). If certain regulatory constraints (PKLN and the Net Open Position) are not binding, banks will borrow off-shore to meet the higher reserve requirements, as happened in February 1996 (see Figure 1.5) or Bank Indonesia will buy (sell) SBPUs (SBIs); deposit rates will be essentially unchanged; lending rates will rise for those bank customers who cannot go off-shore; and banks' profitability will tend to fall. Bank Indonesia has also said that the smaller money multiplier could slow the growth of money supply.

Source: Bank Indonesia.

pick-up in growth is attributable to loans for construction and real estate development; mortgages, the least risky component, continues to decelerate.

F. The Outlook for Macro Policies

1.63 Macroeconomic policy's main contribution to economic development is the continued maintenance of macroeconomic stability (Box 1.5). The more immediate objective of monetary and fiscal polices is to reduce the risk in Indonesia's medium-term outlook. This has become more complicated in the past year or so, owing to the surge in external confidence, which was reflected in strong capital inflows in 1996. In the near-term, these have put upward pressure on the rupiah, thereby frustrating GOI's attempts to use the exchange rate to improve external

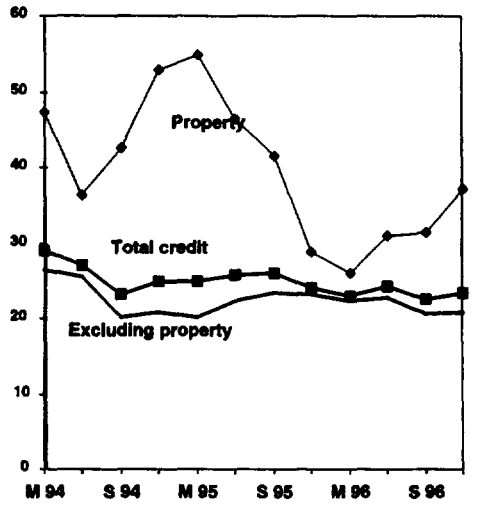
competitiveness. As recent developments in Thailand indicate, a turnaround in these flows could exert pressure on the economy.

1.64 The Government could react to these capital inflows in essentially two ways (see also Box 1.6): i) by further widening the exchange rate band; or ii) by changing the mix of economic policies. Widening the band has benefits (Section C). But in the present external environment, it also tends to undermine Indonesia's international competitiveness which, as mentioned, is a matter of concern for the Government. This outcome can be avoided by exercising the second option, namely by easing monetary policy, which would reduce capital inflows, in conjunction with tight fiscal policy, which will keep the economy from overheating, by limiting any rise in aggregate demand. During most of 1996, the authorities followed the first approach, then eased interest rates late in the year, just before the tight Budget for FY1997/98 was brought down. Bank Indonesia followed-up, by reducing interest rates on short-term SBIs in early 1997, apparently making the most of favorable market reaction to the tight Budget for 1997/98.

1.65 There will likely be considerable room to continue this approach in 1997. On the side of monetary policy, it will require opportunistic reductions in key interest rates, guided by lasting declines in the swap premium when the exchange rate is under pressure. It would also be helpful to combine this with rising reserve and capital requirements at commercial banks, which would keep a cap on lending. In some circumstances, moral suasion might be a useful adjunct.

1.66 In addition, macro policies need to be prepared for two, slightly different eventualities. First, in the event of over-heating, policies may need to be tightened quickly. Experience of the past decade

Figure 1.9: Credit Development at Deposit Money Banks
(year-over-year % change)



Source: Bank Indonesia.

indicates that monetary policy is capable of reacting forcefully and quickly in such circumstances. But, it would be less risky—and more effective—if fiscal policy were to take the lead role. To this end, it would be helpful to have ready at hand a package of fast-acting fiscal measures. Some specific, fast-acting measures—which generally have beneficial secondary effects—could include:

1) Raising property taxes on urban properties, especially luxury residences (which would permit a reduction in central government transfers to lower level governments). The current property tax rate in among the lowest in the world, measured as a percentage of assessed value. As secondary effects, this would assist with decentralization by increasing the autonomy of local governments; it would also assist with keeping the property boom under control.

ii) Increasing domestic fuel prices—so as to eliminate the subsidy in the budget. A major beneficiary of current subsidies is

Box 1.5: Traditional Culture Parallels Macro Stability

"Macroeconomic instability is like the evil witch Rangda in the traditional Balinese Barong dance. It cannot be permanently defeated. It can only be held down by vigilance and good behavior."

Anonymous, 21/11/96

the 2 million or so car-owners (probably less than 1% of all residents), including businesses and expatriates who are concentrated in Jakarta. This subsidy is particularly inappropriate for users of Premix (high octane gasoline), who must certainly be at the upper end of Indonesia's income distribution.

iii) Increasing power tariffs, as proposed by PLN. Current levels are unsustainable, and they threaten PLN's privatization prospects and its access to multilateral loans (Chapter 4).

iv) Reversing the present trend towards wider tax exemptions. Tax holidays, selected automobile exemptions,[21] exemptions for shipping agents and port services, and elimination of the exit tax to ASEAN countries all represent significant tax losses.

v) Increasing forestry royalties, including for environmental reasons. Currently, statutory rates are low and collections are far lower.

vi) Making more goods subject to luxury taxes. And,

vii) Bringing more off-Budget spending on-Budget (para 1.54).

1.67 The second eventuality concerns the likelihood of some shock—external or domestic, economic or non-economic —triggering a sudden loss of confidence that is characterized by extensive capital flight. In this case, the first line of defense is a relatively wide exchange rate band, backed by a large stock of official international reserves. Beyond this, financial policies would need to tighten—significantly and probably quickly—in a manner that convinces investors that financial stability will be maintained. This is likely to entail a three-part combination of monetary action and fiscal measures to restore stability, supported by a strong deregulation package to reverse expectations and sustain growth. It would be helpful if the key fiscal and deregulation components could be on-the-shelf, ready for use on short notice.

1.68 As detailed elsewhere in the Report, many other policies have a role to play in reducing risk in the outlook (Box 1.6). For example, privatization and deregulation policy—especially as concerns agricultural commodities—would increase the capacity of markets to absorb shocks. On minimum wages, real increases need to be kept in line with productivity increases. Over the longer-term, better policies are needed to give workers a stronger voice in representing their own interests. Similarly, prudent debt management gives public policy more room for maneuver, while more effective regulation, for example of the banking system, could significantly reduce other vulnerabilities (Chapter 5). Also in the banking sector, this period of strong external sentiment is an outstanding opportunity to address other issues that have been delayed in the past due to fears of capital flight—for instance, banking secrecy, money laundering and closing insolvent banks.

Box 1.6: The Interim Committee Declaration on Partnership for Sustainable Global Growth

On September 29, 1996, the so-called Interim Committee (representing the governing body of the International Monetary Fund) issued a strategic declaration that significantly broadened that group's previous statements on economic policies. The declaration attached particular importance to the following eleven points, which the Managing Director of the International Monetary Fund has referred to as "The Eleven Commandments":

- Stressing that sound monetary, fiscal, and structural policies are complementary and mutually reinforcing: steady application of consistent policies over the medium term is required to establish the conditions for sustained noninflationary growth and job creation, which are essential for social cohesion.
- Implementing sound macroeconomic policies and avoiding large imbalances are essential to promote financial and exchange rate stability and avoid significant misalignments among currencies.
- Creating a favorable environment for private savings.
- Consolidating the success in bringing inflation down and building on the hard-won credibility of monetary policy.
- Maintaining the impetus of trade liberalization, resisting protectionist pressures, and upholding the multilateral trading system.
- Encouraging current account convertibility and careful progress toward increased freedom of capital movements through efforts to promote stability and financial soundness.
- Achieving budget balance and strengthened fiscal discipline in a multi-year framework. Continued fiscal imbalances and excessive public indebtedness, and the upward pressures they put on global real interest rates, are threats to financial stability and durable growth. It is essential to enhance the transparency of fiscal policy by persevering with efforts to reduce off-budget transactions and quasi-fiscal deficits.
- Improving the quality and composition of fiscal adjustment, by reducing unproductive spending while ensuring adequate basic investment in infrastructure. Because the sustainability of economic growth depends on development of human resources, it is essential to improve education and training; to reform public pension and health system to ensure their long-term viability and enable the provisions of effective health care; and to alleviate poverty and provide well-targeted and affordable social safety nets.
- Tackling structural reforms more boldly, including through labor and product market reforms, with a view to increasing employment and reducing other distortions that impede the efficient allocation of resources, so as to make our economies more dynamic and resilient to adverse developments.
- Promoting good government in all its aspects, including by ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption, as essential elements of a framework within which economies can prosper.
- Ensuring the soundness of banking systems through strong prudential regulation and supervision, improved coordination, better assessment of credit risk, stringent capital requirements, timely disclosure of banks' financial conditions, action to prevent money laundering, and improved management of banks.

G. The Short-Term Outlook and Donor Assistance

1.69 **Economic Prospects**. Indonesia is experiencing an increase in investment that is projected to keep annual growth between 7.5% and 8% and to temporarily widen the current account deficit for the next few years (Table 1.10). This investment expansion is resulting from a combination of rapidly rising domestic investment and continued expansion of foreign direct investment. As has been the case in recent years, the main source of growth is projected to be the non-oil & gas, non-agriculture sectors (about 9% p.a.). Oil & gas sector output is projected to remain relatively flat, and agricultural sector output will increase relatively slowly (about 3% p.a.).

1.70 As oil prices fall back to about $17 per barrel, and investment remains high, import growth will increase the current account deficit (Table 1.10). In 1997/98, these developments seem likely to translate into a current account deficit of about $10.1 billion (4.0% of GDP). The current account deficit is likely to remain close to 4% of GDP for the following two years (*i.e.*, between $11.5 and $12.2 billion) before beginning to fall as a percentage of GDP around the turn of the decade, as investments mature. Non-oil & gas export growth is projected to be 12.8-13.8%, well above the relatively low level of 6.6% in 1996/97, but less than the 15-18% p.a. in the two previous years. Part of the lower non-oil & gas export growth in 1996/97 was due to low prices (para 1.25). Export growth is expected to rebound as the non-oil terms of trade stabilize and export-oriented projects take hold.

1.71 Import growth is projected to remain above GDP growth, but not to reach the unsustainable rates of 1994 and 1995. In 1997/98, oil sector imports are projected to decline sharply as prices drop-off and domestic sources substitute for imports. This will allow overall import growth to be quite modest at about 7% although non-oil sector imports grow at about 13%. Much of the projected increase in the current account deficit for the years 1997/98 to 2000/01 is expected to be induced and financed by an increase in foreign direct investment.

1.72 Projected growth of GDP and non-oil exports, together with the prepayment of $3.2 billion in high interest public debt since late 1994 and third-currency movements, are projected to result in a continuing fall in the debt service ratio in the next few years (Table 1.10). M&LT debt service in relation to exports was 31% in 1996/97 and is projected to fall to about 25% within five years. It should be noted that prepayment of $1.6 billion accounted for 3.1 percentage points of the 1996/97 debt service ratio (DSR). The underlying DSR was this much less and the projected fall over the next few years is partly due to this prepayment. There is projected to be a sharp change in the composition of debt and debt service payments over the coming years, with all the increase in debt being private debt. Public debt is projected to continue to decline.

1.73 The savings and investment balances summarized in Table 1.11 reflect the increase in private investment and the associated temporary rise in foreign savings (the financing of the current account). Central government investment is projected to rise slightly relative to GDP, beginning in the next 5-year plan (Chapters 2-4), and financed by a comensurate rise in central government savings. The projected rise in total investment as a share of GDP is initially financed by a rise in foreign savings. Only after foreign savings level off and begin to fall as a share of GDP (*i.e.*, 1998-99 and beyond) is private savings projected to rise to provide this funding.

1.74 These projections are subject to familiar risks. First, oil and other commodity

Table 1.10: Medium-Term Outlook

	Estimated	*Projected*		
	1996-97	*1997-98*	*1998-99*	*2000-01*
National Accounts (%)				
Real GDP	7.8	7.8	7.8	7.8
Non-Oil & Gas GDP	8.1	8.2	8.2	8.2
Investment (GDFI)	10.0	10.4	10.6	7.8
Balance of Payments ($ billion)				
Merchandise Exports (FOB)	52.2	53.8	59.4	74.3
Non-Oil & Gas Exports	39.6	44.6	50.7	65.7
Merchandise Imports (cif)	-50.8	-54.2	-60.7	-75.2
M&LT Interest Payments	-5.3	-5.9	-6.4	-7.7
Current Account Balance	-8.1	-10.1	-11.5	-12.6
Gross Reserves (months Merch. imports)	4.7	5.0	4.9	4.8
Export Real Growth Rate (Merch.FOB)(%)	8.2	6.7	9.3	9.6
Import Real Growth Rate (Merch.CIF)(%)	10.3	6.9	9.9	8.7
Non-Oil & Gas Export Growth in $ (%)	6.6	12.8	13.6	13.8
Non-Oil & Gas Import Growth in $(%)	10.4	13.0	12.1	11.5
Net Public M&LT Borrowing	-0.7	-0.3	-0.2	-0.2
Foreign Direct Investment	6.5	6.7	7.6	9.5
Debt Indicators (M&LT Debt)				
DOD ($ billion) [a]	86.9	94.0	102.6	119.8
o.w. Public	58.5	58.2	58.4	58.6
Debt Service/Exports (%)	31.1	30.0	26.3	24.2
o.w. Public	14.6	13.8	11.2	9.1
Memo Items:				
Official Reserves ($billion)	19.9	22.2	24.5	29.8
Oil Price ($/bbl, average OPEC Price)	20.5	17.0	16.7	16.5
Non-Oil Terms of Trade (1994=100)	97.7	97.7	97.3	97.0
Current Account Balance/GDP (%)	-3.5	-4.0	-4.1	-3.7

[a] End of period Stocks.

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

prices are volatile and could be lower than projected. Second, there is a possibility that widening current account deficits could weaken external confidence in Indonesia. Third, uncertainty concerning the outlook for deregulation could reduce foreign investment, or raise the cost of doing business in Indonesia to uncompetitive levels. In all these cases, Indonesia's traditional responses—increased public savings (Section F) and restored momentum to deregulation (Chapter 5)—would resolve the situation.

1.75 **The Continuing Need for Foreign Assistance.** Although the private sector has provided a growing share of Indonesia's external financing needs in recent years (Table 1.12), official foreign assistance will

continue to be important for several reasons. First, it represents virtually the only source of stable, long-term funding for public investments that are not attractive to the private sector. These include education, public health, and most infrastructure, especially in the Outer Islands. Second, official assistance often comes with strong project appraisal and preparation as well as technical assistance. Third, private finance is only available in a few infrastructure sectors. Fourth, there is risk involved in relying too heavily on private finance for public investments, as highlighted, for example, by the Mexican crisis. Finally, the long-term nature and risk diversification associated with official assistance improves the structure of debt and the debt service profile, thus reducing exposure to the risk of sudden shifts in private capital flows.

1.76 In view of these considerations and bearing in mind the availability of private finance, a level of commitments from the CGI roughly similar to last year would be very supportive. These considerations also point towards a need for the donor community to improve the relevance and effectiveness of its assistance.

1.77 The priorities for assistance remain similar to those identified at last year's CGI meetings. These include: human resource development; poverty alleviation; environmental improvement; infrastructure development (especially those areas not of interest to the private sector); and balanced regional development.

Table 1.11: Saving-Investment Balances (% of GDP at current prices)

	1994-95	*1995-96*	*1996-97*	*1997-98*	*1998-99*	*1999-00*
Gross Investment	30.3	31.3	32.0	32.7	33.5	33.5
Gross National Savings	28.4	28.0	28.5	28.7	29.4	29.6
Savings-Investment Gap	-1.9	-3.3	-3.5	-4.0	-4.1	-3.9
Central Government (on budget)						
Investment [1]	6.3	5.5	5.3	5.3	5.5	5.6
Savings [1]	6.4	5.6	5.7	5.5	5.6	5.8
Savings-Investment Gap	0.1	0.1	0.4	0.2	0.1	0.2
Private Sector and Public Enterprises						
Investment	24.0	25.8	26.7	27.4	28.0	27.9
Savings	22.0	22.4	22.8	23.2	23.8	23.8
Savings-Investment Gap	-2.0	-3.4	-3.9	-4.2	-4.2	-4.1

[1] There was a change in the classification of some Government expenditures between 1994/95 and 1995/96 which has contributed to a shift in investment and savings.

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

Table 1.12: Sources and Uses of External Financing
($ billion)

	1995-96	*1996-97*	*1997-98*	*1998-99*	*1999-00*
Uses of Financing	*15.6*	*18.1*	*18.3*	*18.8*	*19.4*
Current Account Deficit	7.0	8.1	10.1	11.5	12.2
(o.w. MLT interest payments)	4.9	5.3	5.9	6.4	7.0
Principal Repayments	5.9	6.1	5.9	5.0	4.8
Increase in Official Reserves	2.7	3.9	2.3	2.3	2.4
Sources of Financing	*15.6*	*18.1*	*18.3*	*19.0*	*19.4*
Foreign Direct Investment (Net)	5.4	6.5	6.7	7.6	8.5
Other Private Capital (Net)	4.5	6.2	6.0	6.0	5.9
Public MLT Capital	5.7	5.4	5.6	5.2	5.0
CGI Assistance	3.7	3.5	3.6	3.5	3.5
Other	2.0	1.9	2.0	1.7	1.5

Source: Bank Indonesia and World Bank staff estimates.

Endnotes

1. Unemployment in Indonesia is largely transitional in nature and contains a high percentage of first-time job seekers searching for a job. Of particular note is the relatively high duration of search, typically about 10 months. Studies indicate that the length of search of university graduates is related to the quality of their institution and the field of discipline that they study. REDECON (1994) finds that graduates from the more prestigious universities and from technical faculties find jobs much faster than others. The study also found that more females suffer from long-term unemployment because they attend lower quality institutions and enroll in less-marketable fields of study than their male counterparts.

2. The 1996 increase came in two parts. There was an official increase of about 10 1/2% in the average daily wage, which was reasonable. However, there was a second, hidden provision that regular (as opposed to daily or casual) workers be paid on the basis of a 30-day month, compared with the previous convention based on a 6-day week. Effectively, this boosted the minimum wage by a further 15-20%.

3. BPS data indicate higher growth in non-oil and gas exports in 1996 (and lower growth in 1995) than BI data, largely due to differences in methodology (BI allocates all exports to the date on the shipping document irrespective of when the data is processed). As a result, BI records some exports in 1995 that BPS records in 1996.

4. Part of the reason Bank Indonesia's growth in imports in 1996/97 (10%) is larger than BPS's figure for 1996 is the estimates made by BI to include rapidly increasing imports into free trade areas.

5. This partly reflects the slowdown in parts for automobile production.

6. See Table 1.5 in World Bank (1996a).

7. For FY1996/97, state banks and state-owned companies were subject to ceilings of $500 million and $800 million, respectively. For their part, private banks were subject to a collective ceiling of $1 billion; supervisory authority was delegated to Bank Indonesia, which spread the overall ceiling among some 80 banks, based upon a formula that takes into account, *inter alia*, each bank's outstanding borrowings and capital.

8. The definition of "off-shore borrowing" was clarified to include any funds borrowed from non-residents in any currency (in principle, including CDs, which looks difficult to enforce).

9. Under these agreements, monetary authorities of a signing country may obtain liquidity assistance from other monetary authorities to overcome attacks in foreign exchange markets, through sales of holdings of U.S. government securities to partners with a promise to buy them back later.

10. As noted in last year's Report, measures of the real effective exchange rate are sensitive to the choice of country weights and prices/costs (for example, consumer prices, wholesale prices or unit labor costs). The IMF measure (shown in Figure 1.4) uses trade weights (with an allowance for third country effects) and consumer prices. These weights, which were revised during 1996, are: Japan (26%); European countries (30%); USA (14%); other Asian (21%); and Others (9%). The revisions, just mentioned, reduce the weight of the yen from 37% to 26%. Nevertheless, movements in the yen/dollar rate continue to have a substantial effect on this measure of Indonesia's real effective exchange rate. If a different index were calculated using a significantly smaller weight for the yen (and a correspondingly larger weight for the US dollar), it would indicate a substantial real appreciation in the 1990s. Likewise, an index using unit labor costs (which are not available in Indonesia) would probably show a significant appreciation, owing to the rapid increases in real wages in Indonesia in the 1990s (see Section B).

11. The mechanics of this are roughly as follows. As international oil prices rise in the face of constant domestic retail prices, non-tax revenues accruing from domestic sales of petroleum products (which were budgeted at Rp 800 billion) decline, reaching zero at approximately US$18/bbl. At higher international prices (and continued constant domestic prices), budgetary transfers must be paid to Pertamina as re-imbursement for domestic operations. These transfers are recorded as a current expenditure in the budgetary accounts. It should be noted that the timing of these re-imbursements to Pertamina is somewhat uncertain.

12. In principle, payments of some $1110 million were paid from the budget surplus of 1995/96; effectively, Government deposits were drawndown, then rebuilt by the high oil revenues. Since the oil revenues were in foreign exchange, there was no impact on international reserves. In addition, in December the Government privatized an additional 4.15% of PT Telkom, and prepaid another $530 million of foreign debt (see Section D). There were also some payments carried over from the previous year.

13. These are accounted-for in part by rapid growth in self-financing (*Swadana*) by some government departments (especially Health and Education), which are being brought on-Budget. These have a counterpart in non-tax revenues.

14. Very limited data exist on this issue. Those that are available (see Table 1.7), measure only *net* flows of (what is probably) a relatively small portion of the total.

15. Members of Parliament have called for an accounting of off-Budget non-tax revenues, including items such as: reforestation funds and the 2% surcharge on high-incomes (see main text); 1% of certain telecommunications revenues to be paid to Tourism, Post and Telecommunications; a levy of $3.50 imposed by the Ministry of Tourism, Post and Telecommunications on each sale of a handphone; a levy of $20 on every laborer working overseas; a $200 mandatory training fee for laborers wanting to work overseas; and a levy on television ownership in the name of TVRI.

16. The swap premium is a sensitive financial indicator of exchange rate risk. It is the amount (measured in % per annum) that must be paid to guarantee purchase of foreign exchange at a specified rate at some specific date in the future. In Indonesia, most transactions are at a short maturity, with an estimated 80% of transactions for less than a week; of these, most are overnight. Trading at the 3-month rate maturity is sometimes thin, but indicative rates are available back to early 1993. It should be noted that, on occasion, BI has intervened in this market, for example, during the Mexico exchange rate crisis.

17. The rise in the money multiplier after 1988 is generally attributed to financial deregulation, which led to significantly wider financial intermediation. Not surprisingly, it flattened-out in the early 1990s after the main market penetrations had been made. The immediate difficulty is with the steep climb since early 1995, apart from the once-only identifiable drop directly attributable to increased reserve requirements in February 1996.

18. In early 1997, Bank Indonesia announced new targets for 1997. In total, the growth target would be roughly unchanged from 1996.

19. For example, Bank Indonesia required each bank to submit budgets for approval; Bank Indonesia then met with banks early in the year reducing significantly most of the banks' lending targets. The final targets for 1996 were around 15% for the state commercial banks; 20-25% for big and medium-sized banks (the sole exception being Bank Duta which was granted 30% because of its negative growth from 1991 to 1994); and a ceiling of 30% for small banks. Nevertheless, credit extended by private foreign exchange banks expanded by around 30%.

20. These data are known to be very rough, they cut across standard sectoral definitions, and they may well underestimate the extent of banks' exposure because many additional loans that are extended through Groups' finance companies, which are still excluded. On the other hand, these loans are not uniformly risky. For example, roughly one-third are mortgages, which have experienced a relatively low level of write-offs historically. The most risky would be loans for property development (which also constitute about one-third of the total), as developers might be encountering cash flow problems due to slower-than-expected property sales. The remaining one-third is categorized as loans for construction.

21. For example, the exemption from luxury tax for the national car and certain other autos that achieve 60% local content, is roughly estimated to cost $1/4 billion per year.

2
HIGH GROWTH WITH EQUITY INTO THE 21ST CENTURY

A. Overview

2.1 By 2005, Indonesia's GDP per capita will exceed $2300 (in current prices) at present growth rates. Nearly half of Indonesia's 220 million people will live in urban areas, up from about 31% in 1990. Wages would increase approximately as fast as per capita income, and outer-island growth would be rapid, if current trends continue. But, if policy were to deteriorate, then growth could slow to 5% per annum. This would mean only $1850 per capita GDP in 2005, about 20% less than with 7.5% growth. With such a slowdown, growth of wages and outer-island incomes could slow even more. The lower GDP also would mean significantly fewer resources to address social issues.

2.2 Policies in five areas would sustain high growth and contribute to equity:

- Macroeconomic stability;
- High investment and saving rates, which are linked to macroeconomic stability;
- Human resource development, with full female participation;
- Efficient resource allocation, through a deregulated incentive framework that forces efficiency and international competitiveness; and
- Improved government and institutions, including improvements in the legal system and business practices, realignment of public spending toward more transparent, competitive management of public/private interactions and shifts in the Development Budget away from areas of private interest.

These factors have been critical to East Asian economies' strong performance, according to many analysts.

2.3 Indonesia is a prime example of these factors' importance. Until macroeconomic stability was restored around 1970, low growth, investment and savings were the rule. Growth of basic education was a major factor in economic expansion, higher wages and reductions in poverty. When oil prices fell in the 1980s, quick adjustment and deregulation, supported by bilateral and multilateral lending, shifted resources into internationally competitive sectors. Correspondingly, Indonesia's recent growth was more rapid than can be accounted-for by increased physical and human capital; significant growth in total factor productivity also occurred. The broad-based, labor-using growth strategy, coupled with human resource development, has increased labor incomes sharply, especially for females.

2.4 Indonesia's further emphasis on these factors will support sustained high growth and improved equity into the 21st century. Attention to these factors is especially important given the new challenges Indonesia faces, including: globalization; educational quality; an aging population; natural resource depletion; environmental problems; and infrastructure to maintain the urban "engine of growth".

2.5 Indonesia's deregulation of trade and finance have already helped meet the challenge

of globalization, by forcing higher productivity and internationally competitiveness. Continued high saving and investment rates, educational upgrading, and restoring momentum to deregulation and completing the unfinished deregulation agenda will increase productivity further. Indonesia's international commitments in the ASEAN, the APEC and the WTO will help in this regard.

2.6 Improved government and institutions will play a major role in meeting the new challenges. Of great importance will be realignment of government's role, focussing less on production, more on institutions and regulatory functions, *e.g.* improvements in the legal system, upgrading of subnational governments and state enterprises, and setting up clear competitive, regulatory frameworks. Greater reliance on the private sector, fostered by such frameworks for private participation, will help provide resources and better meet users' needs. Realistic pricing policies for resources, such as petroleum, gas, power and forestry would yield large benefits in terms of revenues, efficiency and equity.

2.7 Such a realignment would allow the Government to focus and increase Development Spending on areas like basic human resource development and urban infrastructure, where private interest is low. Institutional improvement, as well as more funds, will be critical in these areas. In many cases a combination of decentralization, improved institutions and imaginative reliance on the private sector could reduce costs and make spending more responsive to user needs. Institutional development of a secure, more fully-funded pension system for the aging population would raise savings while providing contributors with reasonable retirement incomes.

2.8 Equity would also benefit from these measures. Continuation of rapid, labor-based growth through human resource development and external and internal deregulation would maintain rapid growth in wage incomes and jobs, including in the Eastern Islands. Transparent, competitive frameworks for privatization and low protection, would ensure that all Indonesians benefit from greater private sector participation, through good sales prices for concessions and public assets and through low prices for better quality services.

2.9 As a result of these policies, Indonesia would move up the ladder of higher-value-added exports, onto the rungs now occupied by Thailand and Malaysia. Growth of human and physical capital and business and entrepreneurial skills would naturally lead to more technology- and capital-intensive output, without the high costs, inefficiencies and inequities involved in protection from competition.

2.10 In contrast to this scenario, worldwide experience suggests that macro-instability, failures in human resource development and slow or reversed deregulation tend to reduce growth and competitiveness. In such cases, the benefits of growth have tended to accrue to those in the protected sectors or with access to government, and equity declines. Attempts to support uncompetitive, high-cost firms by channeling funds to them has often led to financial instability.

2.11 This Chapter discusses these issues as follows: Section A describes Indonesia in 2005, if it continues its recent record. Section B examines the policies that Indonesia will need to follow to continue its high growth with equity, based on the lessons of success in East Asia, including Indonesia's own history. Section C identifies some of the new challenges that Indonesia will face in the 21st century and outlines policies to help to meet them. Section D discusses the key issue of improved government and institutions, including managing the public/private sector interaction and realignment of the Budget. Details are followed-up in subsequent Chapters.

B. Indonesia in 2005

2.12 Indonesia's average GDP growth was 6.6% per annum in 1965-95, ranking in the top five large, developing countries. Growth also exceeded 6% per annum in each of the last three ten-year periods, a sustained growth record matched by only four other large economies and rare among all countries (Easterly, *et. al.*). In the first half of the 1990s, Indonesia's average growth increased to 8% per annum. Recognizing Indonesia's higher potential, President Soeharto raised the REPELITA VI growth target to 7.1% in August 1995.

2.13 What would Indonesia look like, if, say, 7.5% per annum growth could be sustained through 2005? The highlights are:

- GDP per capita would more than double in current prices, to over $2300;
- Indonesia would become one of the world's 20 largest economies;
- Dependence on primary production would continue to decline;
- Exports will rise to about 28% of GDP;
- External debt indicators would improve markedly;
- Population would reach nearly 220 million;
- Half the population would live in urban areas; and,
- Greater Jakarta's population would reach 25-30 million, making it one of the largest metropolitan areas in the world.

2.14 **Output Trends**. Within GDP, the role of primary products will continue to decline. This is a well established growth pattern worldwide. It reflects low income elasticities of demand, demand for more value added to primary products from outside the sector (*e.g.*, packaging, convenience, and quality) and technical progress in production. Agriculture

Table 2.1: Economic Indicators 1990 to 2005
(1993 prices, Rps., %, and $billion current prices)

	1990	*1995*	*2005*
GDP (Rps. trillion 1993 prices)	263.3	383.1	791.0
Percent in:			
Agriculture	20.2	16.1	10.3
Mining & Quarrying	10.1	9.3	7.9
Oil & Gas Mining	8.3	6.2	2.7
Industry	27.3	32.6	39.3
Oil & Gas Mfg.	3.3	2.5	2.7
Non-oil/Gas Mfg.	17.3	21.3	25.6
Elec., Water, Gas, Const.	6.7	8.7	11.0
Services	42.4	42.1	42.5
Memo Items:			
Non-oil GDP (Rps. trillion 1993 prices)	232.7	350.3	748.5
Non-oil GDP as % of GDP	88.4	91.3	94.6
Exports (US$ billion current price)	25.4	45.5	130.0
Oil & Gas	11.1	10.5	10.0
Non-oil Exports	14.3	35.0	120.0

will continue to shift away from rice, toward more higher value-added foods, as, for example, has occurred in Thailand already. Per capita demand for rice is already stagnant among most Indonesian income groups. Rice exports would either require much higher world (relative) prices of rice or large subsidies. At the same time, a sound base exists for efficient production of many foodstuffs, if institutional problems such as land titling, transport restrictions, storage arrangements, etc., can be overcome. Lifting restrictions on exports and inter-island trade, plus shifts in agricultural research and extension to non-rice crops, would improve national efficiency and benefit Eastern Indonesia (Chapter 5 and World Bank 1996b).

2.15 Forestry suffers from overcutting according to government figures. Unless overcutting is reduced, output in this sector is likely to fall permanently. Even with a shift to more sustainable forestry development, output is likely to fall for some years while forests regenerate (see Chapter 5). The projected development of pulp and paper, based on managed plantations, is unlikely to offset this decline in the next few years.

2.16 Mining prospect are good. Numerous exporters will come on-stream soon, reflecting improvements in the incentive framework since the 1980s. Oil output is projected to decline gradually, reflecting exhaustion of existing fields and the high cost of developing new ones (see World Bank 1994a). But LNG and LPG will continue to grow, based on development of proven finds and continued high external demand for clean fuels. Growth can be spurred by focussing development on lowest cost fields, whereas emphasis on development of high-cost new fields would raise investment requirements, and slow growth of output, exports and national productivity. Natural gas for domestic use has potential if a more attractive framework can be set up for investors (see Box 2.9 in World Bank 1996a). Greater use of this fuel domestically would reduce pollution and, by substituting for diesel, slow depletion of oil fields.

2.17 Manufacturing will continue growing faster than GDP, with an export base. Its growth will depend on continued investment, human resource development, and foreign investors who bring capital, technology, managerial skills and access to markets. Electricity, gas, and construction will need to grow even faster, if infrastructure needs are to be met. Finally, Service sectors are likely to grow about as fast as GDP.[1]

2.18 Non-oil exports would rise at least 13% per year, under the scenario of (a) continued rapid growth in manufactures based on exports and (b) growing mineral exports. Increased gas exports will more than offset the projected fall in oil exports. Total exports would rise about 180%. With tight macroeconomic policy restraining current account deficits and external debt growth, the ratios of debt and debt service to exports would fall sharply.

2.19 **Demographics.** Population growth is projected to decline to about 1.4% per annum for 1995-2005. Its continuing decline, together with longer school attendance, will slow labor force growth. Longer life expectancies will increase the average age of the population. By 2005, the proportion of retirees relative to the work force will be rising, which means a sound pension system will be needed soon.

2.20 Population distribution among the main island groups will not change much. Java-Bali population is likely to decline from 61.5% of the total in 1990 to 59.2% in 2005, Sumatra to increase slightly, from 20.2% to 20.6%, and the Eastern Islands to rise from 18.2% to 20.2%. Differences in the three areas' "natural" rate of increase are the main determinant of this projection; net migration is assumed to remain small relative to natural rates of growth, even in the Eastern Islands (World Bank 1994a).

2.21 **Urbanization.** A majority of Indonesians will live in urban areas by 2005, compared to only 31% in 1990. This rise will occur even if urban population growth slows from the current 5% per annum, which is among the highest rates in East Asia (World Bank 1993c).

2.22 Jabotabek's population is projected to rise from 17.1 million in 1990[2] to 25-30 million population (almost one-quarter of Java's population), even allowing for some slowing of its growth rate. As a result, Jabotabek would become the second or third largest metropolitan area in the world. More than half of Jabotabek's population would continue to live outside DKI Jakarta. The concentration of population, and economic activity, in and around Jakarta is high (Henderson, Kuncoro and Nasution). In many large countries, *e.g.* China, India, Brazil, there is a smaller proportionate gap between the largest city and the next larger cities.

2.23 Much of Indonesia's urbanization has come, and will continue to come, from urban expansion into areas previously defined as rural, rather than in-migration, as shown in Box 2.1 for Jabotabek.[3] This pattern probably reflects, among other things, lack of land titling at the urban fringes. Substantial back-and-forth, rural-urban movements also occur within a given year in response to changes in employment opportunities. These patterns represent a challenge—to avoid urban sprawl—and an opportunity—to provide infrastructure and organization without the constraints of an already developed area.

2.24 Reaching 7.5% growth will depend increasingly on rapid growth in and around Indonesia's cities. This is a worldwide pattern. Thus, maintaining rapid GDP growth will depend on making Jabotabek, Surabaya, Medan, Ujung Pandang, etc. "work", as well as creating an efficient network of secondary cities. This in turn will depend on more resources for urban infrastructure, but also on improved institutions (Box 2.1 and Chapter 4.)

2.25 Resolving environmental issues will be critical to sustaining high growth, particularly in the cities, and to ensuring that Indonesians enjoy a quality of life commensurate with their higher incomes. Ensuring safe water, management of increasingly scarce water, and dealing with air pollution will become more and more important issues, from a cost, as well as a quality of life issue. Taking action on industrial pollution now, rather than cleaning up later, is necessary because nearly 80% of the potential pollutants will come from factories not yet built, and because cleaning up investments is far cheaper than retro-fitting "dirty" factories (World Bank 1994c, 1995a, and 1996a).

2.26 **Equity Issues.** Continuation of past trends will increase real wages about as fast as per capita income growth; administrative attempts to speed up wage growth could well slow employment and lead to a widening gap between formal and informal labor markets (see Section C and World Bank 1996a). The Eastern Islands would benefit from continued fast growth (World Bank 1996a and Manning), plus domestic deregulation that would raise the prices received for their products (Chapter 5), and from the reorientation of the development budget. With these policies demand for labor would grow rapidly (Manning) in the Eastern Islands

2.27 **A Slower Growth Scenario.** Slower economic growth is certainly possible. Indeed, a "regression to the average" is a common tendency among developing countries (Easterly *et. al.*), often coming from a weakening of policy. The stable growth of over 6% per annum in East Asia for the last three ten-year periods is very unusual.

2.28 For example, suppose Indonesia's current 7.5-8% per annum growth rate declined

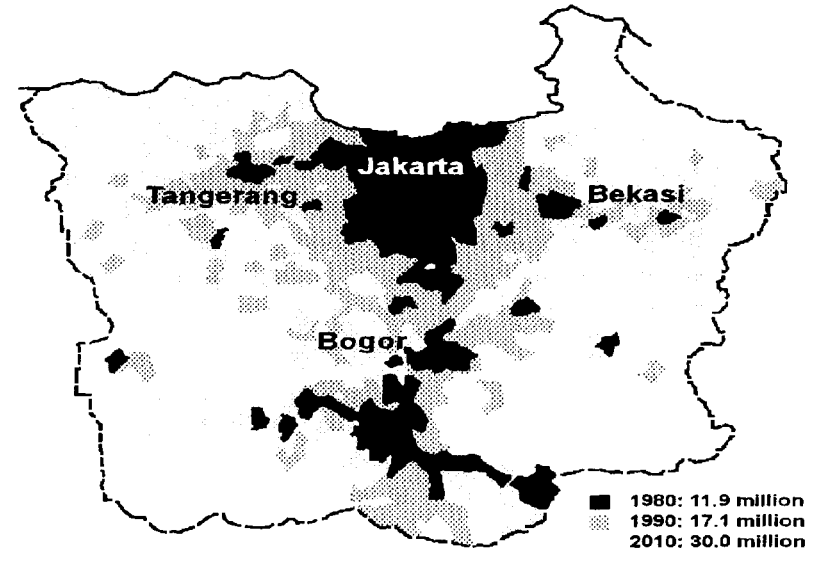
Box 2.1: Jabotabek: Keeping an Engine of Growth Running Smoothly

Jabotabek was a major engine of Indonesia's recent growth, accounting for an estimated 25% of the non-agricultural GDP growth between 1983 and 1993. Population grew over 4% per year (including incorporation of formerly rural areas). Jabotabek's growth reflected deregulation of the financial sector and of labor-intensive industry. Firms located in Jabotabek to be near a major domestic market that also had good international access. Industrial growth of Jabotabek also was stimulated by the expanded intra-Jabotabek road network (Henderson, Kuncoro and Nasution). This allowed firms to set up outside DKI Jakarta but retain access to the city and world markets.

A slow-down of the Jabotabek engine of growth would make it harder to maintain a 7.5% per annum GDP growth rate. Increasing congestion is one threat to Jabotabek's growth. Increased traffic is already congesting roads and the port. Vehicle registrations have been increasing rapidly and national exports/imports are projected to increase by about 120% in volume by 2005. The new ring road and other private toll roads will help reduce road congestion, and the new private port will ease physical bottlenecks to trade. But more public funds also are needed for improving the rest of Jabotabek's road network. In Jakarta, improvements can be realized by de-bottlenecking investments. But possibilities are limited—road area represents a smaller fraction of city area than Bangkok, and is much below the generally recognized 20% standard. Hence better traffic management, congestion taxes, and mass transit will be needed to move goods and people. In addition, investment in "Botabek" road expansion, intra-city links within Jabotabek, and an inter-city network would encourage decentralization and keep the engine going.

Meeting Jabotabek's environmental needs also will be critical to sustaining its growth. In particular, increased provision of piped water, which currently reaches only 10-20% of the population, and sewerage treatment will be critical. Dependence on well water is leading to salinization of the aquifer and to land subsidence, which contributes to floods. Dependence on septic tanks and weak management of waste disposal is increasingly contaminating well water (World Bank 1994a, 1994c). Increased atmospheric pollution is raising health costs (World Bank 1994a, 1994c)—strong implementation of the Presidential announcement to phase out leaded gasoline, improvements in two-cycle engines, and greater reliance on clean natural gas for power would help limit the growth of pollution.

The Spread of Urbanization in JABOTABEK, 1980 to 2010



Cartography by Peter Midgley EA3RS

to 5% per annum. Such a drop could easily come from a drop in productivity such as occurred in other East Asian countries when policy shifted (Box 2.4), and as is now being predicted for Thailand. Although a higher rate than most large developing countries have been able to achieve, it would be much less than the REPELITA VI target. What difference would this fall make?

2.29 A 5% per annum average GDP growth for 1995-2005, would mean a GDP per capita of about $1850 (in current prices) in 2005. This is a substantial improvement compared to 1995's $1023, but it is about $450 (20%) less per capita than the baseline outcome.

2.30 Slower growth would mean lower demand for labor, and slower improvement in wages and jobs. This would be especially true if the growth slowdown reflected misallocation of resources to overly capital-intensive industries (World Bank 1994a and 1996a). Slower growth also would mean less reduction in poverty and regional disparity (see World Bank 1996a and Garcia-Garcia for the links between regional and national growth). Failure to reduce internal trade barriers would miss an opportunity to improve regional equity; attempts at investments to compensate for regional disparities, without reducing internal trade barriers, are likely to reduce the productivity of scarce capital. In addition, slower growth would mean fewer resources to tackle these inequities through human resource development and transfers.

2.31 What policies are necessary to encourage a 7.5% growth rate with the corresponding increase in labor incomes, reduced poverty and increased regional and personal equity, rather than a 5% rate? What new challenges will Indonesia need to meet in order to continue its current high growth rate? The next two sections examine these questions based on the experience of the large, high performance East Asian Economies, including Indonesia's own experience.

C. Lessons of Success in East Asia

C.1 The Large, High Performing, East Asian Economies

2.32 What lessons can Indonesia learn about sustaining high growth with equity from the remarkable record of growth and reduction of poverty in East Asia (Hong Kong, Indonesia, the Republic of Korea (henceforth Korea), Malaysia, Singapore, Thailand and Taiwan, China).[4] Many analyses broadly agree that four interrelated factors were critical to these countries' rapid growth with equity:

- Macroeconomic Stability;
- High Investment and Saving rates;
- Human Resource Development, with strong female participation; and
- Efficient Resource Allocation, more in line with market signals and international competitiveness than other developing countries, which produced high export, and import, growth.

2.33 The East Asian economies are generally near the top of developing countries in these four areas. When their performance in these areas weakened, growth and equity tended to suffer. Of course, the countries' growth paths and policies were not identical, as discussed below in more detail for the five larger, high-performing East Asian economies (henceforth, HighPerformers): Korea; Taiwan, China, Malaysia; Thailand; and Indonesia.[5]

2.34 **Sound Macro Fundamentals.** Low to moderate inflation, high public saving, small government deficits, and realistic exchange and interest rates—are generally considered to have been major factors in the HighPerformers' rapid growth and high investment rates (see Stiglitz, for example). Macroeconomic stability also contributed to equity; it limited

the "inflation tax on money" which hits the poor hardest, and it helped to create a favorable investment climate that led to growth of labor demand.

2.35 The HighPerformers also adjusted quicker to macroeconomic shocks than other groups of countries, in most cases. In some periods, HighPerformers' current account deficits did worsen and external debts grew rapidly. But rapid export growth, and quicker changes in policy than in other developing countries brought a fast resumption of growth (World Bank 1993b, Little *et.al.*).

2.36 Macroeconomic stability in these countries is not a matter of culture or luck. In some periods, for example in Korea, and Indonesia in the first half of the 1960s, it was lacking. In these periods, investment/saving rates were below 10% and growth was low.

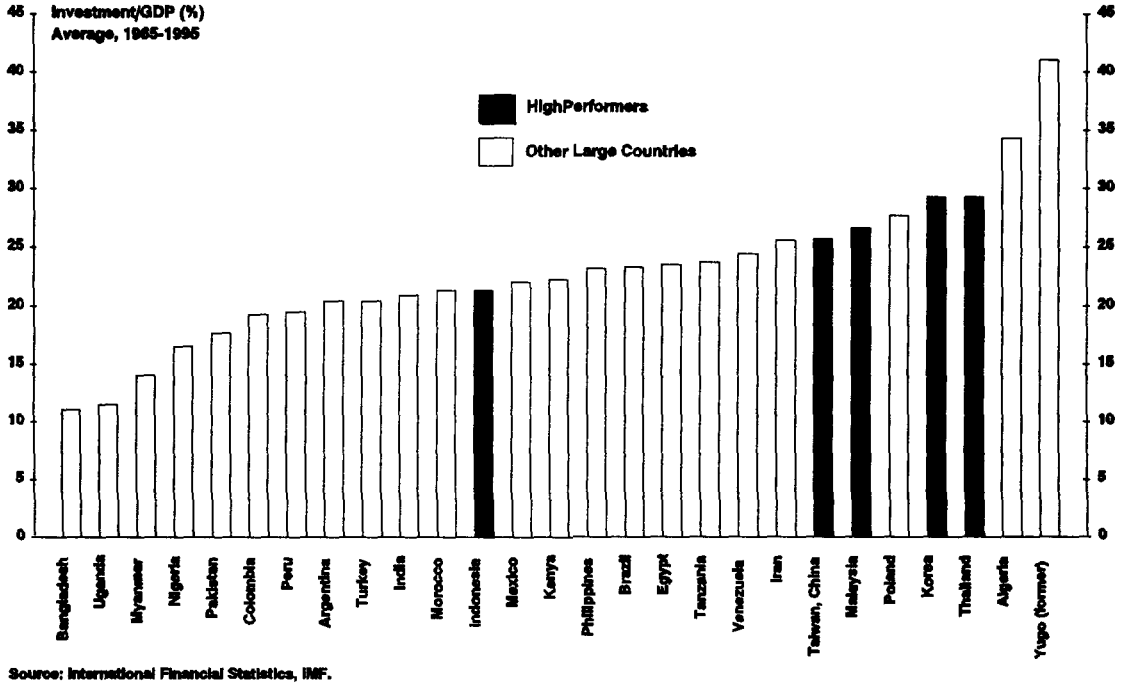
2.37 **High Investment and Saving.** Average investment rates of the High Performers exceed most of the larger developing countries' (over 20 million population), except the former Communist states' (see Figure 2.1 for 1965-1994).[6] Investment and saving tended to rise in the HighPerformers, as confidence developed in the fundamentals and growth process, generating what McKinnon called "a virtuous circle".[7] Over time, the HighPerformers' higher-than-average domestic savings rates, including higher-than-average public savings rates, financed much of their high investment (World Bank 1993b, pp. 203-210; Corbo and Schmidt-Hebbel; Stiglitz and Uy). Their high savings allowed them to rely less on foreign saving (have smaller average current account deficits), on average, than most large developing countries.[8] However, in recent years, Indonesia, Malaysia and Thailand have been among the largest recipients of foreign direct investment and portfolio capital.

2.38 **Human Resource Development Makes a Difference**. Improvements in human capital have been a third major pillar of rapid growth with equity in the HighPerformers. School enrollment rates rose sharply in HighPerformers after World War II, and have continued high (World Bank 1993b, p. 45-46, Rodrick). As a result, education levels in the HighPerformers' labor force rose more sharply than elsewhere between 1960 and 1980 (Figure 2.2). Increased educational attainments added the equivalent of about 1% per annum to labor force growth in Indonesia, Korea and Taiwan, China (Dasgupta, Hanson and Hulu; Young, 1995). The HighPerformers had much higher public, and private, spending on primary and secondary education than other countries. (World Bank 1993b, p. 199-200).

2.39 More education reduced poverty as well as raising human capital. Families were raised out of poverty as better educated workers found jobs under the labor-based, outward-oriented development strategy (see below). Females benefitted particularly from these developments. The gap between female and male enrollment levels has closed much faster in East Asia than South Asia and Africa (Barro and Lee). Moreover, growing job opportunities allowed a rapid shift of females from informal, rural work to formal sector employment (see World Bank 1996a and Dasgupta, Hanson and Hulu for Indonesia).

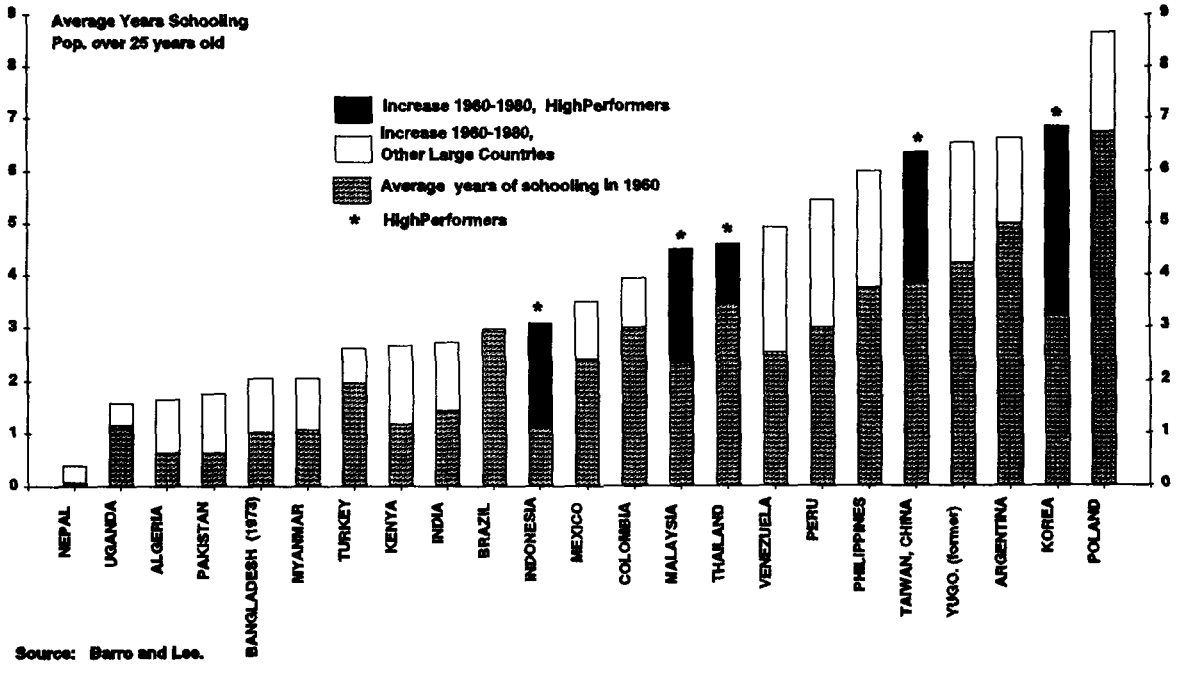
2.40 The demographic transition occurred sooner (and quicker) in the HighPerformers than elsewhere in the developing world, particularly in terms of lower fertility rates. This was part of a second virtuous circle (World Bank 1993b); improved female education and job opportunities contributed to lower fertility, and lower fertility meant more resources per pupil from the same amount of public spending for education. Moreover, the sharp demographic transition and increased job opportunities raised the ratio of the working population to children and retirees. This (relative) increase in workers implied a higher GDP per person.

Figure 2.1: High Performers Are High Investors



Source: International Financial Statistics, IMF.

Figure 2.2: The High Performers Increased Schooling Rapidly in the Labor Force



Source: Barro and Lee.

2.41 **Efficient Allocation of Resources is Important.** In the HighPerformers, 25-50% of per capita GDP growth depended on increased efficiency in using resources and technology; it cannot be accounted for by the accumulation of human and physical capital.[9,10] Former communist countries had higher rates of accumulation of physical capital than the HighPerformers, but their growth rates were much lower. Brazil's "miraculous" growth in the 1960s and 1970s slowed sharply when the debt crisis and oil price rises exposed the internationally uncompetitive investments that had been made (as well as problems of macro stability and human resource development; see Box 2.2 and Fig. 2.2). Thus, differences in growth per capita between HighPerformers and other developing economies also reflect differences in the efficiency of using resources and technology, between and within sectors.

Box 2.2: Brazil: From Miracle to Instability

The Brazilian "Miracle" as it was known at the time, lasted from about 1957 to 1977. Estimated GDP growth averaged over 7% p.a. in this period. With inflation also averaging over 30% p.a., Brazil was often cited as a counter-example to the importance of macroeconomic stability for growth. To some extent, inflation's distortionary effects were reduced by indexing (inflationary adjustment of the principal of government and housing debt, instituted after 1964) and a "crawling" exchange rate (regularly adjusting the exchange rate for inflation with a crawling peg after 1968). However, the "Miracle" ended in the mid-1970s. Since then, lower, more volatile growth has prevailed.

The oil price shocks and the debt crisis exposed the unsustainability of Brazil's growth strategy (which other Latin American countries also had followed to a greater or lesser degree in this period). First, investment rates in Brazil were less than in the HighPerformers. Saving rates were even less, so investment was more dependent on foreign capital inflows, particularly in the 1970s. Macroeconomic instability probably contributed to outflows of Brazilian private saving (although less than in other Latin American countries) and to the need for a major public sector role in investment and external borrowing to finance it.

Second, Brazil's improvement in education was by far the lowest among the large developing countries in 1960-80. In part this reflected low rates of spending and emphasis on higher level education. These policies not only tended to slow growth, they contributed little to improving equity.

Third, Brazil's resource allocation followed an inefficient, forced import substitution model. Protection and large subsidies increasingly shifted scarce resources into high-cost, capital-intensive, uncompetitive sectors such as airplanes, computer technology, and gasohol. (This also over-stated the GDP growth, as the import substituting industries were included without adjusting for their higher prices compared to imports of the same goods.) Productivity growth in Brazil's protected import substitution manufacturing was actually less than in the economy as a whole (Elias cited in Young, 1995). As an indicator of Brazil's attempt to produce everything, whatever the cost, exports plus imports of goods and non-factor services averaged less than 20% of GDP. The use of much of the investment in industries that generated little employment combined with the limited increase in human capital to produce one of the most unequal income distributions in the world.

With the mid-1994 introduction of the Real Plan, macroeconomic stability returned to Brazil. The import substitution model is being dismantled with the elimination of quantitative restrictions and lowering of tariffs. Productivity growth has been substantial since 1992. With privatization and reduction of the state monopolies in infrastructure, further productivity gains are possible.

See Coes and works cited there.

2.42 The importance of aggregate resource allocation is often overlooked. If resources are kept in internationally uncompetitive sectors or firms by protection or subsidies, then growth suffers. The resources could be used more effectively elsewhere. Shifting the resources to the more efficient sector will raise growth by producing more output, and exports or efficient import substitutes.

2.43 One example is agriculture. In Korea, the shift out of traditional agriculture was accompanied by a high rate of total factor productivity growth in the economy as a whole; this slowed as the transition was largely completed (Kim and Park). In Indonesia, rapid growth of total factor productivity accompanied the shift of females from unpaid rural work to formal sector employment that accompanied the deregulation at the end of the 1980s/early 1990s (Dasgupta, Hanson and Hulu). High protection of traditional agriculture tends to keep more resources in agriculture than necessary. It also raises the price of food, which hits low income families.

2.44 Similarly, high protection of industry or parts of industry reduces GDP. The availability of protection attracts capital and skilled labor that could be used more efficiently elsewhere. It also tends to worsen equity, by generating incomes for those who are best able to negotiate protection, not the most efficient producers.

2.45 The HighPerformers paid more attention to international competitiveness of investments and market-based signals than other developing countries. For example, in labor markets they did not attempt to push up wages artificially (see Box 2.3). In the financial sector, average real interest rates on deposits were slightly positive and had a small variance, while in most other developing countries real rates were either very negative or had large variances (largely associated with variations in inflation) that raised risks to holders of savings deposits and money.[11] HighPerformers did use subsidized, directed credit during part of this period, in particular in Korea toward exporters and certain industries[12] (See, for example Stiglitz and Uy and works cited there). The interest rate subsidies seem to have been smaller than in most other regions (World Bank 1993b pp. 285, 309). However, non-performing loans to the subsidized sectors have been a continuing problem since the mid-1980s, as has been the case in many countries.

Box 2.3: Successful Approaches to Labor Markets

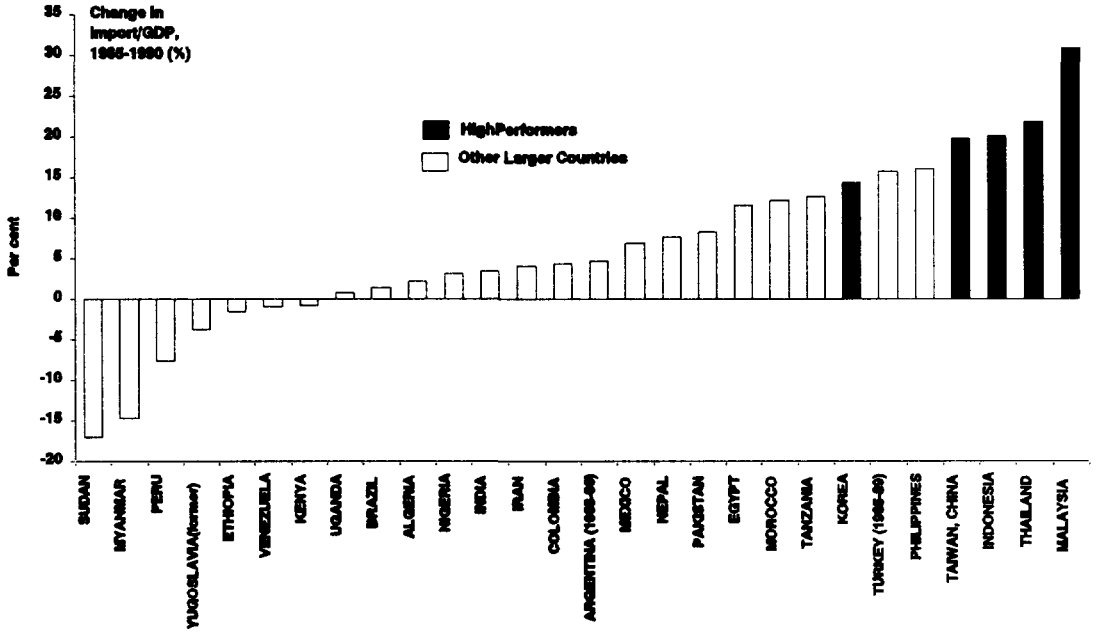
"In East Asia, more than elsewhere, governments resisted the temptation to intervene in the labor market to counter outcomes unpalatable in the short run or to particular groups.... A relatively high level of efficiency in the allocation of labor was achieved by allowing wages and employment to be determined largely by the interaction of those supplying and those demanding labor services, rather than by government legislation, public sector leadership, or union pressure.

In East Asia, wages were pulled up by increases in the demand for labor, whereas elsewhere there was a greater tendency for wages to be pushed up artificially."

Source: World Bank 1993b, p. 266.

2.46 Resource allocation in the High Performers was more export-oriented (and less distorted by protection from imports) than in most developing countries (World Bank 1993b pp. 295-300, Thomas and Wong, Ranis). This was particularly true as the HighPerformers shifted to outward-oriented growth and deregulated. Maintenance of realistic exchange rates was one key factor (World Bank 1993b, pp. 125-127). Also, all five economies generally lowered protection (and reduced export subsidies that initially were used to offset the anti-export bias of protection) as export-led growth took hold.[13] This allowed the countries to benefit from specialization in the goods they were best at producing, and use export sales of these goods as a more efficient way to "produce" imports. The result has been that the HighPerformers' exports have grown more than most large countries' (as a share of GDP), but so have their imports (Figure 2.3).

Figure 2.3: High Performers Are High Importers, as well as Exporters



2.47 HighPerformers' government interventions were largely "market friendly" (World Bank 1991), and "complemented markets" (Stiglitz). Macroeconomic stability, a friendly investment climate and a commitment to education prevailed. Milder financial repression than in other countries was the rule (partly reflecting the HighPerformers relatively low inflation).

2.48 Export promotion was an obvious intervention, particularly in Korea and Taiwan, China. However, to some extent it simply offset the import protection that existed initially (Nam, World Bank 1993b, pp. 295-300). The subsidies were fairly uniform for all exporters (Krueger, 1997), including some arrangements for indirect exporters. Institutions (Government and Industry Councils) enforced competition for the subsidies in terms of performance (World Bank 1994b pp. 11, 93-102). In Korea, "Exporters eligible to receive support were limited to those whose past year's exports exceeded a target amount. To get

Box 2.4: Korea's Interventions in the 1970s

In the 1970s, the Korean Government increased its economic interventions sharply, reacting to numerous pressures. In 1972, the Government cut the debt burden of firms to the curb market and banks. However, "[this policy] raised social equity issues, as the wealth of depositors in the curb market and banks was transferred to the corporate sector, especially large firms. The fact that there was no profit sharing agreement in return for the wealth transfer created discontent among the public" (Kim *et.al.*, p. 193).

In 1973, the Korean Government intensified its promotion of Heavy and Chemical Industries (HCI). Even this program's objective was increased exports not import substitution, as there was recognition that the domestic market would have been too small to achieve economies of scale. The policy was implemented through subsidized credit and tax incentives, protection, entry restrictions and direct involvement in industrial decisions. Credit was the most important. The Government guaranteed foreign loans to business and external debt shot up, to become the third largest among developing countries by 1979. A National Industrial Fund was set up to channel a substantial part of domestic credit into the HCI and their power and gas suppliers.

High costs characterized the rapid industrial development under the HCI policy. Exports of the HCI did reach the target of more than 50% of exports, but later than originally planned, when the yen appreciated and world markets recovered from the second oil price shock. Many have commented favorably on the role of the policy in Korea's transformation (for example, Amsden, Wade). However, HCI was costly in terms of investment and apparently reduced national productivity. GDP growth rates did remain roughly constant between 1967-72 and 1973-79, but annual growth fell sharply in 1980-82. To maintain growth, the investment rate rose about 25% after 1973, implying a corresponding fall in investment productivity. Average (total factor) productivity actually declined in manufacturing in 1975-80 (Young, 1995). No doubt other factors contributed to these developments, but it is generally recognized that substantial excess capacity was created. More micro analyses also suggest that Korea's industrial policy may have slowed growth (Yoo, cited in Krueger p. 24), or at best wasn't a major drag (Stern *et.al.*, cited in Kim and Leipziger p. 25). Total factor productivity in the supported industries seems to have grown slowly (World Bank 1993b pp. 306 and 310 and Lee cited in Rodrick p. 33.), and these estimates may well overstate productivity by neglecting the increases in price (cost) related to the initial import substitution.

Increased inequality in Korea during the 1970s (Leipziger *et.al.*, p. 10) accompanied the interventions. The intervention policy also hampered financial development. In particular, the demonstrated willingness of the Government to help firms had two negative effects: i) firms were encouraged to take excessive risks; and, ii) financial sector development was hindered by the overhang of low return loans, the reduced incentives to screen projects and the continued Government intervention (Nam *et.al.*, p. 143; Leipziger p. 24; World Bank 1993b. p. 309), problems that continue to exist today.

When growth slowed sharply after 1979, the Government reduced emphasis on HCI and turned to deregulation to speed growth (Nam, p. 158).

more privileges, exporters had to work hard to compete with other exporters and foreign businesses" (Kim *et.al.* p. 186). However, the failure of such policies in many other countries, and the limits on such policies under current international rules, suggest they probably would be less successful today.

2.49 When the HighPerformers intervened in resource allocation substantially, the results were generally unfavorable. The most well documented cases are Korea (see Box 2.4) and Taiwan, China. In Taiwan, China, government support seems to have been negatively related to productivity growth in the subsectors of

manufacturing (Yang). Studies of Korea in the 1970s, when substantial interventions took place, generally conclude that rapid expansion of industry and private business were fostered, but at the cost of higher savings and investment, slower productivity growth, financial development and worsening income distribution. Similarly, efforts by Thailand to selectively target potential export growth over the past decade appear to have been ineffective —other exports grew at least as fast as those targeted (James). The financial sector was saddled with low return investments and interventions that are hindering its development even today. Outside East Asia, Brazil's protected industrial sector seems to have had less factor productivity growth than the rest of the economy (Elias cited in Young, 1995).

C.2 Indonesia's Own Experience

2.50 The details of Indonesia's experience as one of the HighPerformers strongly support the importance of macroeconomic stability, high investment and saving, human resource development and market-based, internationally competitive, resource allocation.[14] In the 1950s and 1960s, Indonesia's macroeconomic instability and state-led, import substitution strategy led to low levels of saving, investment and growth. In the mid-1960s, Indonesia was poorer than India.

2.51 Since the late 1960s, Indonesia has been characterized by macroeconomic stability. Inflation has averaged around 12%, and has been in single digits for the past decade. Excesses of public expenditure have been limited by the 1968 balanced budget regulation and, in the early 1990s, by saving oil windfalls in the Development Budget Reserve *(CAP)*. Current account deficits have generally been kept financeable. External debt now exceeds $110 billion but rapid export growth, close government monitoring and donor assistance have kept it manageable. The open capital account, which dates from 1970, has provided strong discipline on macroeconomic policy.

2.52 Investment rates have steadily increased, so that in the 1990s, Indonesia has one of the world's highest investment rates. The open capital account has encouraged capital inflows. But domestic saving also has grown, so that Indonesia continues to finance about 90% of its investment domestically.

2.53 Human resource development has been a major objective of the government, with a major increase in adult literacy and achievement of universal primary education. Female enrollment rates have steadily risen as a percentage of male rates (Chapter 3).

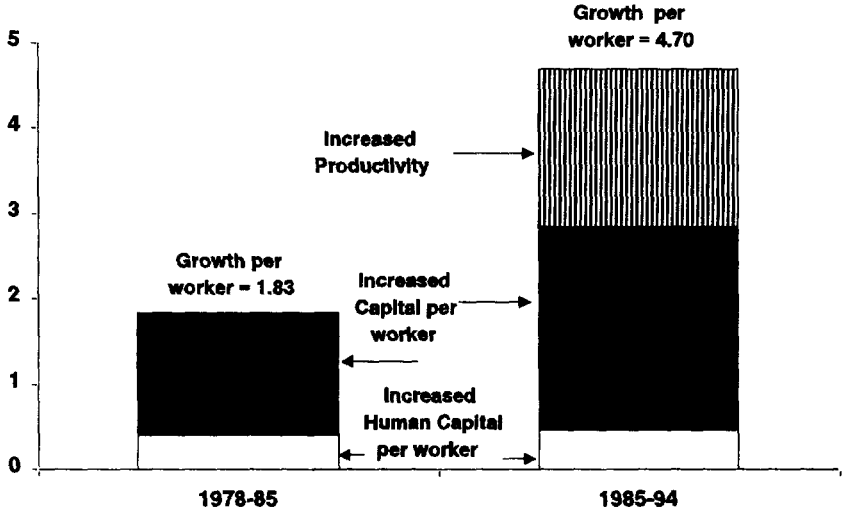
2.54 Indonesia kept the excesses of the 1970s oil boom under much better control than other countries. When the boom ended, Indonesia made the quickest adjustment to the drop in oil revenues of all the major oil exporters (Gelb *et. al.*), cushioned by borrowing from bilateral and multilateral institutions. Current account deficits and inflation were quickly brought back to moderate levels. Financial sector deregulation from 1983 onward, and especially after 1987, promoted the growth of financial intermediation and cuts in intermediation costs (Kenward). Spending on human resource development was protected from budget cuts better than in most developing economies (Dasgupta *et. al.*).

2.55 Deregulation at the end of the 1980s increased efficiency and incentives for exporters. Cuts in protection forced producers to become more competitive internationally. By the mid-1990s, the Government had eliminated most non-tariff barriers outside agriculture and cut the unweighted average tariff rate to 13% (Chapter 5), making Indonesia one of the HighPerformers' economies most open to external competition. Moreover, changes in foreign investment regulations in 1994 also

made the economy one of the least discriminatory in the region toward external investment, leading to some $90 billion of approved FDI projects in 1994-96.

2.56 In sum, Indonesia's economic policies have supported a growth rate averaging over 6% for the last 30 years, a record that ranks in the top 10% of developing economies. Per capita GDP now exceeds $1000, over 3 times India's. The shift in policies since the mid-1980s has brought a major improvement in resource allocation to internationally competitive sectors. This has been reflected in a sharp improvement in the total factor productivity of the Indonesian economy: whereas before the mid-1980s nearly all of Indonesian growth in per capita GDP was explicable by increases in capital and human capital, afterwards about 40% was explicable by improvements in the productivity of resources (Figure 2.4).[15]

Figure 2.4: Sources of Growth in GDP per worker (Average growth rate per year)



2.57 The broad-based, labor-oriented growth strategy, backed by the strong record in human resource development, has brought one of the sharpest reductions in poverty in the developing world. In the last few years, real wages have grown about as fast as per capita GDP, continuing the long run trend (World Bank 1996a, pp. 70-71) Females have benefitted from the strategy, which provided them with rapidly growing, paid employment in the formal sector, that allowed them to switch out of unpaid work in the rural sector. Off-Java, growth has also been high, among the highest in the developing world. Social sector indicators such as infant mortality, fertility, and school enrollments have improved in all provinces of the country since 1980, although substantial differences remain between the Eastern Islands and Java. (For an extended analysis, see World Bank 1996a, Chapters 3 and 4, World Bank 1994a, Chapter 5 and Manning.)

D. Meeting New Challenges to High Growth with Equity

2.58 Indonesia's growth has strong momentum. Increased emphasis on the four factors in the HighPerformers' success—Macro Stability; High Investment and Saving; Human Resource Development; and Market-based, Outward-oriented Resource Allocation—will go

a long way towards sustaining high growth with equity. However, structural issues could impede that process, including i) exhaustion of the gains from first round deregulation; ii) loss of deregulation momentum, iii) globalization; iv) educational quality; iv) an aging population; v) depletion of natural resources and environment problems; and vi) infrastructure shortfalls, especially urban infrastructure.

2.59 **Restoring Deregulation Momentum.** Some of the gains from past deregulation packages, especially those related to deregulation of foreign investment, will continue to maintain high growth. However, the gains in output from resource reallocation, are gradually being exhausted. Further deregulation would give another upward push to growth and increase labor demand and real wages (Chapter 5).

2.60 **Globalization Means Tougher International Competition.** Other developing countries are adopting the open economy model that has proved so successful in East Asia. They are all searching for foreign markets more intensively. They are all seeking foreign investment. Indonesia will face increasingly tough competition in globalized markets.

2.61 In the final analysis, Indonesia is most likely to keep up with the competition by relying on those instruments that have already served it well: (i) macroeconomic stability, (ii) a deregulated economy with equal incentives/low protection and no discrimination against foreign investment, and (iii) rapid physical and human capital growth. Aside from providing this framework, the public sector's role in production will involve provision of key infrastructure in areas of low private sector interest and some help to widen dissemination of information about technology.

2.62 **Globalization Also Provides Opportunities.** Global and regional trade treaties will open up bigger markets to efficient Indonesian producers. In addition, Indonesia has undertaken international commitments to a deregulated economy in the context of WTO, APEC and ASEAN. The Government has appropriately broadened these commitments to include all trading partners, in order to ensure access to least-cost suppliers. Meeting these commitments will ensure that Indonesia maintains a deregulated, efficient economy.

2.63 **Quality Human Resource Development.** Both government and business recognize that improving the quality of the labor force is a critical factor in sustaining high growth and rapid improvement in labor incomes, especially in the more competitive international economy. The Government has done well in increasing literacy and universalizing access to primary education. However, continued growth in real labor incomes will depend on quality (as well as quantity) improvements in education, training, and health services (Chapter 3).

2.64 **An Aging Population.** An aging population and slower labor force growth are inevitable outcomes of current population trends. In addition, health improvements and better diets are leading to longer life spans. Meanwhile, labor force growth is slowing because of lower population growth and increases in the average years of schooling.

2.65 These developments have three major implications. First, slower labor force growth and faster inactive population growth will tend to slow growth of GDP per capita, unless offset by education and investment. Second, an older population will demand more health services than a younger population. Meeting these demands efficiently will depend on major health sector improvements, including greater reliance on the private sector (Chapter 3).

2.66 Third, reasonable retirement incomes will be needed for the aging population. Their provision represents both a challenge and an

opportunity. The opportunity arises because an aging population initially means larger working age cohorts with high savings potential. An efficient financial sector and pension system will encourage their saving and thereby generate additional domestic funding for investment. "Fully-funded" pension institutions, in which individuals contribute to an individual account and their savings are invested in productive assets, have contributed to high saving/investment rates in Singapore and Malaysia (Stiglitz and Uy) and Chile. The major issue for Indonesia is setting up a system that provides good returns and is not just a new directed credit scheme that would only be a tax on labor (Leechor and Chapter 5). Use of privatization proceeds and budget surpluses to fund public pension liabilities could help this process.

2.67 **Sustainable Natural Resource Development.** Indonesia's resource base (particularly oil and forestry) is being depleted, which could slow export growth. Increased gas exports could well offset most of the decline in oil exports. However, competition is growing for Indonesia's LPG/LNG exports and strong growth will depend on focussing development on low cost fields. Forestry-based exports have declined in volume terms in the last few years. Government estimates of cutting exceed its estimates of sustainable yields, leading to projected further declines in exports early in the next century. Imports of logs are already needed for profitable operation of some mills. Minerals exports, from mines already under construction, will offset some of the slowdown of other resource-based exports, but further growth will depend on new concessions, and how they are handled.

2.68 The central issue in these resource-based products is a framework that a) provides for efficient development of the resource, b) a reasonable, predictable rate of return for the investor, and c) a reasonable share of the proceeds for the state, which is the owner of natural resources under the constitution. Where the framework has been unclear and potential rates of return are low (for example, oil in the 1950s and mining in 1974-85, when no contracts of work were issued to foreign mining companies), development of the resource has been limited. On the other hand, where the framework does not consider all three issues, there tends to be over-exploitation of the resource, and the benefits accrue to special interests, not the public (for example, in forestry; see Chapter 5).

2.69 **Ensuring Adequate Infrastructure.** Infrastructure limitations could hinder growth and reduce Indonesia's attractiveness to investors. The potential problem may be greatest in urban areas. Lack of water, sewerage treatment, electricity and inter- and intra-urban transport will raise costs of pollution, health care, congestion, distribution and power inputs. In Jabotabek, these problems threaten the source of nearly one-quarter of recent non-agricultural growth. Surabaya and other large metropolitan areas suffer from similar problems (Chapter 4).

E. Improved Government and Institutions: A Fifth Factor in Growth

2.70 Better public sector management and institutions will be a critical, fifth factor in sustaining high growth with equity and meeting new challenges in the 21st century. Specific areas in which improvements could be made include:

- laws and the judicial system (Chapter 5);
- greater reliance on clear transparent rules;
- greater reliance on the private sector, through the set-up and institutional implementation of clear, competitive frameworks that would encourage private participation and privatization while ensuring that the public receives maximum benefits from private participation;

- integration of private and public investment more effectively, through public planning (for example, the intra-urban transport network, water basin management and power generation, transmission & distribution); and,

- concentration and increased effectiveness of public spending in areas of limited private sector interest (for example, water & sanitation, inter-urban roads, drainage control and sanitation) through realignment of the Development Budget, improved public management and institutions, and decentralization of revenues and spending to sub-national governments with increased accountability and capacity at all levels.

E.1 Greater Reliance on the Private Sector

2.71 Greater reliance on the private sector could improve Indonesia's growth prospects and delivery of service to consumers. Although progress has been great in some areas, improvements in the framework and its institutional implementation could reap large benefits.

2.72 Despite some improvement, state firms' performance, in terms of rates of return, remains poorer than the private sector firms, on average.[16] Many public firms show losses or require conversion of Government loans to equity. Service provision often is poor, particularly in infrastructure areas such as water supply.

2.73 Private sector interest in developing country infrastructure has grown substantially in recent years. Indonesia has increasingly taken advantage of that development by turning from the traditional public sector approach for infrastructure to greater private provision of infrastructure, a process that has speeded-up recently (Chapter 4). The greatest advances have occurred in telecoms (full privatization, partial privatization and privately managed joint ventures in various parts of the industry) and power generation (private production for sale to a public distributor), as is the case worldwide. But private participation has also grown in toll roads, water, and ports, although construction has been slow getting underway (see Box 2.5).

2.74 Greater reliance on the private sector, both privatized services and private provision of services would provide three major benefits:

- Increased revenues (for the government and/or the enterprise) from sales, which can be used for investment or public debt prepayment;

- Private sector investments reduce the need for public investments, freeing development resources for social uses; and,

- Increased efficiency, that is, better service at lower cost.

2.75 To date, substantial benefits have been generated along these lines. The domestic portion of PT Telkom's listings has raised about $1.4 billion in new capital. This is roughly equal to the total Development Budgets for Telecommunications & Postal Services in 1994/95-1997/98. In addition, PT Telkom expects to receive about Rp.1 trillion per year from its joint operating schemes. BNI increased its capital 25% with its share offering. Moreover, the Indosat and Telkom listings on international markets, plus the recent private placement of Telkom shares, raised about $2.1 billion that was used to prepay high interest rate debt, saving substantially on interest payments.[17] Private investors will install about 40% of the planned increase in lines during REPELITA VI. It is still too early to measure the efficiency gains that have occurred, but the experience worldwide has been highly positive (Box 2.8 in World Bank, 1996).

Box 2.5: The Privatization Process in Indonesia: An Update

In power generation, 21 power purchase agreements have been concluded as of early 1997, and an additional 22 are in various stages of negotiation, with a total capacity roughly equal to PLN's current capacity. The value of these investments is estimated at over $20 billion. The contracts involve no tax concessions or direct Government guarantee. The Government has split the on-Java generating facilities of the state power company (PLN) into two companies, with a view to partial privatization (Chapter 4).

In 1993, a second franchise for long-distance telephone service was given to a private, well-connected firm, Satelindo; which in turn sold 25% of its equity to Deutsche Telekom for $586 million in 1994. In 1995, PT Telkom formed joint operating schemes with five partners, selected through competitive arrangements, to manage the phone system in areas outside Jakarta and Surabaya. In addition, PT Telkom and PT Indosat were partially privatized (20% in 1995 and 35% in 1994, respectively) through stock markets. An additional 4.15% of PT Telkom was sold through private placement in late 1996.

Private participation has grown in other areas as well. Private toll roads covering 531km are in operation, 162km are under construction, and contracts for another 1021km are in various stages of negotiation. A bulk water concession has been signed for Surabaya, after many years, and the Jakarta water company (PAM Jaya) signed a memorandum of understanding to negotiate a 25 year concession with two well-connected groups in October 1995. Another well-connected private firm has begun construction of the long-delayed new Jakarta port. And, outside infrastructure, PT Tambang Timah and Bank Negara Indonesia (BNI) sold parts of their equity in the stock market (35% in 1995 and 25% in 1996, respectively).

The Government has also expressed interest in partially privatizing, *inter alia*, Krakatau Steel, Garuda, and additional state banks. The publicly owned plantations were consolidated in early 1996 to help with the process of divestiture.

Sources: World Bank 1994a Chapter 3 and World Bank 1995a Chapter 2, Section E

2.76 **Important Remaining Issues**. Despite the substantial progress to date, some issues remain. For example, perceptions of non-transparency, lack of competition, unfair dealing and favoritism will need to be addressed as the privatization program is implemented. In addition, with regard to institutional mechanisms for pricing outputs and inputs (Chapter 4), some "framework" issues also remain, such as subsidies in industry, mining, fertilizer and steel production. In the power sector, concerns remain about harmonizing the interaction between public and private sector in order to avoid and/or to cope with excess power generation capacity (Chapter 4).

2.77 Increases in these benefits would come from Government realignment toward increased management and regulation and more focussed direct provision of services. This realignment would involve:

(a) Provision of a transparent, competitive framework for sale of concessions and assets (Box 2.6);

(b) Maintaining sectoral frameworks that are competitive, including clear, sustainable pricing policies; and

(d) Focussing the remaining public provision of goods and services in sectors/areas where private interest is limited (such as urban infrastructure, basic education, and some infrastructure in the Eastern Islands).

2.78 A clear, competitive framework for privatization and for granting concessions (Box 2.6) would encourage additional investment and greater benefits from increased private participation. Such a framework would ensure that the nation maximizes the receipts from sales of its assets and that user needs are met at the least cost. Improved management along these lines will potentially benefit private participation and ownership, which in turn will increase efficiency and reduce prices, and monopoly rents.

2.79 **Alternative Forms of Privatization.** One approach is privatization through financial markets, which tends to be transparent. The main issues are competitive choice of the marketing services, and pricing of the initial offering and allocation of shares.[18] Financial markets require transparent audited accounts and meeting this requirement often provides some benefits. However, partial privatization through financial markets may not do much to improve corporate governance (see Section E of Chapter 5 and Boxes 5.15 and 5.16).

Box 2.6: Improving Transparency and Competition in the Sales of Concessions and Assets

Maximum returns to the nation from the sale of concessions or assets could be ensured by an institutional process with the following characteristics:

(a) Pre-qualified potential bidders based on prior experience and performance.

(b) Clear definition, up-front, of the scope/conditions of the concession or sale of assets, including clear, comprehensive information on the contractual arrangements and any provisions that might mitigate the risk of the investor. Specifications that are unclear, or generate risk, will lower the price received by the nation.

(c) Well-defined bidding variables (preferably only one), such as the cost of service/price of the asset.

(d) Choosing lowest cost bid for the service or the highest price for the asset.

(e) Prompt public announcement of the winning bid.

(f) Clear institutional arrangements to deal with unsolicited bids and to resolve disputes.

Without such clarity and competition, complaints will always arise regarding favoritism and low returns to the nation at the expense of the recipients of the concession or asset. "Negotiations", especially over unsolicited proposals, face this problem, and also have proved to take an extended period. A transparent competitive framework would ensure that the Government receives the maximum from its asset and concession sales. The Government is developing a KEPPRES to regulate the sale of concessions which incorporates many of these points.

2.80 An alternative approach is competitive sale of ownership or concessions or management rights. This is likely to yield smaller up-front cash returns and may increase economic concentration. But it also may improve management more than partial privatization through financial markets. However, a major issue is ensuring a reasonably competitive sale—failure to do so would leave the Government open to charges of favoritism.

2.81 Sectoral frameworks that are transparent and competitive will also increase

the benefits to the country from privatization. Transparent sectoral frameworks, in particular the pricing arrangements, increase private sector interest. The ease of setting-up a transparent framework for power generation, through take-or-pay contracts, explains the large interest in that sector. When the framework is not transparent or lacks credibility, then the risks will lead private providers to charge high prices for services/pay low prices for the concession, reflecting their risk. An important institutional issue in setting up sectoral frameworks is to separate the regulatory agency from any remaining public presence in the sector, to reduce potential conflicts of interest.

2.82 **The Costs of Guarantees.** To substitute partially for non-credible, unclear frameworks, government guarantees may be requested. The guarantee is a way to bind the Government to the framework conditions. But, guarantees have costs. They represent a hidden cost on society, which becomes explicit if the framework is not maintained for any reason. Moreover, guarantees may themselves raise issues about credibility, typically if one firm receives a guarantee, then all seek them. Poorly specified guarantees also may reduce incentives for private sector performance. In particular, they may reduce the benefits of private risk-taking that is part of the efficiency of the market. For example, the take-or-pay type contract can easily lead to over-capacity, which would be less likely to evolve if private participants were risking a lack of demand for their product. Indonesia has revised its new power purchase agreements to reduce this problem.[19] Finally, to the extent private sector debt is guaranteed, it counts as public debt and uses up scarce public borrowing capacity, nullifying one of the benefits of private participation.

2.83 **Encouraging Competition to Generate Benefits from Private Participation.** A competitive sectoral framework, or one that mimics competition, will encourage private sector participation to cut costs, provide better service and improve technology, thereby benefitting society. Deregulation has given many tradeable goods sectors a fair degree of competition. This means that the Government can divest quickly its many directly productive enterprises in these sectors. Competition will ensure a low price and good quality to buyers from these firms, otherwise the supplier will go out of business. However, avoidance of special protection, subsidized inputs, or below-market credits are important to prevent the new private operators from benefitting at the expense of the nation. To maintain the gains from privatization of these firms, the Government will need to press ahead on deregulation.

2.84 For infrastructure, which is not tradeable and often involves some degree of "natural monopoly", Government improvements in the regulatory framework would pay large dividends. In many cases, "unbundling"—splitting-up or hiving-off activities of the public sector firms—will provide a good regulatory framework. "Unbundling" often creates sub-sectors that are competitive or need only a few well-chosen regulations to ensure competition. Such sectors are then attractive to investors, while efficiency is ensured. Examples include power generation, cellular phone service, and gas generation, as well as many services that can be bought from the private sector such as printing, janitors, maintenance, etc. In other cases, competition from substitutes—for example between various modes of transport—can provide competition. In these cases, privatization and private participation can also move ahead.

2.85 Where "natural monopoly" elements remain—for example, water supply, power and gas transmission—a more complex regulatory framework will be needed to mimic competition. A key element here is

independence of the regulatory agency from any remaining public producers in the sector. In both competitive and "natural monopoly" sectors, avoidance of subsidized inputs, or below-market credits are important to maximize benefits to the nation, rather than to the new owners.

E.2 The Development Budget

2.86 The Development Budget is a key instrument in the Government's management of infrastructure investment. Development Budget spending represents the Central Government's investment spending, either directly carried out by the Central Government or through transfers to sub-national governments and public enterprises, which carry out the investments.[20] The Development Budget is financed by Central Government saving and external borrowing. In addition to the Government Budget, public enterprises fund investments out of their own savings; borrowing in the cases of some public enterprises *(Perseros)*; and recently capital issues in the case of partially privatized firms.[21]

2.87 Development spending has grown little in real terms and declined relative to GDP in REPELITA V and REPELITA VI (the previous and current 5 year development plans).[22] The Development Budget has declined to about 6.5% of GDP in 1996/97, from 7.7% in 1989/90. And, since 1992/93, development expenditures have grown slower than routine expenditure. This pattern of expenditures means that Government revenues, including revenues from depletion of national resources, are increasingly funding current spending, rather than investment.[23]

2.88 Within Development Budget expenditures, the shares of infrastructure spending for Regional Development, Energy and Telecommunication have risen the most compared to REPELITA V (see Table 2.2). Human Resource Development and Roads have remained roughly constant as a share of the Budget (that is, a decline relative to GDP). Agriculture and "Other" spending has declined as a share of the Budget and relative to GDP.

2.89 Spending for Regional Development has increasingly been through sub-national governments and taken the form of bloc grants, which have replaced directed transfers, (*e.g.*, for schools and rural roads). The share of actual power expenditures has increased steadily, notably in 1995/96 when about Rp.1 trillion more was spent than budgeted. In the Budgets for 1996/97 and 1997/98, the share of power spending was reduced, but the state power company (PT PLN *Persero*), has directly borrowed about Rp.2 trillion (equal to 25% of the Energy spending in the Development Budget) in the last two fiscal years. Spending for Telecoms increased sharply in REPELITA VI, although it was cut slightly in nominal terms in the 1997/98 Budget. Education spending has declined slightly as a share of the Development Budget between REPELITA V and REPELITA VI, notably in 1995/96, when spending was substantially below budgeted levels.

2.90 With projected real GDP growth of 7.5%, the Development Budget will more than double in real terms over the next decade, even if it only grows at the same rate as GDP. This might suggest that substantial funds would be available for infrastructure and human resource development. However, World Bank estimates suggest that infrastructure investment needs to increase by at least one percentage point of GDP (World Bank 1992a, World Bank 1995a, World Bank, East Asia Vice Presidency). Spending on human resources also may need to increase relative to GDP in the short run (Chapter 3).

2.91 The Government has three ways to fund its higher capital spending needs:

- increase revenues or borrowing;

Table 2.2: Indonesia: Development Expenditures by Sector: 1989/91-1997/98
(Rp. billions and percentage)

Sector	*1989/90*	*1990/91*	*1991/92*	*1992/93*	*1993/94*	*1994/95*	*1995/96*	Budget *1996/97*	Budget *1997/98*	Average *89/90-93/94*	Average *94/95-97/98*
Total (Excl. Dev. Reserve) Rp. Billions	13,834	17,452	20,264	24,135	25,661	29,163	29,812	34,503	38,928		
A. Agriculture, Forestry, Irrigation and Water Resources	15	13	13	13	12	10	9	10	11	13	10
A1. Agriculture and Forestry	11	9	9	9	7	4	3	4	4	9	4
A2. Irrigation	4	4	5	5	5	3	3	4	4	4	4
A3. Water Resources	n.a.	n.a.	n.a.	n.a.	n.a.	3	3	3	3	n.a.	3
B. Human Resources Development	13	14	14	15	15	13	12	14	16	14	14
B.1 Health	2	3	3	3	3	3	3	3	4	3	3
B.2 Education	10	10	10	12	11	10	9	11	11	11	10
B.3 Manpower	1	0	0	1	1	0	1	1	1	0	1
C. Physical Infrastructure	32	31	30	31	33	35	38	34	31	31	34
C.1 Road	10	13	12	12	12	13	12	12	12	12	12
C.2 Energy	10	10	11	13	13	13	15	12	11	11	13
C.3 Other Transport	10	7	6	6	7	6	7	7	6	7	7
C.4 Post & Telecommunications	2	1	1	1	1	3	3	3	2	1	3
D. Regional Development and Transmigration	11	14	15	15	17	19	20	19	18	15	19
E. Others (Excluding Development Reserve)	30	28	27	25	24	23	21	22	24	27	23
E.1 Social Policy	5	5	5	6	5	4	5	6	7	5	6
Population and Family Planning	1	1	1	1	1	1	1	1	2	1	1
Social Welfare-Others	0	0	0	0	0	0	0	1	2	0	1
Housing and Settlement	4	4	4	4	3	3	4	4	4	4	44
E.2 Environment and Spatial Planning	3	3	2	2	2	2	1	2	2	2	2
E.3 Mining, Industry, Trade, Science and Technology	13	10	11	9	8	8	6	5	5	10	6
Mining	0	1	1	1	1	0	0	0	0	1	0
Industry	3	3	3	2	1	2	1	1	2	2	2
Trade	8	3	5	3	4	5	2	1	1	5	2
Science and Technology	2	3	2	2	2	2	2	2	2	2	2
E.4 All Others	8	9	9	9	9	8	9	10	10	9	9
Culture, Youth, Sports etc.	1	1	1	1	2	1	1	1	1	1	1
Religion	0	0	0	0	0	0	0	1	1	0	0
Government Apparatus, Security & Others	7	8	7	7	7	7	8	8	8	7	7
Memo Items											
Development Exp. as % of GDP	7.7	8.3	8.1	8.5	7.8	7.6	6.6	6.6	6.5	8.1	6.8
F. Development Reserve Rp. Billions		2,000	1,500								

- switch spending from the Routine (current) to the Development Budget; or
- rely more on the private sector and revenues from privatization and switch spending within the Development Budget.

2.92 Increases in revenues seem possible through changes that would also improve efficiency and equity (Chapter 1). Indonesia's ratio of government revenues to GDP (14%, of which one-fifth accrues from oil) is among the lowest in the region. Non-oil tax revenues have been increasing much faster than non-oil, non-agricultural GDP in the last 5 years. However, at some point non-oil revenue growth will have to decline closer to GDP growth, unless changes are also made in the tax system.

2.93 New measures could increase revenues substantially, while improving equity and efficiency (Chapter 1). Further improvements in tax administration, focussed on high income taxpayers, also are possible. Large additional public borrowing, or guarantees of private debt, would be undesirable, because of the still large external debt (see Box 2.7).

2.94 Room exists for a shift from Routine to Development Spending in the Budget, but large shifts will probably depend on institutional reform of the civil service. Civil service pay is low in real terms, and very little sustainable benefit is likely to be achieved from further depressing real civil service salaries. With a realignment of Government to more planning and regulatory roles, the Government could correspondingly consider revamping the civil service, reducing the numbers in line with the new needs and increasing pay along with increased responsibility. Such an approach also would yield substantial savings on civil service training, by permitting direct hires from the labor market in line with skills that are needed. A revamping of civil service pay, responsibilities and accountability, along with a better match between employees skills and functions, also would benefit the public enterprises, particularly as they are privatized.

2.95 Decentralization offers possibilities of improving the effectiveness of public spending. When public service providers are "closer" to users, accountability can increase, with a corresponding increase in efficiency and service quality (Chapters 3 and 4). However, decentralization is not a panacea, it must be done carefully to reap the benefits. Decentralization yields benefits by capturing "externalities" and, through greater accountability, matching users demands with costs as is done in private businesses. To reap these benefits, the decentralized entities must pay for the services through a self-generated revenues, otherwise they will tend to demand excess services. Hence, raising property tax rates and improving property assessments will be an important element in a successful decentralization. Personnel in decentralized entities also may need upgrading, to meet user demands more effectively.

Box 2.7: An External Debt Strategy For Indonesia in the 21st Century

Reducing the external debt and debt burden, and the risks that they create, has been a national goal for some time. Continued tight macroeconomic management will automatically contribute to that goal by limiting the size of the current account deficit that needs to be financed by borrowing. Greater reliance on tight fiscal policy to limit overheating, rather than tight money, also will reduce the growth of external debt, by lowering the public sector borrowing requirement and by avoiding the high interest rates that tend to attract volatile short-term capital inflows and encourage offshore borrowing (Chapter 1). Rising expenditures can be financed by raising revenues equitably and efficiently (Chapter 1).

In addition, the Government could:

- Set-up a program to continue retiring high-interest public debt through privatization and budget surpluses. This will reduce the debt burden, appropriately balance the sale of government equity with a reduction in the public debt that originally financed it, and to make room for rising private sector borrowing.

- Set-up a strong, fully-funded pension system to increase the supply of domestic financing. Government could help this process by generating additional revenues to fund the conversion of the public pension system from a pay-as-you-go to a fully-funded set-up. Workers' contributions could then be diverted to personal retirement accounts with the additional revenues used to top-up the contributions to an actuarially safe level and to pay pensions of existing retirees (see Chapter 5 and Leechor).

- Continue to distinguish sharply between public debt, and private debt which the Government appropriately takes no obligation to repay. This also would continue the policy of no guarantees for private debt. Even without guarantees, a large volume of foreign funds has become available for certain infrastructure (See Box 2.5). Guarantees run the risk of encouraging even more borrowing.

- Continue to limit risk to the financial system by limiting its offshore borrowing.

- Estimate the magnitude of the Government's contingent liabilities, such as power purchase agreements.

Even with reductions in net external borrowing, Indonesia will need to continue substantial gross borrowing to finance its rollovers of debt and prudent increases in international reserves. To minimize the cost and potential volatility of such borrowing/debt, Indonesia could:

- Continue to rely on concessional finance as much as possible. The amount of concessional finance is likely to decline, at least in relative terms, reflecting tight aid budgets and Indonesia's success. Indonesia will need to program replacement of these funds, in terms of higher domestic revenues. In the meantime, reliance on concessional finance to the maximum possible extent will limit the cost and maintain the long maturity structure of Indonesia's debt. Concessional finance also typically involves project related analysis that increases the social productivity of the project.

- Continue to diversify the currency composition of the debt, and to match, at least partially, currency composition of debt with international reserves, in order to limit the volatility in the debt and debt service burden from cross-currency movements.

- Continue to refrain from using complicated derivatives to hedge public debt positions, until the Government is certain that its management systems will provide a clear indication of costs and potential risks; otherwise it runs the risk of substantial losses, such as the well- publicized losses that have hit public entities, banks, and firms in the last few years.

Endnotes

1. World wide experience suggests that growth of services is difficult to estimate, particularly in real terms. Often it is measured by inputs, rather than output. Another problem is measurement of growth in the real value of owner occupied housing. In Indonesia, the estimated growth of this sector was 5.3% p.a. in 1990-1995.

2. This figure reflects the urban areas in DKI Jakarta, Bogor, Tangerang and Bekasi. The figure for contiguous urban areas would be less, say 10-15 million.

3. An attempt at tracking urban growth 1980-90 in Bandung and Jabotabek suggests slow population growth in the original urban core, with most of the growth occurring on the fringes (World Bank 1994a, p. 123).

4. East Asia's strong performance has sparked numerous analyses. See for example, Fishlow *et al*, Ito and Krueger, Krugman, Stiglitz, Stiglitz and Uy, World Bank 1993b, Petri, Thomas and Wong, Ranis, and Young, 1994 and 1995. See also studies by Wade; Frank, Kwang, and Westphal; and Pack and Westphal.

5. See World Bank 1993b and works cited there for an extended discussion. Hong Kong and Singapore are usually included in the High Performing Asian Economies but, as entrepot, industrial cities, their experience is probably most relevant to large cities. Japan was a notable East Asian success but by most standards it would classify as an industrialized country throughout this century.

6. The comparison refers to the countries for which investment data are available for most of the period. Indonesia ranks 16th, (14th excluding the former communist countries). However, from 1970-94, Indonesia ranks 8th (6th). As is well known, Indonesian inventory investment is very high. This appears to reflect underestimates of national consumption, derived from the national survey. The investment estimates used in this report are based on an assumed rate of inventory investment equal to 2.5% of GDP.

7. Statistically, savings rates tended to follow growth rates in the HighPerformers (World Bank 1993b, pp. 242-245), which is consistent with this view: increased macroeconomic stability and improved resource allocation led to an increase in growth, which together contributed to further increases in growth. Investment rates and growth tended to move together, suggesting capital inflows helped to start the process. (See Nam p. 175-76 and World Bank, 1979 for support for this view in the case of Korea.)

8. This is in line with the results of Corbo and Schmidt-Hebbel that suggest higher public saving tends to raise national saving rates and reduce current account deficits. The HighPerformers' external financing strategies ranged from Korea's reliance on external borrowing, with limited foreign direct investment, to Malaysia's greater reliance on foreign direct investment with corresponding lesser use of external borrowing, particularly since 1985. Thailand and Indonesia have been among the top 10 developing country recipients of foreign direct investment in recent years, but also are among the top 10 developing country debtors. Indonesia, Korea, Malaysia and Thailand have all received large portfolio and equity inflows in recent years.

9. Economists define the portion of growth that cannot be accounted for by increases in capital, labor or human capital as "total factor productivity growth". This "unexplained" residual is a mixture of improvements in the economic efficiency with which resources are used across and within sectors and technical progress. Young 1995, and World Bank 1993b pp 50-69 especially pp. 64-65 suggest that 65-85% of GDP growth in the HighPerformers can be explained by investment in physical capital and human resource development. The exact figure depends on the period, country and methodology. Easterly (pp. 269, 272) and the World Bank (1993b) use Barro's cross-sectional factor approach to explaining growth and yield similar results for the unexplained residual. Rodrick finds a smaller residual, using a smaller sample of countries and includes the initial distribution of income or land, which acts like a dummy variable for East Asia.

10. Some recent analyses (Krugman, Young 1994, 1995) have re-emphasized the major role that human and physical capital has played in raising per capita GDP in East Asia (and changes in participation/formal sector employment). Correspondingly, these analyses emphasize the need to continue such accumulation. Another element of these analyses, that growth in East Asia, being based largely on physical and human capital accumulation, would slow down, has drawn great attention. As noted in footnote 8, the estimated breakdown of growth between resource accumulation and productivity growth depends on the country and period chosen. Moreover, pressures for international competitiveness have tended to keep East Asia growth more efficient than in the former communist countries, where investment and human capital were higher (Figs. 2.1 and 2.2) However, there can be little argument with the proposition that as any country's per capita GDP nears that of the industrial countries, growth is likely to slow. This simply reflects that facts that a) gains from shifts of resources become increasingly limited as traditional agriculture declines, b) the service sector dominates output in high income economies and technical change in this sector appears to be slow or at least difficult to measure, and c) growth on the frontier of knowledge is likely to require more investment than adaptation of technology. However, income levels in the middle-income HighPerformers are substantially less than in the industrial countries. Hence, slowdowns in these countries are more likely to come from policy failures, such as failure to maintain macroeconomic stability, misallocation of resources toward non-competitive industries, failure to maintain economies open to international competition, failure to deregulate agriculture, failure to deregulate services, etc., than they are from reaching the frontiers of known technology.

11. See World Bank 1994b page 206. The only other region with positive real interest rates on average, and low variances was South Asia. Some authors, for example World Bank 1993b, Stiglitz and Uy, have argued that this constituted mild financial repression. But, with limited capital mobility in much of this period and high savings rates it is not clear exactly how much financial repression there was. Moreover, non-bank financial institutions offered rates above banks' in many of the HighPerformers.

12. In Korea, the most often cited case, export related loans were a much smaller percentage of bank loans than exports' share in the economy. The interest differential was nearly eliminated by the early 1980s and preferential access was reduced sharply. These loans clearly played a large role in Korea's early export success. Korea's experience with subsidized credits to large scale firms and Heavy and Chemical Industries in the 1970s was much less successful (See Box 2.4).

13. Two different initial approaches to export-led growth were followed by the HighPerformers. Korea and Taiwan (China) and to a lesser extent Thailand continued to have high tariffs and quantitative import restrictions for some time after they began export-led growth, despite initial reductions in protection. These countries offset the anti-export bias of the protection through various types of export subsidies and duty-free access to imports for exporters, including indirect exporters (See Nam pp. 154-159 and 164-171; World Bank 1993b 295-300). Indonesia, and particularly Malaysia, dropped their protection faster once they began to deregulate, and relied less on export subsidies. Whatever the initial approach, tariffs and export subsidies generally were cut in all countries once the export push gained momentum, allowing the country to benefit from the gains of specialization in products in which they were efficient producers.

14. See World Bank, 1994a, 1995a, 1996a and Bhattacharya and Pangestu for a full discussion.

15. Using the standard approach to total factor productivity analysis, a joint statistical estimate was made of the contribution to growth of capital, labor and human capital and an (assumed) constant rate of total factor productivity growth. Specifically, for Indonesia in 1978-1994:

$$\text{GDP per worker (adj. for educ.)} = -0.106 + 0.52^{**}\ \text{Capital per worker (adj. for educ.)} + 0.018^{**}\ \text{prod. growth in 1986-94}$$

where GDP and Capital per worker adjusted for education are in logs, and ** indicates statistical significance at the 1% level. This equation updates, and follows the same methodology as, the analysis reported in World Bank 1994a, p. 25 and Dasgupta, Hanson, and Hulu. It is broadly similar to the earlier estimate, except for

a higher rate of total factor productivity (1.8% p.a. versus 1.2% p.a.) and a slightly higher output elasticity of capital (0.52 versus 0.45). The updating reflects a splicing to the new, 1993 base GDP and investment series of the old, 1983 base accounts prior to 1988, using GDP growth rates. The higher GDP growth in 1989-91 in the new accounts explains the higher estimate of total factor productivity growth. The capital series was generated as before; a base year (1985) capital was estimated simultaneously at 3 times GDP, based on best fit, lowest autocorrelation of residuals, and most reasonable elasticity of capital, the capital stock was then estimated using the permanent inventory method with a depreciation rate of 2% p.a. The adjustment for human capital was based on weighting each educational group of laborers by their wage in 1988. Labor data was adjusted for underestimates of unpaid family labor in the early years (See Dasgupta, Hanson, and Hulu for the data). The reported equation is a constrained version of the original equation that assumes constant returns to scale and the same coefficient of human capital and labor, with the constraints not worsening the fit significantly. The productivity growth was first estimated jointly by allowing for an average growth of total productivity for the whole period, which was insignificant statistically. Finally, some new estimates were made of productivity growth starting only in 1989 and of gradual slowing in productivity growth—these provided about the same fit as the reported equation.

16. In plantations and banking, which are directly comparable, public sector balance sheets are much worse, rates of return on equity are much lower, and costs are much higher than private sector firms (World Bank 1994a p. 50-55, World Bank 1995a, Kenward).

17. PT Tambang Timah's listing raised an additional $161 million offshore that was used for prepayment and $64 million that was used for additional capital.

18. Initial public offerings have been done through a "book building" process of orders, rather than through an underwriting process in which the marketeer competitively bids a guaranteed price for the offering and then takes the risk of marketing the shares. With "book building" the company bears the risk of a fall in price.

19. Indonesia's original take-or-pay contracts committed PLN to take a minimum amount of power at a contractually determined price. Recent Indonesian contracts have involved payment for capacity building, with the total payment depending on PLN's purchase, thus appropriately returning some of the risk of over-capacity to the power producer.

20. The Central Government also makes large transfers to sub-national governments for personnel, mostly teacher salaries. These items are included in personnel spending in Table 1.7, and are shown under Routine Expenditure, Subsidies to Regions, Personnel Expenditures in the national Budget.

21. Public enterprise profits are returned to the Finance Ministry, but investment expenditures financed by these profits may simply be approved by the Ministry. *Perseros*, public enterprises that have been given more independence by the Government, have more control over investments out of retained earnings and greater freedom to borrow, subject to overall control by the Government.

22. The figures refer to Development Expenditures excluding the Development Budget Reserve (*CAP*) of Rp.2 trillion in 1990/91 and Rp.1.5 trillion in 1991/92.

23. The Development Budget includes some current, as well as capital expenditures, notably the fertilizer subsidy. World Bank estimates of the capital spending by the Central Government exclude the fertilizer subsidy and 10% of other development expenditures (see Table 1.7).

3
HUMAN RESOURCE DEVELOPMENT—FOUNDATIONS FOR THE FUTURE

A. Introduction

3.1 Further development of human resources is a key to Indonesia's future, as discussed in Chapter 2. Effective delivery of services to this end will also alleviate poverty and improve regional equity. For example, education is one of the best escape routes from poverty, and the provision of basic health services is an important means of spreading the benefits of development to the poorest of society. This Chapter looks at human resource development in more detail, focussing on the Education and Health sectors. The former (Section B) draws upon a major new sectoral study, which provides considerably more detail, including data on expenditures; the latter (Section C) reflects more preliminary work.

3.2 The main messages are summarized at the beginning of each Section. Among these, four common features are notable. First, there is a need to expand basic services to the poor and remote regions, particularly by raising quality. Second, much more money is needed, but money alone will not be sufficient; in each sub-sector substantial changes in policy and institutions are needed to make the additional spending effective. Third, there is a need to re-focus the role of the public sector, away from those services that can be provided by the private sector, in favor of basic services targeted on the poor. Fourth, one promising instrument appears to be further decentralization of responsibility to lower levels of government, supported by changes in fiscal arrangements that balance autonomy with accountability.

B. Education: Options for a Transition to Quality[1]

3.3 **Overview.** In the past 20 years Indonesia's progress in education has been impressive. Education levels have increased dramatically since the 1970s, raising workers average earnings. The narrowing of gender differentials across all levels of education has been matched by few countries around the world. Indonesia's decision to decentralize primary education since the mid-1970s (and to equalize student-teacher ratios across provinces) has increased access to education. Also, public educational funding has had a pro-poor focus; over 50% of total public education spending was on primary education, which has been assisted by a supportive policy towards the private sector.

3.4 Indonesia now faces a second stage of educational upgrading. Since the mid-1980s (when universal enrollment at the primary level was reached), the pace educational improvements has tapered-off. Of particular concern has been the stable—if not declining—quality of education. Also, junior secondary saw a decline in enrollments in the late 1980s, which has raised concern about achieving the next phase of expansion (notwithstanding possible reversals of declining enrollments in the past two years). At the post-basic education levels, the rapid rise of the private sector calls for a refocusing of the role of the state.

3.5 These issues, the challenges they pose, and suggestions for policy change are the subject of this Section. The Section begins with a summary of Indonesia's successes to date, followed by a look at the key sectoral priorities and the constraints to making quick progress. In the penultimate sub-section, several policy suggestions are offered as the means to address these constraints. The final sub-section looks at the financial implications of future trends under various policy options.

3.6 The main points that emerge from this Section are as follows:

- A significant enhancement of quality of education is needed. The highest priority should be to improve quality at the primary level. This is where most of the students are concentrated (80% of those in the entire public system) and this is the best way to reach the poor. Also, problems of low quality at the primary level are transmitted upward throughout the system.

- The Government's plan for universal basic education (nine years) is desirable on both efficiency and equity grounds. The expansion will be costly and there is a need to consider different options to ensure that the expansion is affordable, that it reaches the poor and isolated regions, and that it does not replicate existing inefficiencies in the system. Moreover, a prerequisite to achieving universal basic education is the reduction of drop-outs at the primary level.

- Institutional factors are an important impediment to achieving quality universal basic education. It appears that these can be best overcome by devolution of responsibility to lower level governments and schools. Decentralization would require clear assignment of responsibilities —with a larger role recommended for the school, *dinas* and *Bupati*—and changes in incentives and funding mechanisms that balance autonomy with accountability to both national policymakers and the community.

- The strong expansion of the private sector warrants a refocusing of the role of government, especially in post-basic education. This will entail measures to contain costs in public vocational and technical schools and the implementation of government plans for higher education. Cost considerations place a premium on low-cost solutions and encouraging private schools.

B.1 Brief Review of Successes in Education

3.7 **Rapid Expansion of Enrollments.** Indonesia's successes in the field of education are widely acknowledged and well-documented.[2] In 1973, the primary school gross enrollment rate (GER) was only 62% (13 million students). Using revenue from the 1970s oil windfalls, the Government initiated a large primary school construction program. This infusion of financing, together with the abolition of primary school fees in 1984 and large numbers of teachers trained through a crash program, led to a primary school GER of 107% by 1987 (Figure 3.1). Today, there are approximately 30 million students in primary school, the majority of whom are in small public schools.

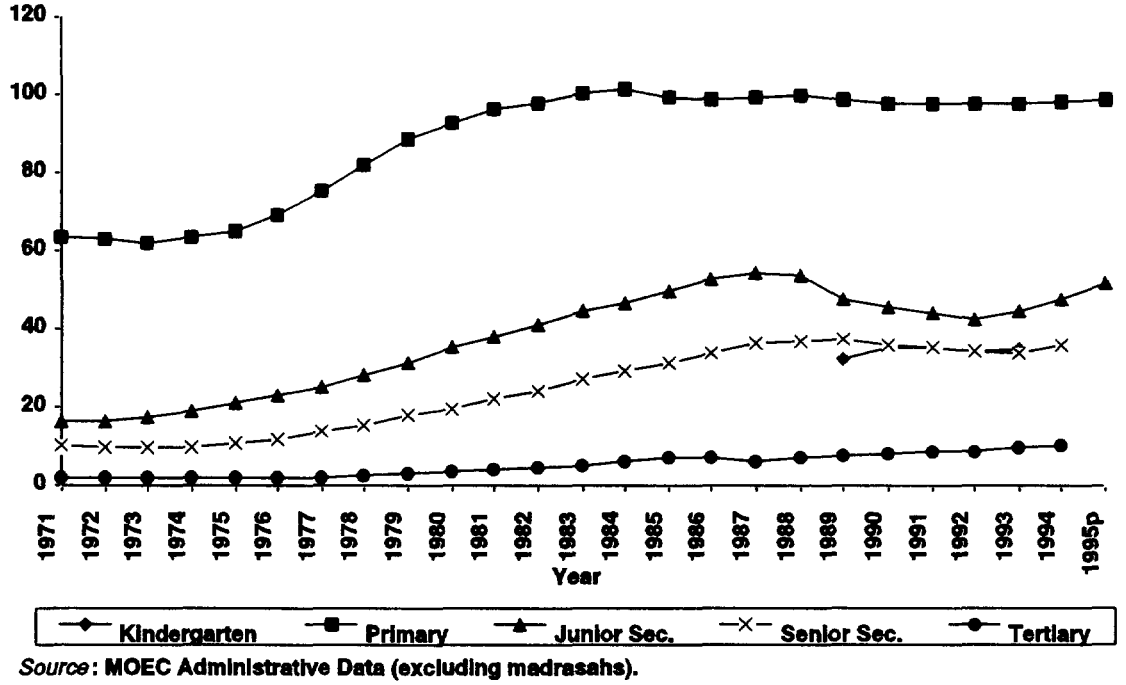
3.8 Junior secondary enrollments rose from 17% in the early 1970s (1.5 million students) to 58% in 1995 (7.8 million students). Senior secondary and tertiary enrollment rates witnessed substantial increases. In 1994, they reached 35% and 11%, respectively (up from 16% for secondary and 4% for tertiary twenty years earlier). They are now comparable to countries with twice Indonesia's per capita income. Growth in the tertiary sector has been particularly impressive as actual enrollment has

risen six fold in the last decade, reaching 2.2 million students in 1993.

3.9 **Reliance on the Private Sector.** The private sector is the major supplier of post-basic education. At the senior secondary level, the number of graduates from private schools now equals the number from public schools. Graduates from private post-secondary institutions and universities is more than double those from public institutions. With respect to training, publicly provided training is only a fraction of the private sector (World Bank 1996d).

3.10 **Up-grading the Workforce.** The rapid increase in educational qualifications of workers has facilitated occupational, industrial, and geographic mobility, thereby integrating the national labor market (Manning, 1996). In ten years, the percentage of workers with less than primary education declined from 56% to 37% while the percentage with more than basic increased from 9.5% to 19%. Wage differentials have also narrowed owing to improved educational attainments and increased mobility.

Figure 3.1: Indonesia Gross Enrollment Rates, 1971-95



Source: **MOEC Administrative Data (excluding madrasahs).**

3.11 **Narrowing the Gender Gap.** Across all education levels, the gender gap in enrollment has declined sharply in the last decade. At the primary level, the gender ratio (f/m) was already high in the mid-1970s at 86% and rose to 93% by the early 1990s (Oey-Gardiner). At the junior secondary level, the gender ratio rose by more than 20 percentage points from 65 to 87%. The change at the senior secondary level was the most striking; whereas in the mid-1970s there were only slightly more than half as many girls as boys attending senior secondary schools, by 1993 the ratio had risen to 84%. At the tertiary level (public and private universities), the ratio was a very impressive 70% in 1993.

3.12 Today, there is no significant gender difference at the primary level either at the national level (93% for boys and 92% for girls) or across the expenditure quintiles, even among the very poor. Also, at the next level of education, only a small gender gap exists. Gender differences start to appear among 16-18 year-olds where enrollment rates differ by almost 30%, even though they have been narrowing rapidly. There are also some gender differences in provinces in Eastern Indonesia such as Central Kalimantan, Maluku, NTB, NTT, East Timor and Irian Jaya.

3.13 **Decentralization of Basic Education.** Indonesia's decision to decentralize primary education since the mid-1970s has enabled greater access to education for the poor. Within the last year, the Government has moved to build upon this success by placing the responsibility for implementing the program to achieve universal basic education (*wajib belajar sembilan tahun*) directly with the *Bupatis*. In addition, the *Daerah Percontohan* program is increasingly placing implementation responsibility for services at the local government level in the *Kabupaten*.

B.2 Sectoral Priorities and Constraints

3.14 Notwithstanding these remarkable achievements, much remains to be done if Indonesia's educational system is to reach the levels necessary for rapid growth with equity in the next century (Chapter 2).

B.3 Enhancing Quality: More Difficult than Increasing Quantity

3.15 The quality of students (defined by competencies in numeracy, reading and reasoning skills) varies considerably, but on average it is low (Box 3.1). By contrast, several studies suggest that the job market in Indonesia is demanding higher quality graduates. The premium for perceived quality is large, and largest for graduates from overseas universities and the top Indonesian universities.[3]

3.16 The highest priority to improving quality should be at the primary level. This is where most of the students are concentrated (80% of those in the entire public system) and this is the best way to reach the poor. Also, problems of low quality at the primary level are transmitted upward throughout the system. The Government's commitment to ensure basic education for all provides an opportunity to put quality issues squarely on the agenda. Implicit in the commitment to basic education for all is a commitment to ensure basic education of an acceptable quality.

3.17 There are eight main reasons why basic education is of low quality in Indonesia. First, school management is generally not effective, particularly as it relates to the role of the principal. Public school principals, on average, have little autonomy in the running of their schools or deciding on resource allocations, and they are ill-equipped to manage or lead schools well. Second, teachers face an incentive structure that does not adequately reward good teaching practices. The current policy of keeping salaries and working hours low, encourages teachers to hold second and third jobs;[4] because there are more employment opportunities in urban areas, the policy also makes working in cities more attractive. Third, student learning time is low in grades 1 and 2. This is due to both low contact hours with teachers and unproductive use of time when the teacher is in the classroom.

3.18 The fourth reason for low quality of education is that there is a large stock of teachers who are poorly trained in both subject matter and teaching processes. Fifth, schools in poor communities have insufficient resources. Parental contributions cover an important part of non-salary costs in public schools and there is a significant margin

Box 3.1: Evidence on Quality of Education

There have been three major studies of achievement and the determinants of achievement in basic education in Indonesia. Two of these studies (Moegiadi 1976 and Suryadi 1989) tested students at the primary level in science, mathematics and the national language, *Bahasa Indonesia*. The third was a reading competency study conducted in conjunction with other countries and included students in primary and junior secondary grades (IEA, 1992)

The findings of the Moegiadi and Suryadi studies suggest that achievement levels were low in 1976 and in 1989 (see Table A). On average, there was less than 50% mastery of science, mathematics and *Bahasa Indonesia*. Virtually the same low level of achievement was found in the second study conducted thirteen years later. In the 1989 study, achievement did improve somewhat in *Bahasa Indonesia* and science, but it declined in mathematics. A possible positive interpretation of the results is that, since there was a major expansion in the intervening years, one might have expected overall achievement levels to fall. The fact that they did not fall dramatically could be viewed as encouraging. Both studies also found substantial variation in achievement across the ten provinces and within each province.

Table A: Results from Quality Studies in Indonesia

Statistics	*Bahasa Indonesia (n=5533)*	*Mathematics (n=5757)*	*Science (n=5790)*
Suryadi Study (1989)			
Mean	27.7	21.6	24.2
Standard deviation	7.9	8.7	6.8
Number of items	47	49	47
% correct answer	59%	44%	53%
Moegiadi Study (1976)			
Mean	35	33	27
Standard deviation	12	9	8
Number of items	60	60	60
% correct answer	49%	55%	45%

The IEA study (1992) was an international study of reading literacy. A sample of students was taken from grades 4 and 8 in Java, Riau and NTT. The results for primary students were low: most of the students correctly answered an average 36% of the items. There were wide regional differences as well: the lowest marks were recorded by those who attended rural schools. The highest literacy achievement scores were recorded by Yogyakarta, followed by Jakarta, East Java, Riau, Central Java, NTT and West Java. Boys and girls recorded similar literacy achievement scores and private schools did better than public schools. At the junior secondary level, the number of questions answered correctly were approximately 52%. The rest of the ranking was similar to that of the primary level.

More recent informal surveys have been carried out on small samples of schools using classroom observations and testing of student cognitive abilities in basic number skills and reading in early years. One study found that students in grades 5 and 6 had not mastered many basic number skills (Somerset, 1994). Furthermore, teachers made similar mistakes as their students. A continuation of this survey into grades 7 and 8 found that errors done in primary school were still prevalent in later years (Somerset, 1996). These results suggest that poor performance begins in primary school and is perpetuated through secondary school.

Evidence comparing Indonesia to other countries with respect to achievement is limited to the IEA reading competencies study mentioned above. Indonesia's primary and junior secondary school students lagged behind their regional counterparts in reading competency (see Table B): about 2% below that in the Philippines, 20% below scores in Thailand and 30% below that in Singapore.

Table B: Reading Achievement Test Scores for Grade 4 Pupils, 1992

Country	*Mean Score (%)*
Indonesia	51.7
Philippines	52.6
Thailand	65.1
Singapore	74.0
Hong Kong	75.5

Source: Vincent Greaney, Literacy Standards in Indonesia, 1992.

between what poor and rich schools can raise in fees to supplement official transfers. Moreover, this low level of resources in poor schools is becoming increasingly visible as the buildings constructed during the major expansion of primary education begin to deteriorate. The problem of poorly maintained facilities is not confined to poor schools, however, and is a manifestation of larger institutional problems. Sixth, there is insufficient availability of textbooks and materials and the quality of what exists is not adequate. Seventh, insufficient monitoring of student achievement and evaluation of investment programs means that problems persist and are not brought more forcefully to the attention of policy makers. Finally, the eighth reason for the low quality of basic education relates to institutional constraints discussed in Section B.5 below.

B.4 Priorities & Constraints: Achieving Universal Basic Education

3.19 In 1989, the Government of Indonesia (GOI) announced a policy of achieving nine years of basic education for all (*wajib belajar sembilan tahun*). Achieving the target is GOI's main education priority, and implementation of the policy began in 1994. While this is a desirable objective on both efficiency and equity grounds, two major issues need to be addressed: (i) a national completion rate of about 80% at the primary level, which has hovered around this rate for the past decade and which is significantly lower in some provinces; and (ii) the sluggish demand for junior secondary enrollment in the late 1980s.

3.20 **Boosting Primary Completion Rates.** The percentage of children who fail to complete primary school has remained stubbornly high over the last 10 years. Close to 20% of primary children do not complete six years of primary education. In six provinces, more than 30% didn't make it through primary school. Higher completion rates will be a major factor in reaching universal basic education.

3.21 **Reversing Declines in Junior Secondary Enrollment Rates.** In the late 1980s to early 1990s, enrollment declined nation-wide at the junior secondary level. Despite rising enrollments since 1993/94, the five consecutive years of sluggish demand for junior secondary have raised serious concerns for achieving the Government's goal of universal nine-year basic education. In addition, much of the 5-year decline occurred among those in the lower income deciles. As a result of the decline, Indonesia's enrollment rate has fallen behind that of its neighbors (Table 3.1).[5]

Table 3.1: Junior Secondary Enrollment Rates in Selected East Asian Countries
(latest year available)

Country	*Enrollment Rates*
Malaysia	83 (net; 1990)
Philippines	79 (gross; 1993)
Thailand	63 (net; 1994)
Indonesia	47 (net; 1995)

Source: Edstat, World Bank, 1997.

3.22 **High Costs and Uncertain Returns.** The issues noted above have a common root. Namely, high direct and indirect costs of education, declining labor market returns and little prospects for continuing on to senior secondary education. The lack of near-by junior secondary schools in rural and remote areas exacerbates the costs of schooling, and in the fast-growing urban areas, the possibilities for casual employment have acted as a disincentive for children to continue schooling beyond primary.

3.23 The high costs of schooling and the burden they represent for poor families can be seen from household survey data (Table 3.2).[6] In West Java, total direct costs for junior secondary schooling constitute 43% of per capita household expenditures of the lowest quartile. Particularly significant are transportation costs which represent 25% of total spending on junior secondary schooling for those in the lowest quartile. Tuition is the next largest expenditure item at 17%.[7] Overall, the cost to families in the lowest quartile of educating a child in junior secondary comes to an annual average of Rp.155,000, which is more than three times the cost of primary education (Rp.50,000).

3.24 **Inefficiency of Teacher Allocations and Poorly Structured Incentives.** There are two significant types of inefficiencies arising from the current allocation of teachers across junior secondary schools. These are: (i) departures from lowest-cost school configurations; and (ii) deviations from optimal teacher allocations. Schools with the same number of classes vary dramatically in the number of teachers they have and many schools have far more teachers than necessary to deliver the curriculum (Annex 3.2 of World Bank 1997c).

3.25 On incentives, there are three major problems affecting the allocation of teachers. First, there are strong incentives for teachers to seek work in urban areas.[8] Second, the individuals who allocate teachers, do not bear the costs of an inefficient allocation. Third, those closest to the school, namely the principal and parents, have almost no incentive to economize on the use of teachers. Eliminating an unnecessary teacher does not free up any additional resources that the principal can use for other purposes.[9]

Table 3.2: Average Household Expenditures per Student in West Java
(Relative to total expenditure per capita, in %, 1995)

	Lowest Quartile	*Middle Quartile*	*Highest Quartile*	*Total*
Primary	14.2	14.5	12.2	14.0
Jun. Secondary	42.8	35.5	27.2	33.6
Sen. Secondary	71.9	56.2	39.0	49.1
Tertiary	151.5	134.4	79.1	84.6
Total	18.9	23.2	29.8	24.0

Source: SUSENAS 1995.

3.26 **Desirability of Public Interventions at the Junior Secondary Level**. Achieving universal basic education is a desirable objective on both efficiency and equity grounds. International research points to the existence of positive externalities associated with expanding secondary education (Subbarao and Raney, 1993).[10] While quantifying externalities is a difficult task, there is little doubt that they are positive and probably substantial. With continued economic growth, those with only a primary education will find it increasingly difficult to break out of the vicious cycle of poverty.

B.5 Priorities & Constraints: Overcoming Institutional Weaknesses

3.27 Among the various sectoral constraints, some of the most intractable problems are those associated with organizational complexity, the fragmented budgetary process and the lack of autonomy for principals and lower level managers (see immediately below).

3.28 **Organizational Complexities in Basic Education.** Assigning responsibility for success of the universal basic education program to the *Bupatis* was a major step. But it is just a beginning. Currently, there is a complex web of overlapping responsibilities for education,[11] which makes it difficult to address personnel and materials issues,[12] and to affect change by actions that cut across jurisdictions (*e.g.*, converting a primary school, where there are excess resources, to a junior secondary school, where there are shortages). Moreover, it is questionable whether the scale of expansion contemplated by the Government for junior secondary education can be managed effectively under the current centralized system at this level. In this context it is notable that the successful expansion of the primary system was managed in a decentralized fashion.

3.29 **Process and Fragmentation of the Budget**. Organizational complexity is reflected in rigidity and fragmentation of the Budget.[13] Consequently, there is virtually no substitutability among expenditure categories (for example, reducing spending on surplus teachers cannot be used to improve textbook supplies), and managers have little incentive to economize on use of either. Moreover, Budgeting involves at least five ministries (MOF, BAPPENAS, MOEC, MOHA, and MORA plus BAKN) and at least four levels of administration (center MOEC and MOHA, provincial *Kanwil* and *dinas* I, district *Kandep* and *dinas* II and sometimes subdistrict *kancam* and *dinas kecamatan*).

3.30 This system has several other negative implications. It discourages a clear sense of responsibility on the part of any level of government or agency. Even when the responsibility is clear (as in the maintenance of school buildings), problems of implementation, monitoring and accountability allow many schools to deteriorate. Planning and development of service provision are difficult. There is no regular assessment of the real level of funding needed, and when money is tight, cuts usually fall on operation and maintenance and quality funding. Also, it is difficult to ascertain and ensure that resources are distributed equitably between regions since each source of finance is allocated separately, according to different criteria. Finally, the multiplicity of sources of finance makes room for abuse.

3.31 **Limited Autonomy for Managers of Schools.** In general, public school principals and managers, who are closest to the problems, have little autonomy in running their schools or in resource allocations. Research (Malo *et. al.*,1994) on strengthening local capacity in basic education in Indonesia finds that more autonomy at the school level enables better education. After controlling for resources, urban location and school type, the study finds that discretion has an independent effect on school performance. More autonomous principals would be an important force for educational improvement in Indonesia, even in the absence of broader structural reforms.

B.6 Priorities & Constraints: Refocusing the Role of Government in Post-Basic Education

3.32 Achieving universal basic education of the necessary quality, which is the top priority, will be expensive. This will draw budgetary resources away from lower priority activities, such as post-basic education (SMK, SMU, training programs and university). Consequently, policy-makers will need to

search for low-cost, and cost-cutting, solutions to problems outside basic education. In this regard, a distinction should be drawn between vocational and technical training on the one hand and higher education on the other (see immediately below).

3.33 **Government's Changing Role in Vocational and Technical Education.** GOI is keen to reform the vocational/technical (SMK) schools, which are relatively expensive operations (World Bank 1991b). It has embarked on a strategy to make the SMK system more effective in labor market terms by making it demand-driven. It has introduced a dual system (*Sistem Ganda* or PSG) involving formal institutional training and on-the-job learning.[14]

3.34 Substantial improvements have already been made in the selection, evaluation, and replacement of principals in senior vocational schools. This should improve the quality of school management, which is essential if the PSG is to be a success. Further success of the PSG will depend upon progress in the three key areas: i) coordination among different players, including the Ministry of Manpower, which runs its own large network of training centers (BLKs). It is not clear that two separate systems are justified, particularly from the employer's point of view. ii) Uncertain industry interest and demand. iii) Potentially higher unit costs than in a general senior secondary program, which must be shared among the students, firms, and the public. And, iv) the development of effective feedback mechanisms that will identify the factors associated with successful implementation of the PSG in some schools.

3.35 **Government's Changing Role in Higher Education.** The higher education system has problems of quality (especially among many private universities and newer public universities) and relevance, with many graduates experiencing a long waiting time to employment. There are low levels of internal efficiency, as indicated by the excessive length of time students take to graduate; by the low student-teacher ratios; and by the low number of student/staff contact hours per week. Finally, there is an inadequate flow of information in the system about the quality of programs to allow parents and students to make informed choices.

3.36 The Government has already articulated a strategy for improvement that largely responds to the need to re-focus the role of the state. It is centered around the implementation of a "new paradigm" in higher education management. This, in term, is built around the promotion of quality, autonomy, accountability, accreditation and evaluation both in the operation of the system as a whole (public and private) and in the operation of individual universities. A key instrument in this restructuring effort is to introduce competitive processes in the way in which funds are allocated to public universities and subsidies are provided to private universities.

B.7 Policy Options

Addressing the Institutional Problem

3.37 **International Evidence on Decentralization.** International experience provides some best practice lessons for addressing institutional weaknesses. Many countries have decentralized their education systems for various reasons. The results have been mixed (Box 4.1 of World Bank 1997c), and decentralization is clearly not an answer for all educational problems. However, the balance of evidence suggests that, in Indonesia's current circumstances, more decentralization will be a necessary—but not sufficient—condition for significantly improving teaching and learning (Chapter 4, World Bank 1997).

3.38 To affect improvements in quality and universal basic education, it will be important to clearly define the roles of the many relevant agencies, particularly in light of the new responsibilities given to the *Bupati's* office. In this regard, the central government should focus on three aspects of education policy: i) promoting national unity; ii) equity in the provision of education across income groups, regions and genders; and, iii) standard setting, evaluation and testing.

3.39 Among these, promotion of the second aspect (equity in the provision of education services) may require the Government to re-examine the current formula for funding underserved schools (paras 3.43, 3.48 and 3.50). Also, some means is needed to reduce the diversion of funds to other purposes at the local level.

3.40 **Reforming Institutions.** Assigning responsibility for success of the universal basic education program to the *Bupatis* is a major step and represents an appropriate approach, but much remains to be done. One proposed structure that would help clarify assignments involves reassigning functions at the primary level so that virtually all activities would be carried out by the *dinas*, the school, or the school cluster—groups that report either directly or indirectly to the *Bupati*. At the junior secondary level, responsibilities that had been assigned to *kandep, kanwil*, MOEC, and Governor would be passed on to the *Bupati, dinas* and the schools. Curriculum and testing would remain the responsibility of MOEC. The proposed structure at the junior secondary level would parallel the primary level, streamlining the institutional structure.

3.41 Greater autonomy should be given to school principals in deciding on resource use and developing school-based strategies in line with local conditions. The greater autonomy would need to be accompanied by: (i) a process of selecting good principals based on skills and characteristics that are needed to operate effectively; (ii) a means of rewarding good principals and replacing poor ones; and (iii) modular training programs where specific deficiencies in management skills exist.

3.42 Many of these changes cannot be carried out quickly and would require considerable effort and consensus building among the various players. For example, this would involve such very difficult tasks as transferring staff from the *kandep* to the *dinas*. Moreover, over time, as has happened in other countries undergoing decentralization, new functions and responsibilities for the central government will emerge, such as standard-setting and technical assistance to other levels. This means it will be necessary to strengthen the responsibility of the line ministries, primarily MOEC, but also MORA, to carry out quality control, and monitoring and evaluation of the programs implemented by local government. To ensure that the *Bupatis* and other managers of education at the local levels can carry out their designated responsibilities, a certain level of capacity building will need to be defined and carried out.

3.43 In addition to clear assignments of responsibilities, it is important to develop institutional funding mechanisms that promote efficiency and equity and that balance autonomy and accountability. It is difficult to achieve these multiple objectives with a single funding mechanism. However, by combining three different funding mechanisms, it is possible to move closer to achieving these goals. The central government may want to consider employing the following three mechanisms to transfer funds to the *kabupaten*: (i) matching grants based on parental (BP3) contributions; (ii) performance-based grants; and (iii) unrestricted grants to the *kabupaten* based on the number of students enrolled. In the short-run, the Government could introduce the matching grants and the performance-based grants without major disruptions to current

institutional arrangements and funding mechanisms. Introducing the third funding mechanism, the per-student grants, could be deferred until local level staff gain experience working with the performance-based grants. A prerequisite for preparing such proposals is having consolidated budgets.[15] Decision makers at different levels (schools, *kecamatan*, *kabupaten* and provinces) cannot make good allocation decisions without better information on their budgets. Moreover, without consolidated budgets, it is difficult for policymakers to ascertain the distributional consequences of the choices they make. Finally, in order to promote transparency and accountability to the parents/community at the local level, a greater role of the community is needed in deciding how budgets are spent. There are many options and several good models to follow (*e.g.*, COPLANER, IDT).

Policies for Enhancing Quality and Achieving Universal Basic Education

3.44 The recommended strategy to enhance the quality of basic education is to combine a set of core interventions targeted on the main constraints (those related to teachers, management, and resources) with mechanisms that would allow local level institutions to propose actions tailored to more specific local-level problems. These mechanisms could be modeled on the performance-based grants programs, already introduced in the higher education sector. In addition, the institutional reforms discussed above are essential elements of the strategy of improving quality.

3.45 **Improving Incentives Facing Teachers.** To improve incentives facing teachers, the Government could: (i) change the incentives facing civil servants by modifying how points are awarded in the functional credit system to reward activities that are likely to lead to effective teaching; (ii) structure incentives of contract teachers to, for example, attract workers to rural areas; and/or (iii) alter the mix of civil servant versus contract teachers, recruiting the contract teachers locally. Over the next ten years, in order to develop a high quality professional teaching work force, Indonesia should move away from its policy of keeping salaries and official working hours low. This would imply having teachers who would work more hours but at higher salaries. It would be advantageous to use the opportunity presented by the major expansion of the junior secondary system to redeploy teachers to meet some of the demand and to eliminate some of the excess teachers.

3.46 **Increasing Learning Time in Grades 1 and 2.** There is a need to increase learning time for students in grades 1 and 2 coordinated with a planned expansion of the school feeding program (see "Reducing Dropouts", below) to re-enforce attention spans. This would require an increase in the length of the school day and training of teachers on more effective use classroom time. With this change, teachers of grades 1 and 2 would teach the same number of hours as upper grade teachers.

3.47 **Upgrading the Quality of Teachers.** The experience from the Primary Education Quality Improvement Program (PEQIP) has demonstrated the viability of an in-service training model centered around the school cluster. Building on this experience, the strategy should be expanded with the bulk of the management done at the *kabupaten* level. In addition, the policy of having an "across-the-board" upgrading of all basic education teachers should be reconsidered, in favor of a more targeted upgrading program based on need.

3.48 **Increasing Resources Allocated to Poor Schools.** Efficient means are needed to channel more GOI funds to the poor schools building on the experience of the PEQIP program and school feeding program. In particular, the mechanism should not undermine the existing system for parental

contributions (BP3) in better-off communities. One useful option would transfer some GOI funds as matching grants to BP3 contributions (on a sliding scale depending on the wealth of the community and up to a maximum contribution), which should actually stimulate parental contributions to BP3.

3.49 **Reducing Dropouts from Primary School.** The Government's anti-poverty program launched in 1993 (the IDT program) and the school feeding program (intended to encourage attendance and lengthen attention spans, by compensating for inadequate breakfasts) are the most promising initiatives in this area. In addition, consideration could be given to policies for offsetting the tendency for late entry into school, particularly among poor rural children.

3.50 **Increasing Access by the Poor to Junior Secondary.** Essentially, public policy needs to address the income and price constraints faced by the poor. Strategies could include: (i) more—and better quality—financing for school facilities in rural and remote areas, including alternative modes of delivery such as SLTP Terbuka, Paket B and other non-formal models; (ii) providing scholarships to poor students and particularly to poor girls; and (iii) providing grants to schools in poor areas to compensate for low BP3 contributions.

3.51 In expanding facilities, three points need to be considered. First, there is a problem of quality, which is largely a governance issue (Chapter 5). Second, lower priority could be given to building public schools in locations already served by private schools. If public expansion proceeds in localities already served by private schools, there is a substitution effect and little net gain in enrollments. Thirdly, there are efficiency gains to be achieved from converting existing primary facilities to secondary schools.

3.52 **Increasing Efficiency in Teacher Allocation by Changing Funding Mechanisms.** The introduction of the funding mechanisms discussed above could enhance the incentives to allocate teachers more efficiently. Both per-student transfers from the center and performance-based grants would encourage the districts to focus on efficient outcomes.

Policies to Refocus Government's Role in Post-Basic Education

3.53 **Vocational and Technical Education.**[16] On spending, the Government should consider having the budget for SMKs grow at the same rate as that of senior general education. To accommodate more limited budgetary resources, cost-containing measures are needed for the SMKs, including: (i) an overall reduction in the budgets for schools based on providing, for up to two years, a curriculum more appropriate to general schooling; (ii) revisions to the budgets of individual schools based on an assessment of student outcomes that consider the labor market relevance of the courses being offered; (iii) revenue for vocational schools could be increased by charging higher user fees; and (iv) the number of schools could be reduced, targeting those engaged in small occupational groupings or those offering courses that can be substituted by private schools.

3.54 The Government should continue efforts to make the vocational system more responsive to needs of firms. This will involve producing students with the balance of basic education, general vocational skills and specialized skills that the market demands at any given time. Effective feedback mechanisms are needed to ensure that resources are not wasted in producing the wrong mix of skills. As the Government moves away from the old system of senior vocational schools to a new system with classroom learning, on-the-job learning and possible advanced training

through a system of expanded polytechnics, it should consider modifying the specificity of the training in senior secondary schools. The curricula and qualifications system for SMKs could be revised to allow the introduction of more basic education within SMKs and the transferability of credits between streams. This would leave more specialized training for polytechnics or job-specific training in firms. The relationship between the SMK system and polytechnics needs to be assessed and a combined strategy developed, particularly in light of the Government's plans to add another 155 new polytechnics by the year 2020—a plan which would have significant financial implications.

3.55 Carrying out such a shift in strategy in the SMK system (and polytechnics) would be difficult given the overlap in responsibilities between Ministries involved in vocational education and training. An over-arching Council driven by the private sector is needed to take responsibility for setting policies. The Council would need to be given an appropriate status in government, enabling it to handle cross-ministerial issues.

3.56 **Higher Education.** The increased importance of the private sector calls for some shift in Government priorities. A greater role for the Government is warranted in: (i) regulation and accreditation; (ii) ensuring adequate information on quality of programs; (iii) investing where private interest is low and where social returns are sufficiently high to justify the investment; and (iv) creating incentives for better management of public universities and more effective public assistance to private universities.

3.57 At present, the main task is to implement GOI's "new paradigm" for higher education, which will require some time. On relevance and quality, a substantial challenge is presented by the sheer magnitude of the task of accreditation (with 11,500 programs needing to be accredited over 5 years). It is highly likely that there will be pressure to lower standards and direct more public resources to support failing programs. This pressure will need to be resisted since it would keep the Government from following through on its plan to focus public subsidies on high priority fields and to promote geographical and social equity. It could also risk distorting the overall strategic plan for the entire education sector by diverting more funds to the higher education sector. Finally, a continued emphasis on cost recovery is warranted since there are high private returns to higher education and most of the students come from families in the uppermost income decile.

B.8 Financial Implications

3.58 This sub-section considers the financeability of initiatives that have either been recommended here or identified as desirable by GOI.

3.59 **Projected Costs.** Table 3.3 presents estimates of the costs of specific investments. These include costs of recommendations made above, as well as costs of expansion in the post-basic sector that GOI desires. These estimates are not comprehensive, but include most of the major initiatives.[17] The assumptions underlying the projected costs are presented in Chapter 6 of World Bank 1997c.

3.60 **Projected Availability of Resources.** Affordability of the specific investments depends upon the likely path of the education budget. The key determinants of the path are the initial levels and trends of GDP, total government expenditure and the share of education.[18]

3.61 Three scenarios are considered for the evolution of the total education budget. In all three the share of government expenditure as a percent of GDP is assumed to be the same and is fixed at its current (GOI basis) level of

17.7%. The three scenarios are distinguished by the assumptions made about the rate of growth of GDP and the share of public educational expenditure in total government expenditure. The base case uses baseline projections for GDP growth (an average of about 7 1/2% between 1997-2010; Chapter 2) and assumes that the share of educational expenditures stays at its current level of 15.7% (see footnote 18). The low GDP scenario combines the low case scenario for GDP growth (an average of 5% between 1997-2010) with the same assumption of constancy in the share of education expenditure relative to total public expenditure. Finally, the third scenario combines the low case scenario for GDP growth with an increasing share of public education expenditure in total government expenditure from 15.7% to 20% by 2010. Note that increasing the share to 20 percent roughly compensates for the difference in GDP growth between the base case and low GDP growth scenarios.

3.62 **Projected Shortfall of Budgetary Resources.** Figure 3.2 presents the projected shortfall of budgetary resources under the three scenarios discussed above, if all the investments in Table 3.3 were to be undertaken. Under all three scenarios, there would be a substantial budgetary shortfall in the initial years. This implies that it will be necessary to set tighter priorities.

Table 3.3: Estimated Costs of Specific Investments for Quality Improvement

	1997	*1998*	*2000*	*2004*	*2008*	*2010*
Basic Level						
Continuous Teacher Training	0	139	556	1390	1390	1390
Matching Grants	0	46	184	461	461	461
Performance-based Grants at Basic Level	70	70	140	176	176	176
Increase in Non-salary Expenditures for Existing Junior Secondary Schools	17	36	77	177	307	384
Expansion of Junior Secondary (with Declining Private Share)	1057	1171	1399	1854	2309	2536
Post-Basic Level						
Expansion of Senior Secondary	368	438	593	963	1435	1718
Expansion of Existing Universities	747	779	842	967	1093	1156
Expansion of Existing Polytechnics	182	186	192	204	216	223
Expansion of Existing IKIPs & Art Institutes	10	11	13	17	20	22
Establishment of New Universities	0	0	16	297	313	113
Establishment of New Polytechnics	326	331	5007	1051	1281	1317
Performance Grants at Tertiary Level	70	84	98	112	112	112
Subtotal Post-Basic	**1704**	**1829**	**2261**	**3612**	**4471**	**4661**
Increase in Wage Bill (both levels)	**316**	**656**	**1417**	**3255**	**5617**	**7013**
Total	**3165**	**3947**	**6033**	**10924**	**14730**	**16621**

3.63 Figure 3.3 presents the budgetary shortfalls after setting priorities. The investments related to expanding junior secondary schooling (but with encouragement for greater private participation) and improving quality of basic education (through continuous teacher training, matching grants, increases in non-salary spending in junior secondary and performance grants) would be retained. The major modifications to the investments described in Table 3.3 are:

- Limit growth rates in senior secondary for both general and vocational to 3% for 3 years. Thereafter, have public vocational grow at the same 5% rate as senior general.

- Phase-in expansion of existing universitites at 20% of original target annual rate for 1997-1999, 50% of original target rate for 2000-2002, 75% of original target rate for 2003-2005 and 100% of the original target rate for 2006-2010.

- Phase-in expansion of existing polytechnics following the same pattern as for universities.

Figure 3.2: Budgetary Imbalance for Education Investments: Before Setting Priorities (Rp. billions)

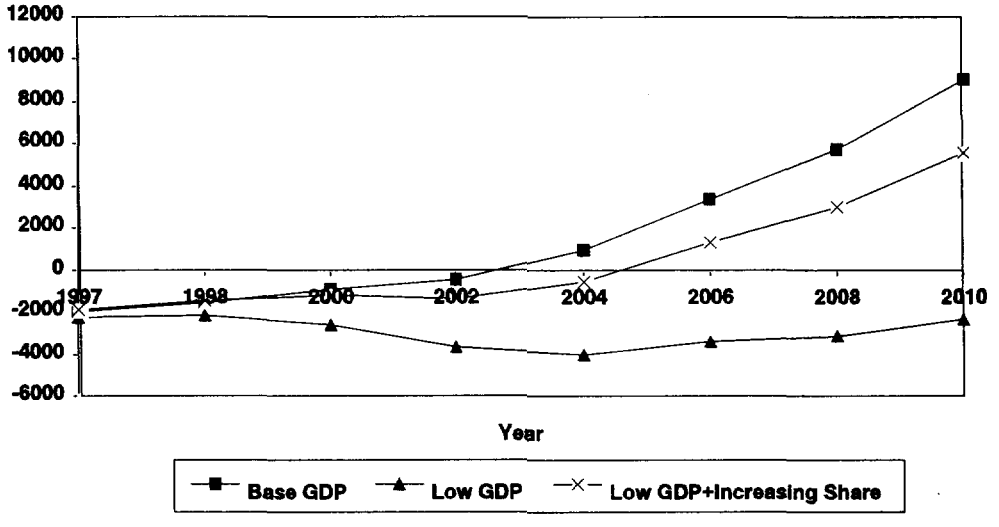
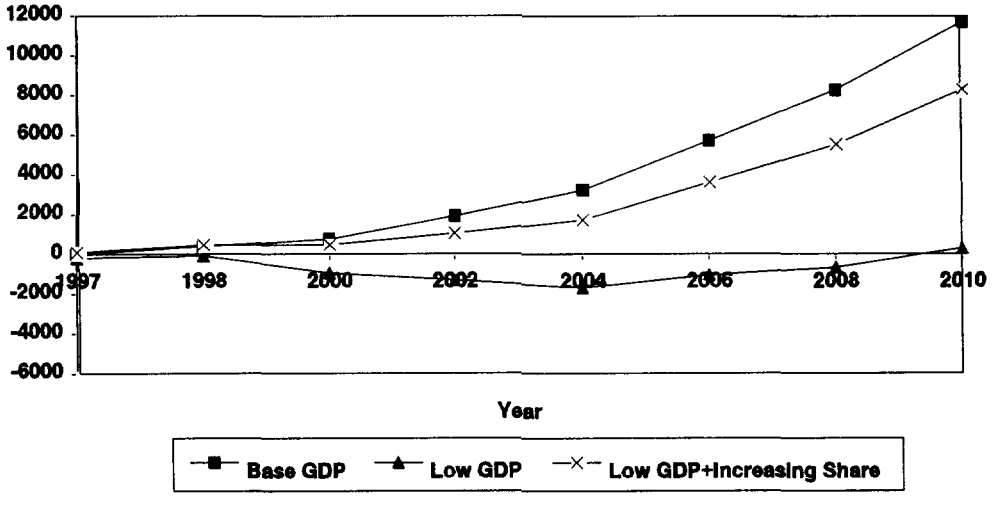


Figure 3.3: Budgetary Imbalance for Education Investments: After Setting Priorities (Rp. billions)



- Phase-in the new polytechnics more slowly and reduce the total number constructed, with one polytechnic for 1998 and 1999 and three new polytechnics a year between 2000 and 2010; and

- Delay the wage increase by one year.

3.64 To summarize considerations of financeability, although the priority investments (to achieve 9 years of universal education, quality improvements and limited expansion at the post-basic level) are substantial, they are feasible provided: (i) the initiatives are phased-in over time; (ii) the Government adopts some of the lower cost options in expanding universal basic education; and (iii) there is strong growth in the education budget.

C. Health: Transitions and Challenges

3.65 **Overview.** Rapid development of the Indonesian economy is engendering change in the structure of health financing, expenditures and service delivery. Some changes are the product of rapid economic growth while other changes are the outcome of central government policy choices. As regards the latter, over the last 5 to 6 years the Government has pursued gradual decentralization of planning and budgeting, modest increases in administrative autonomy, control of growth in public sector employment in health, and experimented with alternative forms of financing. The Government has also introduced innovative programs to widen access to services (*e.g.*, the contract doctor (PTT) and low-income village (IDT) schemes). These policies are moving in the right direction, but they need to be strengthened and accelerated, through continued innovation in public sector finance and incentives, and growth in quality of both public and private sector services.

3.66 This Section examines the changing trends in finance and expenditures in the health sector. It sets out the salient features and issues of ongoing changes, and discusses the policy implications of these changes. The first sub-section examines recent trends in expenditures, financing and resource allocation in the health sector, including implications for geographical and vertical equity. The second sub-section looks ahead at the implications for health spending of continued rapid income growth and urbanization. The last sub-section recommends a focus for public policy for the forthcoming decade.

3.67 The main messages of this Section, whose details are discussed below, include:

- Increase Services to the Poor. Public sector spending has a vital role in the provision of basic health services for the poor. Government spending needs to increase substantially to fulfill this role.

- Improve the Quality and Efficiency of Public Institutions. Increased spending is not enough. Change is needed to achieve better budgeting, management and organization of services, and to improve the incentives and skills of public sector health professionals, and better quality of services delivered in *puskesmas*.

- Support the Provision of Private Health Care. The demand for modern private sector services will continue to grow as household incomes and urbanization increase. The Government needs to initiate policies to support high quality private services.

- Continue the Decentralization of Health Services. More decentralization would assist with effectiveness and quality of public sector spending. Clear responsibilities and stronger incentives are needed to make the most of increased authority of district and facility management decision-making.

C.1 Expenditure Trends

3.68 **Aggregate Spending on Health.** Based on very rough data, Indonesia spends less on health, in both the public and private sectors, than other countries of a similar level of development in the Asia region (Prescott 1997d). Total health spending (public plus private) was 1.9% of GDP in 1993, compared to a range from 2.9% (China, 1993) to 5.4% (Thailand, 1992) for five nearby comparators. Public spending is especially low; it has remained at less than 0.9% of GDP from 1984/85 to 1994/95. This is less than two thirds of the next lowest comparator ASEAN country at 1.3% (the Philippines).

3.69 Following a nadir of public expenditures on health in 1987/88, the Government has achieved substantial increases in health spending, which are continuing into the 1997/98 Budget. In constant 1993 prices, the per capita aggregate expenditure for Government at all levels, has increased by an annual average of almost 8% since 1987/88 (Table 3.4).[19] The increase in government health expenditures comes from both increased government spending generally, and from an increasing share for health in total public expenditures. Health expenditures increased from 2.2% of total public expenditures in 1987/88 to 3.5% in 1994/95 (Chapter 2).

Table 3.4: Indonesia: The Structure of Health Expenditures
(Rp. billions, in 1993/1994 prices)

	1984/85	*1987/88*	*1992/93*	*1993/94*	*1994/95*	*Growth of Spending* [1]
Government	1188.0	1076.8	2030.4	2010.1	2062.7	7.8
Center	1014.3	874.6	1704.7	1687.9	1702.1	8.0
Level I	125.4	120.7	137.9	136.4	150.9	1.4
Level II	48.2	81.5	187.8	185.8	209.6	12.4
Aid Donors	66.1	45.2	318.3	215.0	348.8	31.5
Private	2872.0	3336.2	4011.2	3910.0	4158.0	1.3
Out of Pocket	2226.5	2605.3	3023.0	2954.0	3128.0	0.8
Corporate	158.8	230.8	386.8	375.3	405.5	6.4
Parastatal	289.5	347.7	420.5	407.9	440.8	1.6
Insurance	197.2	152.5	180.9	172.8	183.8	0.9
Total	4126.1	4458.2	6359.8	6135.1	6569.5	3.8

[1] Real per capita, in % per annum; 1987/88 to 1994/95.

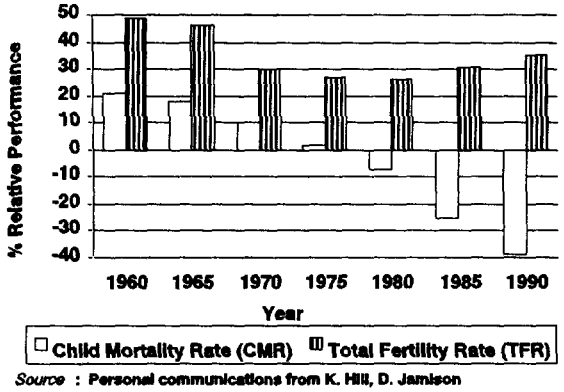
Source: Private data files of Dr. A. Ridwan Malik, LITBANKES, Department of Health.

3.70 Within overall government expenditures, the shares of both central and district governments rose and the share derived from province revenues fell. Over 80% of government expenditures continues to be accounted for by the central government, either directly or indirectly through a system of subsidies to local governments. It should also be noted that the points on institutional weaknesses in budgetary process for education (para 3.29) apply equally to health.

3.71 **Health Performance Indicators.** Performance on key health indicators reflects the moderate rise in health expenditures. For example, many indicators of health have improved over the past twenty years: infant mortality has fallen from 145 in 1971 to 55 in 1995; and child mortality has fallen from 218 in 1971 to 103 in 1990.[20] Despite this improvement, performance is well below what would be predicted from the levels of income and literacy relative to other Asian

countries.[21] For example, among Asian countries in the early 1960s, the under-five mortality rate (CMR) was 20% better than would have been predicted for the income and literacy level. By the early 1990s, the relative performance had steadily fallen until it was approximately 40% worse than the predicted level (Figure 3.4).

Figure 3.4:
Indonesia: Health Performance Indicators



Source : Personal communications from K. Hill, D. Jamison and J. Wong (December 1996)

3.72 The deteriorating relative performance of child mortality contrasts with the performance on total fertility rate which throughout the last thirty years has remained substantially better than would have been predicated by income and literacy. Key factors in the good performance on total fertility are the quantity of public and private resources committed, private sector involvement, and concerted institutional support at all levels of government.

3.73 **Functional Distribution of Public Expenditures.** Over the last 5 years, the Government has made steady progress in improving the composition of health spending. It has steadily decreased the proportion of government expenditures on hospitals and increased the share of expenditures on primary health care and communicable disease control (Table 3.5). This shift in the functional allocation of health expenditures is consistent with the primary causes of morbidity, mortality and general health problems.[22]

3.74 International research has demonstrated that prevention and basic health services (delivered through primary health care) are the most cost effective programs to deal with Indonesia's range of health problems (Box 3.2). Cost effective preventive programs include: pre-natal care; immunizations; health education; improved water and sanitation; and micro-nutrient supplements. Cost effective primary care programs include: diarrhea treatment using oral rehydration and *puskesmas*-delivered care; tuberculosis treatment through outpatient short-term chemotherapy; safe motherhood programs sing prenatal care and delivery by trained personnel; and facility delivery of high risk pregnancies. As mentioned, the Government has strengthened these programs over the last few years through the greater allocation of resources to primary health care and communicable diseases (Table 3.5).

Table 3.5: Government Expenditure on Health by Function
(In % of total)

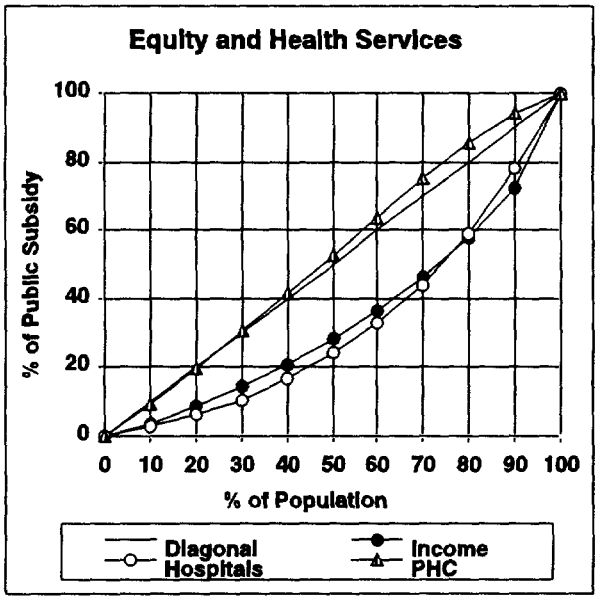
Function	*1989/90*	*1994/95*
Hospitals	51	41
Primary Health Care	19	26
Communicable Disease Control	2	5
Training	4	5
Other	24	23

Source: Ministry of Health, LITBANKES and Bureau of Planning.

Box 3.2: Equity and the Provision of Health Services

The Government has sought to redress regional imbalances in health status through wider access to health center services and a greater supply of health workers. There is evidence that this policy has had positive effects. The rates of infant and child mortality have declined in every region of Indonesia over the last ten years (World Bank, 1996a), as has variation across provinces.[1]

However, some provinces are notable outliers, both statistically and geographically. One example, focussing on sensitive indicators, is a detailed examination of child mortality in 1993 and its relationship to illiteracy and per capita health expenditures across all provinces. After correction for differences in literacy, a 10% increase in health expenditures is associated with a 5% decrease in child mortality in the average province.[2] Examining the difference between the predicted and actual child mortality rates for the separate provinces reveals five provinces which have greatly under-performed in relation to literacy and health expenditures. These are Nusa Tenggara Barat, North Sulawesi, Central Sulewesi, Central Kalimantan, and Irian Jaya. All are characterized by difficult transportation and communications, and challenging epidemiological environments, especially as regards water and sanitation problems, and low access to trained health professionals. Special efforts are likely to be required to offset their difficult situations.



Turning to vertical equity, there are sizable imbalances in the use of health services across income groups that favor well-off households. This is true, not only for private service, but, surprisingly, also for use of public services. The distribution of subsidies for various health services is compared with the distribution of income in the accompanying Figure, which uses 1990 SUSENAS data (World Bank, 1993c). The overall distribution of the health sector subsidy is slightly more equitable than the distribution of income. However, the distribution of subsidy to hospital inpatient and outpatient services strongly favors upper income groups. By contrast, the distribution of the subsidy for primary care services has the opposite impact; namely, it favors lower income groups and improves equity. The implications are clear; if government services are to be targeted on the poor, the subsidy should be applied to primary health care services and facilities. Wherever feasible, hospital services should be left to the private sector.

[1] From 1990 to 1995 the standard deviation between individual province infant mortality and the average for Indonesia declined by 6 infant deaths, and the coefficient of variation (the ratio between the standard deviation and the average across provinces) also declined from 0.28 to 0.22.

[2] Based on a cross section logarithmic regression of the under five child mortality rate (CMR) on illiteracy (ILLIT) and total per capita health expenditures (HEXT/N):

$$CMR = 8.6 - 0.46\ HEXT/N + 0.145\ LLIT \qquad r^2 = 0.32 \quad \text{No. obs.} = 27$$

(4.49) (-2.42) (1.96) (t statistics in parentheses)

3.75 Nonetheless, greater support is needed for communicable diseases and primary health care programs. But further shifts in the composition of government health sector resources to these programs is not advisable; certain hospital services, especially at the district level where funding is already low, are an important complement to the basic health care programs. It is essential to have a credible referral capacity if there is to be effective use of primary care programs at the entry level. Consequently, additional resources to support prevention and primary care programs must basically come from an absolute increase in government expenditures in the health sector and from greater sector efficiency.

3.76 **Patterns of Health Spending.** There has been a shift in the composition of investment expenditures to non-construction or equipment categories. From 1989/90 to 1994/95 the share of development spending for these latter two categories fell from 90 to 50% (Table 3.6). The share of development expenditures for training, institutional development, rehabilitation, maintenance increased from 8 to 49%. The shift to non-construction investment follows several years of facility construction to increase the density of health sector coverage in the last decade and a half.[23] This shift in focus was appropriate and needs to be maintained.

3.77 On current spending, there has been a marked rise in the share of expenditures on personnel and an off-setting drop in spending for drugs. Other categories have been roughly constant (Table 3.6). This rise in personnel spending mirrors the upward trend in the overall Budget (Chapter 1). The decline in spending on drugs is less well understood but points towards deep-rooted problems in the pharmaceuticals industry: high prices of drugs; wholesale and retail margins (averaging 21 and 34%, respectively) that are among the highest in the world; low capacity utilization (an average of 25%, on some estimates); and typically very little local value-added. More work is needed to study the structure of this industry.

Table 3.6: Government Health Expenditures by Line Item
(In % of total)

	1989/90	*1994/95*
Investment		
Land	0.2	0.1
Construction	60.1	26.1
Equipment	31.4	24.4
Other	8.3	49.3
Total Investment	100.0	100.0
Recurrent		
Personnel	52.9	57.3
Drugs	14.5	9.2
Other Supplies	23.5	21.7
Other	9.1	11.8
Total Recurrent	100.0	100.0
Percent of Investment	24.8	33.1
Percent of Recurrent	75.2	66.9
Total	100.0	100.0

Source: Ministry of Health, LITBANKES and Bureau of Planning.

3.78 Investment expenditures have increased to 33% of total spending in the health sector (Table 3.6). Taken together, the increase in investment and the change in its composition are generating a need for increased operating expenditures. It is estimated that the 1994/95 level of investment expenditure, coupled with baseline expenditures to continue operation of existing programs, will require a 10% increase in the level of real operating expenditures.[24] In addition, added expenditure is needed to cover the recurrent cost of demographic growth. Actual expenditures were appreciably less from 1987 to 1995 (see the discussion of

expenditure trends, above). Consequently, to benefit from the current high level of health investment, a substantial increase in operating costs will be needed in the near future.

3.79 **Role of the Private Sector.**[25] Private sector health spending is almost twice the level of government expenditures. But private sector expenditures are on the decline as a share of total health expenditures (from around 70% in the mid-1980s to near 63% in the mid-1990s); measured on a real per capita basis, they have grown by less than 1 1/2% per annum over the past decade, which is surprisingly low.

3.80 Most private sector services are provided by health professionals whose primary job is in the public sector.[26] Health service advice is also provided by pharmacists in conjunction with pharmaceutical sales. Private clinics, hospitals and health personnel are located primarily in urban areas. In rural areas, there are few private clinics or hospitals, and most private services are provided by individuals operating out of their homes or out of public facilities during off-hours. The use of traditional healers and their medicines is very common in rural areas and it remains substantial in the cities.

C.2 Looking Ahead: Spending

3.81 **Future Spending Patterns.** Income growth and urbanization will be important engines driving increased private sector expenditures over the next decade. However, simple plausible projections illustrate that policy change is needed. Without policies to foster growth in the supply of private sector services, middle and upper income groups will continue to place great resource demands on the supply of public services, diverting vital services from the poor. The situation will be exacerbated, if public support for the health sector continues to be low. This may well threaten the objectives of delivering higher quality essential services, especially to the poor.

3.82 The accompanying projections compare the *status quo* path of low public and private expenditures in the health sector with an alternative path that is achievable by government policy (Table 3.7). On the basis of reasonable assumptions,[27] the private sector will continue to decrease slowly as a percentage of total health expenditures, and total health spending as a percentage of GDP will remain at 1.9% (Table 3.7, columns 1 and 2). Under a more optimistic scenario (Table 3.7, columns 3 and 4)[28] the private sector would grow slowly as a proportion of total health expenditures; public spending would rise; and the total health sector expenditures expand to 2.5% of GDP.

3.83 Faster growth in the provision of private services allows re-prioritization of public spending. Most importantly, it reduces the *de facto* subsidy of public services currently enjoyed by upper income groups. The freed-up resources can be used to improve service quality and strengthen essential services for the poor and remote areas. This shift will not occur spontaneously; it requires changes in public policy (see immediately below).

C.3 Looking Ahead: Policies

3.84 **Policies for Supporting the Private Sector.** The most important step in this area would be to convert selected urban hospitals and clinics to private status. This—coupled with cost recovery in remaining public sector hospitals—would encourage a shift to private sector services, with the equity benefits outlined above.

3.85 Government policy should support improved quality of private services. Transparent and effective licensing and regulation are needed. Quality assurance programs and competency based training should be extended to the private sector. Professional associations (including those for nurses and other professionals as well as doctors) need to be supported and encouraged

Table 3.7: Projections of Health Expenditures Under Alternative Scenarios

Year	*Status Quo*		*Faster Expenditure Growth*	
	Spending[1]	*% GDP*	*Spending*[1]	*% GDP*
1997	44	2.0	45	2.0
1998	46	2.0	48	2.0
1999	48	2.0	52	2.0
2000	50	1.9	56	2.1
2001	53	1.9	61	2.1
2002	56	1.9	67	2.2
2003	59	1.9	74	2.3
2004	62	1.9	82	2.4
2005	69	1.9	94	2.5

Source: Staff projections.

[1] Per capita, per annum in Rp.1,000.

to be active within provinces as well as at the center. The private sector should be allowed to benefit from training programs and distance support.[29] Training curricula should assist doctors, nurses and midwives in starting a private practice.

3.86 Furthermore, decentralization of public services (see below) could be combined with contracting for private services at the local level. Contracts can be used by districts for specialist services, drugs and supplies, materials equipment, training, and other inputs. Broader contracts can also be written to cover entire units of care or population, as is being done in many other countries.[30] Development of health insurance would be a complement to the increased use of fees for public facilities and reliance on the private sector for high cost hospital services. By reducing the price sensitivity of the insured, health insurance can promote the development of the private sector.

3.87 **Policies to Reach the Poor and Remote Areas**. The freed-up public resources should be shifted to primary care and essential services, targeting the poor and remote regions where market failures have prevented the development of private services. The priorities, including for donor support, should include: immunization; antenatal care; micronutrient supplements; TB and malaria treatment; treatment for respiratory infection and diarrhea in children; vector control; health education; family planning; school health programs; water and sanitation programs; and, hygiene and sanitary education. Several diseases or population groups are special targets that will require added development expenditures, for example, high maternal mortality and low quality of deliveries. Primary health care services, including safe delivery, can be strengthened by better integration of district level hospitals into health sector services.

3.88 **Policies for Improving the Quality of Services**. Programs of rational drug management (initiated since 1990) should be extended, and adequate resources of pharmaceuticals and supplies should be provided, especially of basic pharmaceuticals. In the private sector, more research is needed to study the competitive structure of the

pharmaceuticals industry, especially at the distribution. Also, training and information should support better dispensing and prescription practices. Quality assurance programs for service delivery are being developed for *puskesmas* services in selected provinces. These programs need to be refined as experience accumulates, extended to other service levels, and replicated in other provinces. Improved professional standards and quality of training are needed for all types of health professionals (doctors, nurses, midwives, sanitarians, etc.). Both pre-service and in-service training programs can be strengthened by rigorously screening defined competencies and tying the training outcome to the quality assurance programs.

3.89 **Policies to Continue Decentralization.** Building upon successes in this area to date, more MOH responsibilities could be devolved to provinces, including planning and budgeting, procurement, service delivery, accreditation and quality assurance, and personnel planning and management. Within provinces, important parts of these functions can be further devolved to kabupaten and facility level.[31] For example, increased responsibility for budgeting and short range planning is already being taken by district administration. Still greater district control over resource allocation is required, however, for increased sector efficiency. Personnel is a particularly sensitive area where greater district, and even facility, control is needed. Global budgeting of facilities and block grants to districts can facilitate flexibility in resource allocation, and greater mobilization of district and province revenues is needed, including through increased cost recovery and broadening the local tax base. The Government is moving towards decentralization at a measured pace. But within a five year target, greater local control of resource allocation, over the entire budget including personnel, is needed to achieve greater efficiency in the public sector.

Endnotes

1. This Section draws heavily upon preliminary drafts of World Bank (1997c).

2. For example, Manning (1996), Oey-Gardiner, and World Bank (1996 and 1997).

3. Three separate studies of university graduates suggest that there is a premium paid to graduates of public universities over graduates in the same field coming from private universities. Except for a very few elite private universities, public universities are generally regarded as being of higher quality than the private universities. Dhanani and Sweeting (1995), reporting on the results of a 1994 Tracer Study of Technical Graduates report a 68% premium for 1989-93 male engineering graduates from public universities relative to those of private universities. A tracer study of 1989-1991 graduates of ten universities indicated that the waiting time to a job was shorter and the average salaries roughly 80% higher for graduates of universities considered to be among the top 5 in Indonesia. Finally, a survey of 350 firms in the private sector on their hiring and training practices revealed a smaller premium being paid between graduates of public and private universities (around 8%). However, the premium for graduates trained in overseas universities was on the order of 80%.

4. These would include other teaching jobs in private schools, and providing private tuition.

5. Until recently, Thailand was the only fast-growing East Asian country with lower junior secondary enrollment rates than Indonesia. However, as a result of the Thai government's launching of an aggressive secondary education improvement program, transition rates from primary to secondary increased from 52% in 1990 to 86% in 1994 (*Thailand Secondary Education Quality Improvement Project,* SAR.)

6. It's not clear where the "hidden costs" of education are categorized in the survey. These costs are believed to be substantial, and they may be additional.

7. In February 1994, GOI abolished official fees (SPP) for junior secondary education. Even though data on the effect of such a policy are not yet available, field visits reveal that schools reacted to the policy announcement by asking parents to pay the SPP in the form of higher parental contributions (BP3) as the school's loss of revenue was not fully compensated by additional public funds. Hence the costs to families may not have declined mush, and they continue to be a significant deterrent to the poor.

8. Typically, urban areas can afford to provide their teachers with higher salary supplements from the parental BP3 contributions, and there are more opportunities for second jobs. The current strategy of paying low wages but requiring few hours per week increases the relative attractiveness of working in urban areas.

9. Indeed, the incentives tend to be perverse, because some of the funding formulas governing non-salary expenditures are dependent on the number of permanent teachers. Reducing the number of permanent teachers may actually reduce resources that could be spent on educational materials.

10. These include reduced fertility, child mortality, and improved nutritional status, all of which correlate with female secondary education. For Indonesia, survey results indicate that a mother's education is an important determinant of prenatal care utilization: more than 90% of women with junior secondary education use prenatal care, in contrast to only 75% of women with some primary education (IFLS). Maternal education also has a strong effect on children's nutritional status. For Indonesian women with between zero and five years of education, an additional year of education has no impact on the child's nutritional status; among women with six to twelve or more years of schooling, an additional year of education improves nutritional status significantly (Frankenberg, Surisatini, and Thomas, 1996).

11. At the primary level, the Ministry of Education is responsible for technical quality and educational content (curriculum, teacher qualification and certification, testing, textbook evaluation and provision of teaching materials). The Ministry of Home Affairs (MOHA) at the local government level (*kabupaten*) is responsible for implementation of matters concerning manpower, materials and resources, including teacher recruitment and placement, school buildings and all physical aspects of the school (also see footnote 13). For junior secondary schools, the Ministry of Education is responsible for all educational activities and carries out most of the activities at the *kanwil* and *kandep* levels, rather than at the center. For religious schools, both public and private, the Ministry of Religious Affairs is responsible.

12. The supervision of the quality of teachers is considered to be a responsibility of MOEC, but they do not have the ability to affect personnel matters. The distribution of schoolbooks and materials has been interpreted sometimes as a technical issue (and therefore under the purview of MOEC) and sometimes as a physical issue (and therefore under MOHA).

13. The DIP and DIK are prepared in isolation from each other. MOF, MOEC and MOHA prepare the DIK. The DIP is prepared by Bappenas, MOEC and MOHA. BAPPENAS must approve the development budget for all MOEC programs, including the INPRES SD. The Ministry of Finance (MOF) must approve all routine budget requests. Budget proposals with staffing implications are jointly reviewed and must be approved by the State Ministry for Utilization of Government Apparatus (MENPAN) and the State Civil Service Agency (BAKN), as well as BAPPENAS and MOF.

14. Two other strategies, concerned more with education issues, are also being discussed, albeit at a more preliminary stage: i) the education and training system should be more flexible allowing freer movement between the two education streams; and ii) vocational schools should put greater emphasis on general education, leaving employers to provide more specific vocational skills. Debate continues over how best to bring about these strategic changes, how interested employers are, and how much public funds should be devoted to bring about these changes given competing demands.

15. A consolidated budget (incorporating central and regional governments and current and development expenditures on education) was estimated in World Bank (1997c). A review of recent expenditure patterns is included in Chapter 6 of that study. However, this type of consolidation should be carried out on a regular basis by GOI.

16. For more details in this sub-sector see World Bank 1991c.

17. The notable exception is the System Ganda, for which cost estimates are not available.

18. Base figures for 1996 are: Rp.528,954 billion for GDP (see Chapter 1); Rp.93,466 billion for total government expenditure (GOI basis); and Rp.14,649 for consolidated education expenditure (Chapter 6 of World Bank 1997c).

19. The authors of this Report are grateful to Dr. Ridwan Malik for making these data available. It should be noted their collection on a reasonably consistent basis involves extensive effort, particularly at the provincial and district levels.

20. Indonesia, Indikator Kesejahteraan Rakyat (Welfare Indicators) 1995, Biro Pusat Statistik, Jakarta, 1996.

21. This result is based on an examination of residuals from a cross country regression of child mortality on income and education. The text reports ongoing research being conducted by K. Hill, D. Jamison, and J. Wang. December 1996 communication.

22. As an economy develops, an epidemiological transition is expected with, for instance, rising rates of cardiovascular diseases and life-style health problems in more advanced stages of development. In Indonesia, the pattern of mortality is still pre-transition. Communicable diseases account for 56% of premature years of life lost from mortality, with the leading causes being diarrhea, respiratory infections, and tuberculosis. Malaria and tuberculosis are continuing problems that require an enlarged public effort to combat. Childhood malnutrition problems, especially micronutrient deficiencies, are an important underlying cause of mortality. Children account for 32% of the total number of years of life lost. In addition, the maternal mortality rate is among the highest in the world and obstructed labor, sepsis, complication of abortion, hemorrhage, and toxemia, together account for 5% of total years of life lost from premature mortality. AIDS is a growing threat that needs a concerted public effort to control. See Soewarto, Kosen *et. al.*, LITBANKES, 1996.

23. This extension of the network of health centers and district hospitals was required to achieve greater coverage with the public sector network of health services and to provide the hard infrastructure shell that facilitates the delivery of programs. The recent shift in the focus of investment expenditures to programs rather than new buildings and equipment has been important to allow the greater development of programs of primary care, outreach services, and programs targeting special diseases and vulnerable groups.

24. By way of rough estimates, new hospital construction has a ratio of recurrent expenditures to capital outlay of approximately 0.2, new health centers a ratio of 0.3 and primary care program investment a ratio of 0.5. These ratios can be used to approximate the operating cost implications of the aggregate program.

25. This is defined to include household expenditures and spending by business on health services for their employees. It excludes public sector insurance for civil servants (ASKES) and parastatal services.

26. For doctors with dual public and private sector employment, it is not clear whether the public job is subsidizing the provision of private care, or the private income makes low-salaried public employment feasible.

27. Both projections assume that GDP and personal consumption will grow at the rates projected in World Bank (1996a). Namely, Government expenditures continue at the 1995 percentage of GDP, and urbanization continues at the pace of the last decade. The *status quo* projections for the public sector assume that the central health budget remains at 3.1% of total Government expenditures, and the health expenditures derived from province and district revenues remain equivalent to 20% of central health expenditures. The *status quo* for the private sector assumes that household health expenditures grow modestly, with a household income elasticity for health of 0.5.

28. For the public sector, the alternative assumes that central government support of the sector will increase to 4.2% of the government budget (which would bring the public share in line with other Asian countries) and that district and province resources are mobilized to bring their expenditures to 0.25 of the central level expenditures. For the private sector, the alternative assumes that policies are undertaken to increase the use of private sector services and the expenditure elasticity of demand for services increases to 1 by the year 2002.

29. For example, private sector professionals would have access to distance programs in the public sector, including networks for general practitioners, nurses and other health professionals, television and radio support, and access to reference resource centers.

30. For example, the French Government contracts for services of private clinics for the national health service; in the state of Massachusetts services for prisons are contracted-out. Among developing countries, the Governments of St. Lucia and South Africa contract with private providers to deliver services, and South African hospitals contract-out specific parts of service delivery. In Egypt, there are contracts with private general practioners for health services for school children.

31. Over the last few years, the government has expanded facility autonomy (*unit swadanah*) programs to allow increased autonomy for a growing number of hospitals. The program has great promise, and the consensus is that it has been a success. If it passes careful evaluation, it should be extended cautiously to smaller hospitals and *puskesmas* in selected districts.

4
BUILDING "HARD" INFRASTRUCTURE: A LOOK AT KEY SECTORS

A. Overview

4.1 Until the late 1980s, Indonesia followed the prevailing public sector approach to infrastructure (World Bank 1994a and Chapter 2). During much of the 1970s and 1980s, this was mainly increased public spending, financed from oil revenues and donor assistance. Although Indonesia's infrastructure expansion was among the most rapid in the world before the 1990s, bottlenecks developed in key areas such as urban infrastructure, power generation and transportation. Service problems sometimes forced users to rely on higher unit cost alternatives, such as private power, wells or bottled water. At the same time, mismatches of capacity, high-cost contracts, inadequate maintenance, and "lost" output characterize some sectors. Resource constraints and institutional issues, particularly in the cities, have made it difficult to resolve these problems.

4.2 During the 1990s, the Government has begun to rely more on the private sector in some infrastructure areas that formerly were reserved for the public sector. This Chapter looks at the status of the Government's efforts in some of these areas, with an emphasis on remaining issues and policy solutions. Attention is focussed on three key sectors—Power (Section C), Urban Infrastructure (Section D), and Transportation (Section E).

B. Cross-Sectoral Policy Issues

4.3 Certain common issues emerge in the sectors reviewed in this Chapter. The most striking are highlighted in this Section. Addressing these issues would go a long way towards reducing costs, sustaining high growth and raising living standards well into the next decade.

4.4 **Role of the Private Sector.** The most striking commonality among these sectors concerns the role of the private sector. There are two equally important dimensions to this issue. The first is the wide possibilities for relying more on the private sector. The second concerns the potential high costs of this approach, if it is not done in a competitive, transparent fashion.

4.5 The Government recognizes the potential benefits that the private sector can bring to infrastructure provision. In some key sectors, foreign and local interest is high. However, in some cases (*e.g.*, power generation, urban water supply and toll road construction) there are signs that the process is running ahead without the benefits of a transparent, competitive framework. Consequently, Indonesia risks creating high-cost electricity, toll roads and urban water supply, and the Government's contingent liabilities are rising rapidly. Eventually, the public will have to bear these costs, for example, in the form of large power tariff increases, which could be as high as 50% by 1999.

4.6 **Creeping Reregulation.** Another common thread, especially in sectors that were early targets of deregulation (*e.g.*, transportation), is the increasing incidence of reregulation. For example, complaints were already on the rise concerning port delays attributed to the customs service, many months in advance of termination of the pre-shipment

inspection service; there are proposals to channel most cargo through Batam for transshipment; levies are high in the road and maritime subsectors; and there are pressures for reregulation of shipping. In almost all cases, the impact of the reregulation is to stifle competition. It is important for Indonesia's economic future that there be a return to the spirit—and practice—of deregulation, which has been the basis for much of the country's success in the past decade.

4.7 **Decentralization and a Sustainable Revenue Base.** Another common solution to problems dogging these sectors appears to be devolution of more authority to a lower level of government or to an agency that is closer to the user. To be sure, decentralization is not a cure-all and there are significant risks (Davoodi and Zou, and Prud 'homme). Nevertheless in most of the cases considered here, a better arrangement would be for the central government to focus on setting policy frameworks, budget envelopes, best-practice standards and implementation guidelines; local governments would have more autonomy (including the possibility of contracting-out) in the details of policy formulation and implementation.

4.8 For more decentralization to work, there must be greater financial autonomy on the part of lower level governments. To be sure, more block grants, grant funds on a matching basis, or greater borrowing authority would be of assistance. But the key is the creation of a sufficiently large, sustainable revenue base to support greater autonomy. The Government's Local Taxes and Fees Bill, approved by Parliament in early 1997, is a significant development in this regard.[1]

4.9 Higher property taxes and increased user fees would add significantly to local governments' revenue base and they would improve equity (World Bank 1994a). The property tax could also be set up to provide some redistribution to poorer, lower level governments, as has been done in Chile (Box 4.5 in World Bank, 1996a). Some offset to these higher taxes could be provided by rationalization of existing local taxes, many of which cost almost as much as they yield (Box 5.5).

4.10 **Procurement and Contracting Procedures**. In all the sectors discussed below, contracting is an important activity, and it is a very lucrative business—for all associated parties—which also accounts in part for local preferences for large projects. Consequently, another common theme among these sectors is the pervasive weakness in government procurement procedures (also see the Section on Governance in Chapter 5). For example, well-connected parties often appear to get preferential treatment under KEPPRES 16 and for unsolicited proposals for private sector participation in infrastructure development. Also, agencies are sometimes pressured to accept overly costly equipment (*e.g.*, buses, railways, vessels, and aircraft) and services.

4.11 **Human Resources.** Most institutions face major challenges in terms of human resource needs (*e.g.*, pilots and air traffic controllers in civil aviation, and trained professionals for transport planning and traffic management in urban transportation). Broadly speaking, problems in this area are twofold: i) recruitment and retention of competent specialized staff; and ii) training needs.

4.12 More financial autonomy for lower level governments, mentioned above, would be of assistance in this regard. Failing this, local agencies should at least have the flexibility to change the composition of staff to better meet local needs. Other steps would also be helpful. For instance, the present system of incentives—whereby staff effectively get a share of spending—needs to change so as to encourage saving, not spending.

4.13 **Technical Assistance.** Many of the preceding comments also apply to the use of technical assistance (TA). Currently, much TA is wasted on repetitive studies for central agencies, which are not disseminated or implemented. Better transparency, competition and accountability should be introduced among heavily-used groups such as engineering, design and supervision consultants, including performance records with non-performers being disqualified. These issues will become more pressing with decentralization.

4.14 **Weak Institutions.** Many GOI institutions have demonstrated that they are good at planning and executing incremental investments. However, they are less effective in matters related to large-scale strategic investments and in the effectiveness of their spending. In some sectors, there is institutional fragmentation (among levels of government or across government agencies) and typically no central policy-making or coordinating body. Also, there are often competing factions—with overlapping mandates—within and across departments. In such circumstances, resistance to policy reform within agencies is common, especially at middle-management levels. Such weaknesses are sometimes amplified by on-going collusion between the bureaucracy and powerful private groups. As solutions, there could be "unbundling" of some functions, and corporatization of others prior to privatization.

4.15 There is also a regional dimension to many issues in these sectors. For example, there is a tendency to respond to demands for regional equity through the provision of more "hard" infrastructure. In many cases these demands may be justified. But it will also be important to ensure reasonable rates of return on such projects, or to subsidize the projects in a way that is measurable and kept under regular scrutiny.

C. Power

C.1 Overview

4.16 Power sales of *Perusahaan Listrik Negara* (PLN, the State Electricity Company) have increased rapidly (by 14-15% per annum) since the early 1980s. In parallel, the number of customers has grown from 2.7 million to 20.1 million, and PLN is now connecting close to 2 million new customers each year. Village electrification increased from 12% in 1983 to 65% in 1996. PLN's operating efficiency has improved; for example, network losses were about 12% in 1995, down from 20% a decade earlier. Financial performance is also better. Prior to this decade, PLN was a loss-maker; now it turns a profit.

4.17 PLN's supply system and customer base vary significantly by region. Java (with 60% of Indonesia's population) has 70% of PLN's customer base and 80% of sales. The inter-connected Java-Bali system has a extra-high-voltage (500 KV) transmission grid, large and efficient generation plants, and a large industrial customer base. Already 88% of villages are electrified, and this figure is expected to increase to 98% by 1999. PLN's Java-based operations earn a profit. In the future, private sector plants will account for most new grid-linked capacity on Java, with the first plants due in 1998. PLN's own on-Java operations are slated for partial privatization.

4.18 The rest of the country is served by seven regional grids (with 150 KV or lower voltage transmission lines), numerous mini-grids, and some 900 diesel plants, which together account for more than 50% of off-Java-Bali generation. Village electrification in 1996 is only 52%. With lower economies of scale, costs are much higher, which makes PLN's operations unprofitable outside Java-Bali.

4.19 **Challenges: Service; Pricing; Capacity; and Managing Private Participation.** Despite its major accomplishments, PLN faces numerous challenges. Outages and supply constraints raise costs to commercial users. Sales per capita and village electrification are still low compared to (higher income) Malaysia and Thailand[2]. Slow adjustment of tariffs has reduced average prices to the lowest in the region, thereby reducing PLN's profitability. The uniform national tariff is below cost outside the Java-Bali grid. PLN still depends heavily on government and donor funding, with an average of around Rp.4 trillion ($2 billion) per annum from the Development Budget in the last two years, and has begun to borrow directly as well, with average annual borrowings of Rp.1 trillion, also in the last two years. In addition, generating capacity is expanding rapidly. PLN is completing its own large program, and power purchase agreements (PPAs) have been signed for (generally unsolicited) private generation projects equivalent to 50% of PLN's current capacity, and negotiations continue on a similar volume. Most of the PPAs are above, or similar to PLN's current average tariff. And, although transmission & distribution capacity is being increased, it still lags generation capacity. The incidence of captive generation is likely to increase even further as domestic natural gas becomes available to industrial sites on Java.

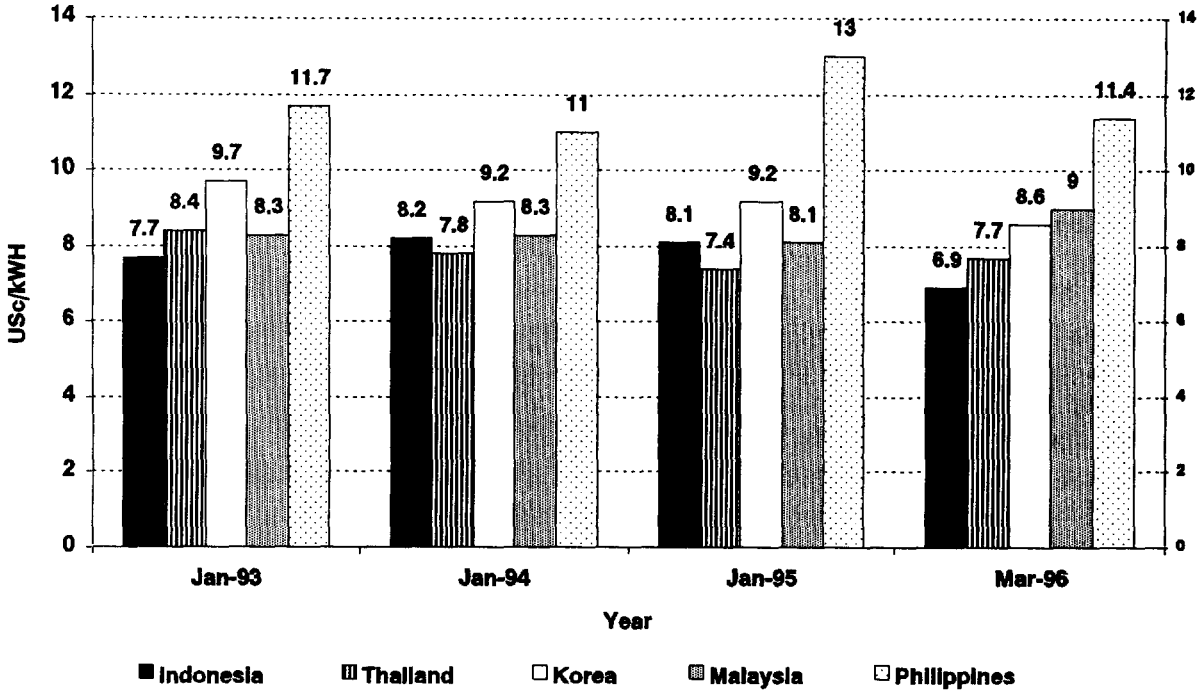
4.20 In these circumstances, the Government faces two major challenges. First, to restructure its approach to reduce government involvement and increase private sector participation within a competitive framework that includes increased and restructured tariffs. Second, outside the Java-Bali grid, the challenge is to find innovative modes of electrification while maintaining reasonable prices for social reasons. Important elements in successfully meeting both these challenges will be: i) an increase in tariffs; ii) a restructuring to reduce cross subsidies that inflate costs; iii) an increase in transmission & distribution capacity, which would assist with increasing demand and PLN's revenue; and iv) a more transparent, competitive framework for private power generation, transmission and distribution. It will also be important to avoid over-capacity and to ensure that future plants are efficient in terms of their place in the grid and their choice of fuel.

C.2 Pricing Issues

4.21 The most recent revision to the uniform national tariff schedule was in October 1994. At that time, a quarterly automatic adjustment mechanism (ETAM) was introduced with the aim of maintaining the basic tariff in the face of changes in fuel prices, inflation, the rupiah-dollar exchange rate, and PLN's power purchase costs. However, the quarterly tariff adjustments did not enable PLN's revenues to keep pace with increasing costs.[3] The average tariff has risen only 2%, while PLN's costs have increased by 8% (and inflation has been 15%). As a result, the rate of return on (revalued) fixed assets fell below 6%, rather than increasing to the target of 8%.

4.22 **Tariff Level.** Since 1989, tariffs have been adjusted about every two years, and a tariff increase is overdue, simply to compensate PLN for cost increases over the last two years. An increase would also ensure PLN is not snared in another liquidity crisis such as it suffered in 1995 and 1996, and it is a precondition to a successful privatization of PLN's generating capacity. Furthermore, an increase would help prepare PLN for its new role (starting next year) as purchaser from large independent power producers (IPPs).[4] Even a substantial increase in tariffs should not undermine Indonesia's external competitiveness because Indonesia currently has a lower average electricity tariff than its East Asian neighbors (see Figure 4.1); one KWh of electricity costs 6.9 US cents today, the lowest price since 1988/89.

Figure 4.1: Average Electricity Tariffs in East Asia, 1993-1996 (in constant 1996 prices)



4.23 The automatic adjustment formula (ETAM) also would benefit from substantial revision. There is some scope for improving implementation of ETAM under the current Presidential Decree. However, a revised decree is needed to remove existing ambiguities and ensure that the new ETAM will be able to deal satisfactorily with the rapid increase in PLN's power purchase costs as the large private plants come on stream, beginning in 1998/99.

4.24 **Tariff Structure.** The current tariff structure involves 24 separate categories and embodies many cross-subsidies. Currently, large customers pay to cross-subsidize small users, and commercial customers generally subsidize all other categories. The large number of categories makes the tariff system non-transparent and introduces potential differences in costs for similar firms. While social arguments exist for subsidizing minimum consumer service, there is no reason why large power consumers, rather than the nation at large, should pay for this social goal. The cross subsidy puts the larger users at a cost disadvantage vis-a-vis other countries, and encourages them to turn to self-generation. To level the playing field, it would be desirable to reduce the number of categories, reduce the subsidy (except for "life-line" levels of consumption) and consider covering the cost of social objectives directly from the national budget.

4.25 PLN's uniform tariff schedule gives customers identical electricity prices regardless of their location in the country. However, unit costs are about twice as high outside the Java-Bali grid. This implies a cross-subsidy from Java-Bali consumers to the rest of the consumers. Part of the subsidy has been

implicitly absorbed by Government acceptance of a low rate of return on equity. But, the subsidy raises costs on Java-Bali relative to competitors and encourages large consumers to install their own plant, as noted above. It also makes it difficult to achieve a rate of return attractive to private investors. If the Government seeks to retain the uniformity of the tariff structure for social reasons, then it would be desirable to spread its costs across the nation, rather than just to electricity users on Java-Bali. The subsidy could be made explicit and the Government could directly reimburse PLN. Clarification of this issue also would help make PLN a more attractive candidate for privatization. In addition, it would encourage off-Java expansion, which now is hindered by costs that exceed the average tariff.

C.3 Capacity Issues

4.26 Generating capacity has grown rapidly for some time under the Government's expansion program. By contrast, transmission & distribution capacity has typically lagged (see below). The resulting problems with service interruptions and high commercial tariffs have encouraged self-generation, which has reached some 70% of PLN's capacity. For PLN, the net result has been historically high ratios of capacity to peak load in the Java-Bali grid, which reached 162% in 1993/94. Recently, the excess of capacity to peak load has fallen to 35%, but because peak load has increased much faster than sales, the average load factor has fallen about 7%. In the near-term, PLN's recent ambitious investment program is coming on line, but PLN plans no new base load generation capacity, apart from completing existing investments, before 2003.

4.27 **Growth in Private Generation Capacity.** PLN has signed twenty-two power purchase agreements, of which 6 major plants have reached financial closure; twenty-four more are in various stages of negotiation. The additional capacity represented by all these projects is roughly equal to PLN's currentcapacity. Almost all of these projects originated from unsolicited proposals, with full or partial "take-or-pay" power purchase agreements (PPAs). In general, the PPAs provide for tariffs that are above PLN's average tariff, although there have been some recent exceptions. (The exceptions tend to reflect the few instances of competitive bidding as well as the worldwide decline in prices of power generation equipment). The private power agreements under negotiation would easily provide sufficient generation capacity to meet projected demands though 2006.

4.28 The ratio of capacity to peak load will rise to at least 40% by the end of the 1990s and the lower load factor will remain, given the commissioning of PLN's own ambitious expansion program and the large private generating plants (beginning in 1998/99). Continued lags in transmission & distribution capacity, plus PLN's difficulties in negotiating gas contracts, may limit the power that could be sold from these plants. Given the take-or-pay nature of the contracts, PLN will be forced to take power from the private plants, even though their cost exceeds PLN's.

4.29 **Managing New Capacity and Lowering Its Cost.** The capacity situation is likely to raise PLN's costs substantially. Hence, the Government should go slow in adding to capacity. An appropriate choice of contracts would place more of the risk of excess capacity on the new plants. The large, projected volume of new capacity will give plenty of time to prepare new projects based on their efficient link-up within the network, and the most appropriate choice of fuels. Accepting any new, unsolicited bids would only add to the build-up of the already large capacity.

4.30 **De-Bottlenecking Transmission & Distribution.** Existing capacity of the 500KV

line will not be sufficient to enable operation of the new plants currently under construction in East Java. Slippages in the 150 KV and 20 KV networks and substations in urban areas constrain sales growth and are a major factor in the frequency of outages and "brown-outs", although recently the network's performance has improved significantly. Expansion of the transmission & distribution network is thus critical to system improvement. The top priority should be construction of the southern 500 KV line and other key sections to allow sales from the large East Java plants. Some scope exists for private participation in transmission & distribution, for example through Build-Maintain-Transfer concessions, allocated by a transparent, competitive bidding process.

C.4 Institutional Issues

4.31 **Privatization.** The Government is restructuring PLN in preparation for its privatization, but much remains to be done on the pricing and regulatory front before a successful privatization can be carried out. Two on-Java generating subsidiaries (PT PJB I and II, also known as Gencos) were established in 1995 by "unbundling", and they are the initial targets for privatization. PLN has recruited an international auditor to provide comfort to investors, and has retained a domestic consortium as financial advisor. A track record for the Gencos is being established. However, a number of issues need to be settled to permit shares to be sold at prices that reasonably reflect the value of the Genco assets. The financial strength of the parent company is also important, and depends on tariff increases and adjustments (Section C.2 above), because sales by the Gencos would be to the parent company. There is also a danger of trying to achieve Genco profitability by sacrificing that of the parent company.

4.32 The projected upturn in excess generation capacity in 1998 (see previous sub-section) also has potentially serious implications for the planned privatization. In particular, it may become necessary to "back-down" the Gencos' baseload plant in order to accommodate the take-or-pay contracts (see para 4.27). Moreover, improvements in the regulation of the power sector, as well as the tariff-setting mechanism, will be crucial to establish the "rules of the game", and in particular to establish the scope for the Gencos in future expansion.

4.33 No decision has yet been made to establish PLN's four distribution units as stand-alone companies, and further technical work, especially on the tax obligations, is required before this can be done. At a minimum, however, PLN needs to accelerate the process of corporate decentralization, and the establishment of its corporate headquarters as a "virtual holding company".

4.34 **Single Buyer Market.** The Government is now implementing its plans for power sector restructuring, in particular for a "single buyer market" for Java. Under the Government's plan, PLN would buy power from a mix of partially-divested generation companies and IPPs. The power would be sold to PLN's distribution units for sale to final consumers. The single buyer market is intended as a transition phase to a fully-competitive, multi-buyer, multi-seller market. Implementation of the single buyer market has already begun with divestiture of assets into two generating subsidiaries (the Gencos mentioned above), the preparation of PPAs for these Gencos, and the gradual transfer of single buyer functions, including system planning, to PLN's Java-Bali Electricity Transmission Unit (JABETU).

4.35 **On the Regulatory Front.** The Government has announced its intention to rewrite Government Regulation 10/89, which currently governs PLN's operations. The redraft should:

i) establish licenses as the main instrument of regulation, thereby bringing the same treatment to PLN (currently PKUK holder) and the private sector (IUKU holders);

ii) redefine PLN's role as single buyer and allow for differentiation between PLN's role in respect of on- and off-Java;

iii) define the regulatory duties of the Minister and the newly-created Directorate of Regulation; and

iv) establish the rules for ensuring competitive procurement (of both power and equipment) in the power sector.

4.36 **The Captive Power Issue.** Self-generation provides a way for businesses to reduce the cost of poor service by PLN and it is a stimulus to improved performance by PLN. Duty-free status for self-generators should continue, in line with PLN's status and the treatment of many other capital goods. Over time, "self-generators" should be allowed to sell into the grid or to other buyers ("wheeling") to allow better use of private-sector generating capacity. However, it is also important that the playing field be leveled by removing the subsidy on diesel oil (the preferred fuel for captives) and reducing the various cross subsidies and taxes (for off-Java operations, small consumers, and for street-lighting) that are borne by PLN's large users.

C.5 Energy Diversification

4.37 GOI energy policy has long emphasized energy diversification away from oil in favor of renewable and "new" energy sources. Significant progress has been made in concluding agreements with combined-cycle gas turbine plants and numerous (mostly private) geothermal power plants. The Government is also trying to develop the market for solar home systems in remote rural areas. However, regulatory and institutional constraints, particularly with regard to gas allocation and pricing, still impede development of the domestic gas market. Pertamina controls all geothermal resources with power generation capacities in excess of 10MW, which impedes additional power generation from this source. Policy changes are needed in order to encourage increased exploration for and timely exploitation of small gas reserves and facilitate expanded use for power generation. Likewise, subsidy of domestic oil fuels, such as high speed diesel (mainly used in generation plants), militates against expanded use of renewables and encourages use of captive plant. Action on those fronts would slow depletion of scare oil fields and make more petroleum available for future export.

4.38 **The Nuclear Option.** GOI has been conducting detailed feasibility studies concerning the controversial possibility of nuclear generation of electric power at a site in Central Java. GOI has indicated that nuclear power is regarded as a last-resort option; this is appropriate. Given the large additional generation capacity still in the pipeline, the continuing strong private interest in supplying conventional power, and the possibilities for expanding clean, gas-based capacity through deregulation, nuclear power is not needed at this time. This is particularly the case considering the environmental risks and the international track-record of long lead times, which would require scarce government funding or guarantees.

D. Urban Infrastructure

4.39 **Overview of the Sector.** Already Jabotabek is one of the world's largest metropolitan area. Important basic services (such as water supply, sewerage and solid waste management) have fallen behind targets in the face of rapid population growth (see Table 4.1). In addition, as mentioned in Chapter 2, an extended period of continued urbanization is in the offing; by the year 2005,

Table 4.1: Indonesia: Estimated Public Urban Infrastructure Spending
(trillion Rps.)

	REPELITA V		*REPELITA VI*
	Planned	*Actual* [a]	*(indicative proj.)*
Total	10.9	4.5	22.6
Water Supply	4.5 [c]	1.5	10.0 [d]
Roads[e]	2.7	1.6	2.5
Flood Prevention & Drainage	1.9	1.2	3.6
Sewerage & Waste	1.2	..	5.4
Kampung Improvement (KIP)	0.7	0.2	1.1
Memo:			
Average Expenditure p.a.,[b] (In thousands of 1990 Rp. per urban resident)	34	12	37

[a] Includes local spending, estimated at about 20% of total.
[b] Estimated at middle year of plan period.
[c] Includes projected Rp. 500 billion private investment.
[d] Included in Table 3.1. Includes projected Rp.4 trillion private investment.
[e] Excludes toll roads, includes the urban portion of Central Government spending in Table 3.1.

Source: World Bank 1994a, p. 45; World Bank 1993b, pp. 47, 132.

more than 110 million people (50% of the total population) are expected to live in Indonesia's cities, of whom well over 20 million will live in Jabotabek. In these circumstances, the Government is facing three major challenges: i) to prevent urban congestion becoming a bottleneck to economic growth; ii) to avoid high-cost infrastructure becoming a hinderance to growth; and iii) to provide an adequate supply of basic services, which are vital to further reductions in urban poverty.

4.40 For the poor, who are a majority of urban residents, Indonesia's cities are not a pleasant place to live. International comparisons (which, it should be noted, are not fully comparable) indicate that urban access to piped water and sewerage service is much lower in Indonesia than in the Philippines, Thailand or Malaysia (World Bank 1994b and World Bank 1993c). Private solutions (such as wells, septic tanks, rivers and canals) in large cities, especially on-Java, have negative externalities: ground water and rivers are increasingly contaminated; seawater intrusion is contaminating coastal cities' aquifers; use of ground water beyond recharge levels causes land subsidence and flooding; and during the dry season, competition for water exists between residential, industrial, recreational and agricultural uses (World Bank 1993 and 1994). Also, industrial and solid waste is often dumped into rivers and canals, thus causing flooding and further contamination of water. Moreover, air pollution is on the rise, largely due to transport congestion. For example, sample evidence suggests that pollution levels exceed WHO standards for 173 days/year at

some locations, versus 153 days/year in 125 major Asian cities (World Bank 1993 and 1994). Moreover, lead pollution is an acknowledged issue; in late 1996, a Presidential Instruction decreed that leaded gasoline would be phased-out by 1999.

4.41 Currently, the better-off benefit more from urban infrastructure than do the poor. For instance, piped water is available to 91% of well-off households (those spending more than Rp.400,000 per month) versus only 10% of poor households (those spending less than Rp.100,000 per month). Also, much of the benefit of low-cost water from standpipes may be siphoned-off by caretakers or vendors. Transport investment tends to benefit car owners, who are much wealthier than average. Air pollution, flooding and poor access to safe water fall most heavily on the poor, because of where they live and their dependence on vendors. Efforts are being made to increase services to the poor, but more attention is needed.

4.42 Until recently, the provision of urban infrastructure was largely controlled, managed and financed by central government agencies. Delivery is through standard-type service provision as proposed by the Ministry of Public Works and Bappenas. Funding for standard budgets is formula-driven (based essentially on population and area) as set by Bappenas and the Ministry of Finance. In addition, tariff policies have not always been effective; for example, high tariffs on industry encourage the use of substitutes, such as wells, which is not socially optimal. Large funding needs are often covered by foreign assistance, although local governments have recently been provided greater discretion in planning and implementing donor funded projects.

4.43 Looking ahead on an institutional basis, many innovative ideas are under consideration in Bappenas and elsewhere, in preparation for REPELITA VII. Their overall framework is broader—as befits current urbanization trends—and central government dictates are narrowing in line with decentralization and increased private sector participation. While details of new approaches still need more definition, one basic problem is clear—limited institutional capacity is holding back progress more than inadequate funding. In this regard, several suggestions are provided below for accelerating the provision of urban infrastructure. Many of these suggestions concern basic issues in development of the Indonesian economy, such as governance (Chapter 5) and decentralization. Progress is likely to be only gradual.

4.44 **Current Patterns of Expenditures and Funding.** Public expenditure in urban infrastructure is low (about Rp.1,000 billion per year); it has consistently fallen short of REPELITA targets (Table 4.1); and it has been roughly unchanged in real terms during the last decade. Consequently, real urban expenditure per capita has fallen-off markedly, to only about Rp.11,000 in 1994/95. Urban spending is a small proportion (about 7%) of total regional government expenditures. Of this, only about 40% is development expenditure, and less than half was spent by Level II governments, which are more concerned with urban infrastructure than Level I governments. (By contrast, large urban projects are financed directly by the central government.) On the composition of spending, roads dominate; for instance, 43% of the urban investment under REPELITA VI was intended for roads (Section E).

4.45 Borrowing for urban infrastructure has also been relatively low. Most of this borrowing has been donor-financed, with central government involvement. To assist, the central government created the Regional Development Account (RDA) in 1989. The local governments have indicated considerable interest in this facility, but their borrowings

have been constrained by availability of funds. The largest municipal borrower from the RDA has been DKI Jakarta, with Rp.156 billion. All other municipal governments have borrowed in total some Rp.150 billion from the RDA, since 1991/92. Most of the borrowing from RDA, some Rp.700 billion, has been by PDAMs (the municipal water authorities; see Section D.1).

4.46 On the other hand, the discretionary investment resources available to Level II governments has increased over the 1990s in line with the government decentralization policy. For example, the proportion of grants under local discretion increased from 20% in 1990/91 to 28% in 1995/96 (INPRES), while the proportion of INPRES available to level II governments increased from 45% in 1990/91 to 57% in 1994/95. Despite some declines, allocations to DIPs (through central line agencies) still dominated through 1996/97, before falling dramatically in 1997/98. Some large projects are executed by the central agencies even when they are not "national" projects (such as urban by-pass roads).

4.47 Looking at the regional dimension, there has been a large shift in public sector investments to Eastern Indonesia, where investments per capita are about double those in the other islands. Smaller and medium cities accounted for 53% of total urban investments by 1993/94 compared to 28% in 1989/90.

D.1 Accelerating Delivery of Better Urban Services

4.48 **Commercializing Municipal Services.** In general, private sector involvement would increase efficiency. But competition, not necessarily ownership, is the key to greater efficiency, and exposing public agencies to greater competitive pressures is often a more feasible alternative than privatization. Changes along these lines, which are highly interdependent,[5] would yield large benefits (Boxes 4.1 and 4.2):

- Change the staff payment system. In the current Indonesian system, staff have an incentives to approve high-priced contracts, and little incentive to ensure quality or service levels. Large increases in staff pay to increase motivation are not an option, because of the budgetary implications. More innovative solutions are needed (see Boxes 4.1 and 4.2).

- Introduce more competition into the procurement system. Currently, agencies use a reference price system; bids are usually within 1% of the reference price; and, at times, participants seem to take turns winning (the *arisan* system). Despite KEPRES 16,[6] fundamental change is needed in this system. One option might be the establishment of a "civil society group" that calls for bids and selects winners. Another possibility is better packaging of contracts to attract international bidders.

- Delegate more authority to local agencies concerning the level and composition of agency-level staff. A good model is the experience to date with the decentralization pilot project.

- Introduce multi-year contracts. The current system typically leaves 3-4 months per year to complete the work, which is unduly restrictive.

- Equipment pools could be commercialized or privatized to improve utilization and reduce costs. Similarly, private operators could directly collect the fees for their services.[7]

- Rationalize the use of technical assistance.

4.49 **Modifying Financing Arrangements.** Some 85% of municipal expenditure is financed with transfers from centrally collected taxes, through block grants (INPRES), allocations to the province, or centrally executed projects/budget (DIPs, which are decreasing, as already noted). The allocations are formula-driven (using population per unit area of the *kotamadya*, a minimum allocation and other factors). When foreign financing agencies are involved, the expenditure level of the related city normally increases for the duration of the project. Cities are told to borrow more against their own resources. For cities that are able to borrow, there is no mechanism to enforce repayment or penalize lack of repayment. In addition, many agencies are getting to the end of the grace periods and may soon face cash flow difficulties. None of these systems rewards the *kotamadyas* that perform better—on the contrary, those that do better are supposed to self-finance more and borrow more, while those that do poorly, eventually get more grant financing.

4.50 Better financing arrangements can come from basically two directions. First, by increasing local revenues (*e.g.*, by raising the property tax rate which is very low, 0.1% of assessment values). And second, by the private sector financing more of the services that can be commercialized; the public sector could provide equity, as necessary to make public projects commercially attractive to the private sector. Beyond this, the time may be ripe to include an incentive mechanism in the allocation of grants to Level II governments, perhaps on a matching-funds basis to encourage local governments to increase their locally-sourced revenues. Also, there is need for greater transparency and efficiency in the use of funds. More specific suggestions include:

Box 4.1: Gainsharing: An Innovative Approach to a Difficult Problem

Indonesia's problem of limited budgetary room to raise the salaries of underpaid municipal public servants is not uncommon these days. Innovative solutions are starting to appear, such as the concept of "gainsharing". In the city of Indianapolis, United States, the Mayor reports that gainsharing reduced unit costs by 25% over 5 years; staff numbers were also reduced by 25%; staff who left, found jobs in the private sector; and all remaining workers are earning more.

In Indianapolis, the ideas for cost-cutting (*e.g.*, out-sourcing) originate with local staff. When these ideas result in lower costs, the staff get a share of the savings. At fiscal year-end, instead of trying to spend the entire budget, staff are looking to save money because they will share in the savings.

A system like this is not easily transferrable, and it has many important preconditions, for example: reference prices; monitoring of service and quality; a transparent procurement system and multi-year contracts; and a transparent process to distribute a share of savings. In Indonesia, this would mean changing many current modalities (*e.g.*, decrees and regulations), and it would not do to change only a few of them. Piloting in a small number of forward-looking agencies may be one way to assess how well a more transparent and "rewarding" system might work for Indonesia.

Source: Osborne.

Box 4.2: The Case of Urban Water Supply

This subsector is important for several reasons. First, the provision of clean water is fundamental to urban poverty reduction. Second, results have been unsatisfactory to date: levels of public investment have been low; service is poor; and costs are high. And third, the commercial nature of much of urban water supply makes it ripe for greater private sector involvement. At present, the major water-suppliers are state-owned regional companies known as PDAMs, which are small-scale (80% serve less than 10,000 customers), high cost and unable to attract good staff. A major overhaul of the sector is needed.

Level of Service. At present, only around 40% of urban residents have access to piped water[1], and much of this is non-potable.[2] Piped or not, water is generally boiled prior to consumption, and bottled drinking water, which is relatively expensive, is a rapidly growing market even for lower income households. Many commercial/industrial firms rely on deep aquifers for their water needs, often with a negative environmental impact such as sea water intrusion.

High Water Losses. Approximately 40% of the water produced by the 296 PDAMs is "unaccounted for". This is very high by international norms. If this loss-rate could be decreased to 25%, a barely satisfactory level by international standards, and the consumption remained at present levels (of 130 liters per capita per day), then the existing production capacity could serve some 1 million more households, up from 4 million served currently.[3]

Major Expansion Foreseen in Demand for Services. Projections indicate that the urban population is likely to almost double by the year 2010 (see Chapter 2). Water will be needed by some 7 million more urban households--more than double the current water supply capacity.

More Public Investment Needed. At current levels of investment, the service rate would rise from about 40% at present to around 50% by 2008, which would still leave some 55 million people unserved. To achieve a 70% service rate requires major new investment (some Rp. 9 to 8 Trillion).

But More Needed than Additional Public Investment. Public investment has increased piped water coverage from some 37% of the urban population in 1990/91 to the above mentioned 40% in 1994/5. To be sure, spending needs to increase further.[4] But funds on their own will not solve the municipal water problem, as evidenced by the experience of recent years when more funding was budgeted than was invested. Significant progress requires that the water supply industry move quickly along the following lines.

- Investment can be financed through cash generation (30%), commercial loans (30%), central government equity (30%), and bonds and private sector equity (10%). A modest tariff increase is needed in the next year or so, followed by automatic adjustments to keep up with inflation. Subsidized loans (*e.g.*, RDA) should be phased-out during Repelita VII.
- Revise pricing principles to serve efficiency and equity objectives. A greatly simplified rate system would be appropriate,[5] reflecting costs and a relatively cheap "lifeline" rate for low-volume, low-income users. The average tariff needs to go up, and billing/collection procedures improved.
- Expand current thinking on private sector participation, from the current view that this is only relevant for enclave areas and production facilities. For example, increased commercialization of operations and management, and private (foreign and off-shore) financing of the investments.
- Re-group or form consortia of PDAMs to gain economies of scale, increase autonomy from municipal politicians, and attract qualified staff. In particular, the principle of one PDAM per local government has to be revisited; ownership could remain with individual local government.
- Prepare long term water supply master plans for all urban areas, taking into account alternative demands. Currently plans are normally prepared on a 5-year basis, which is inefficient and does not guarantee a least cost solution over the longer term.
- On institutions, some consolidation is needed and responsibilities clarified. And,
- Encourage a more customer-oriented attitude, *e.g.*, by, customer representation on Boards of Directors.

As further concerns private participation, there are issues of transparency, as well-connected firms have been awarded contracts in both Jakarta and Surabaya. The central government needs to put-in-place a regulatory framework and an independent body to mediate issues that will arise even with well-drafted contracts. In addition, better/more independent auditors and certification agents should be available. If a private operator wants to start a new water company, it should be allowed to compete with the existing one, perhaps in different zones. For most PDAMs, only management or lease contracts may be feasible with public sector funding still needed.

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1) The rest rely on shallow wells or surface water. Shallow aquifers are often polluted by sanitation facilities at the households.
2) Treatment plants cannot remove pollutants that are accumulating in water bodies, and intermittent service allows suction of pollution into distribution networks.
3) Delivery is by some 3 million residential connections and 40,000 standpipes.
4) Some estimates suggest that $500 million per year is needed for this sub-sector.
5) Only one rate is needed, with a heavy discount to the first, say, 10 m^3 per household. At most, another higher rate could be charged for large monthly consumption.

- Provide grant funds selectively, to meet the needs of poorer local governments. Matching grants are better, as an incentive for better performance.

- Increase the share of block grants in transfers, with the role of the central agency limited to the implementation of large projects.

- Greater predictability in financing, to allow better multi-year planning.

- Review borrowing mechanisms. As part of the current review of the RDA mechanism, consideration could be given to establishing a Municipal Fund for use by qualifying local governments.

4.51 **Changing the Roles of Central Ministries.** The current system is still too centralized. It is cumbersome because of the number (more than 200) of cities that the central ministries oversee, and it reduces local ownership at time of implementation. More is needed along the lines of recent GOI actions to make central agencies more like advisors and monitors, with local agencies having greater independence in their decision-making. Some staff may need to shift from Jakarta to provincial agencies, and better use is needed of TA and training,[8] preferably on a requested and fee-based basis, including in private entities.

E. Transportation

4.52 **Overview of the Sector.** The Transportation sector in Indonesia is highly diverse, reflecting the far-flung nature of the archipelago. By way of example, Indonesia's international and domestic passenger and freight transport demands are served by several competing and complementary modes—road, rail, inland waterway, shipping and civil aviation—whose characteristics and performance in some instances differ markedly from region to region and from urban to rural areas. This necessarily limits the scope for making meaningful generalizations and international comparisons. Moreover, the structure of the transport industry—which is characterized by large numbers of operators, some of which serve only their own needs—necessarily poses problems of data coverage and reliability.

4.53 This sector is vital to sustaining Indonesia's growth. To date, the capacity of the transport system has generally been able to keep pace with increasing demand, although bottlenecks and traffic congestion are emerging in urban areas and regions that have experienced especially rapid economic growth. Services are predominantly private, and there is generally plenty of competition. The quality of transport infrastructure varies considerably between regions and modes, but is generally appropriate to demand levels and characteristics. However, there is overloading of the road infrastructure, and costs continue to be inflated by illegal levies collected by government officials; by distorted procurements of state transport enterprises; and by late payment for contractors' costs. Illegal levies are most pervasive in the road and maritime transport subsectors; excessive BUMN procurement costs are an across-the-board phenomenon.

4.54 The public sector continues to finance most infrastructure investments,[9] but there is strong and growing private sector interest to invest in transport infrastructure in Java and other, more developed regions. The private sector already accounts for the major share of total transport services, and its role has been increasing in some subsectors—such as civil aviation—where the public sector was previously dominant. Nevertheless, state companies still dominate in some modes (*e.g.*, rail).[10] State corporations also continue to play a major role in the construction of roads and other transport infrastructure, and in some

instances (notably Pertamina) operate large "own-account" transport fleets.

4.55 There is an important weakness of GOI's institutional arrangements that cuts across the various subsectors of transportation. This concerns insufficient strategic planning in intra-modal forms of transportation. By way of examples, toll and non-toll arterial roads do not necessarily connect in a rational way with each other or with competing rail networks or complementary ferry services. Also, analysis of demand for transport services has under-estimated the pace of actual developments resulting in capacity constraints on many key linkages. The reasons seem clear: there are few clearly articulated policies; there are no linkages among policy, planning and budgeting; and, many decisions are made on an *ad hoc* political basis, often against sound technical advice.

E.1 Roads

4.56 **Inter-Urban Roads: Key Issues and Policies.** Road is the dominant transport mode by all important measures, including traffic carried and level of investment. Spending on road infrastructure now represents around 1.5% of GDP and 20% of the Development Budget.[11] This reflects rapid growth of 7% per annum during the past decade. The public road network has been able to cope with this growth in part because GOI has consistently devoted considerable resources to road network development and maintenance, and in part because of existing "spare capacity". However, it is estimated that, in 1994, 22% of the inter-urban network suffered congestion sufficient to justify widening and de-bottlenecking (Box 4.3).

4.57 To avoid capacity constraints on the approaches to major urban areas—and to implement plans to improve road networks in Eastern Indonesia—substantial increases in road expenditures will be needed in coming years. The main constraints will be budgetary, the absorptive capacities of the responsible agencies—including as regards their capacity to carry-out competitive bidding—and the longer lead times associated with road widening and new road construction works. Better planning continues to be needed—programs for the upgrading of individual links need to be conceived within the context of longer term regional road network development plans. Particularly for Java, increased attention also needs to be focused on the better integrated planning of investments in the toll and non-toll arterial road networks and competing rail services. Moreover, there remains significant scope for improving the quality of works implementation,[12] including through increased private sector involvement (see immediately below).

4.58 The private sector in Java and a few other developed regions (North Sumatra and South Sulawesi) has shown strong interest in toll road investments.[13] Several of the consortia include foreign partners, although no toll road involving a foreign partner and offshore borrowing had achieved financial closure as of end-1996.

4.59 On the side of transport services, almost all are provided by the private sector. Bus routes and tariffs remain subject to government control, but trucking is largely free of "economic" regulation. Competition among operators is generally intense (bus companies compete on quality of service) and tariffs are relatively low by international standards. The main problems in this area are: heavy overloading of trucks which reduces pavement lives by 20-60%; and traffic accident rates (particularly fatalities), which are high by international standards.[14] To address the former problem, a two-part strategy is needed: i) GOI needs to restructure the annual motor vehicle tax (PKB) to reflect the road-damaging potential for trucks that are properly loaded;[15] and ii) better enforcement is needed to prohibit over-loading of trucks.

Box 4.3: The Urban Transport Sub-Sector

Jakarta, indeed many of Indonesia's major cities, are already congested. Based upon the outlook for urbanization (see Chapter 2), major efforts will be needed to keep the situation from becoming a significant constraint to maintaining the pace of economic growth. Fortunately, there is much that can be done (see below).

Assessment of Current Situation. During the past decade or so, there have been major transport improvements with the construction and extension of intra-city highways, which largely accommodated growth in demand. Nevertheless, analysis indicates that 58% of the present urban road network is sufficiently congested to warrant some intervention to improve traffic flow. To meet their daily needs, the majority of urban residents are captive to walking or low quality bus systems, often for long distances; as soon as incomes permit, people switch to cars or motorcycles. Surveys indicate that 50% of motorized travel in Jakarta and Surabaya is by private vehicle. As a by-product, air pollution levels are high.

Decision-making is institutionally fragmented; there are no clearly articulated policies; and there are no linkages among policy, planning and budgeting. This is further complicated by *ad hoc* political decisions that often run counter to professional technical advice. Fundamentally, the reason is clear; the financial stakes in this sub-sector are high, owing to the costly nature of most solutions and to the lucrative opportunities this presents on all sides (see the Section on Governance in Chapter 5).

Priorities for Economic Policy. The top priority is to create a policy and planning framework that includes a fair, transparent bidding process for private provision of infrastructure *e.g.*, for parking. Next in line are better pricing policies as regards, for example, congestion pricing in the larger cities and user charges to cover the full cost of road maintenance and operations. Also, "dirty" fuels (*e.g.*, leaded gasoline) should be heavily taxed. More deregulation of bus service would also be helpful, and more thorough analysis is needed of the options for supplying transportation services, given that land costs are escalating.

Role of the Private Sector. There are wide possibilities for an expanded private sector, if the process can be implemented within a proper framework (see above and main text). To cite a few examples: toll roads; MRT and LRT (including rolling stock and services); road maintenance; bus services; on- and off-street parking; and training programs.

Institutional Priorities for the Next Decade. Responsibilities in the central government need to be clearly defined (preferably with DGLT taking the lead), including a clear policy on urban transport at the national and local levels. In addition, there needs to be separation of the responsibility for ownership and management (the client function) from design, construction, operations and maintenance (the producer function); those performing the producer function should be corporatized as a step towards eventual privatization. More decentralization of responsibility is also needed.

E.2 Trains and Boats and Planes

4.60 **Rail Transport.** Indonesia has four separate railway networks, one in Java (primarily passenger) and three in Sumatra (primarily bulk freight). Except for some bulk freight, rail already faces strong competition from road and—in some corridors—maritime and air transport. Ownership of the main railway infrastructure rests with the Government, while Perumka is responsible for operating train services and, on behalf of GOI, for operating and maintaining the infrastructure. Private participation is permitted and now actively encouraged, but to date most private projects have only involved

development of prime railway land, often by well-connected parties. Rail traffic has been growing steadily in recent years, while productivity and financial performance have been improving.

4.61 Java's very high population density will ensure growing demand for efficient passenger rail services, while continuing development of coal and other resources will create viable new opportunities for bulk freight services. Development to date has been hindered by excessive GOI intervention and an outdated regulatory framework. Controls on Perumka's tariffs has precluded profitable operation and necessitated reliance on the national budget to finance investments. This in turn distorted decision-making and encouraged under-maintenance of assets. At the same time, dependence on bilateral financing has contributed to some poor investment choices.[16]

4.62 During the late 1980s, GOI embarked upon an initial program of subsector reforms.[17] Now GOI has entered the second phase of the reform program. This will entail converting Perumka into a *Persero* (PTKA) organized along "line of business" principles, establishing a more clearly defined financial relationship between GOI and the new company, and enabling expanded private participation through partial divestment of existing businesses and through creation of conditions conducive to private investments in new businesses.[18] There is strong commitment in GOI to these policies; nonetheless, there is a danger that unsolicited private participation proposals targeted at Perumka's core businesses could disrupt their implementation.

4.63 **Maritime Transport.** Maritime transport is vital to Indonesia's inter-island and international trade (see Box 4.4). The major deregulations of the 1980s (Inpres 4/85 and PakNov 88) resulted in significant improvements in service and reductions in rates on the trunk domestic routes.[19] They also provided a foundation for improved efficiency and competitiveness in the subsector, but significant constraints remain and there are signs of creeping reregulation.

4.64 Domestic shipping is generally highly competitive.[20] However, restrictions on vessel imports (see Chapter 5) coupled with bureaucratic impediments to the leasing/chartering of foreign vessels have constrained the ability of private national lines to compete with regional carriers and created strong pressures for reregulation in some quarters. Levels of investment in modern capacity have been modest due to the constraints mentioned above.

4.65 Indonesia's main public ports are operated by the four state-owned port corporations (Pelindo I - IV), while the smaller ports are still managed by DGSC (companies are permitted to own and operate special industrial ports to serve the movement of their own raw materials and products). The private sector has long been involved in port operations, notably in the general cargo stevedoring business. More recently, MOC has approved several unsolicited private proposals to develop new container terminals in major ports (Tanjung Priok, Tanjung Perak) and to construct major new public ports (notably new deep-water facilities in the Merak/Cilegon area).

4.66 Port productivity remains well below best practice international levels. Congestion/slow turn-around continues to raise costs, hurting both non-oil exports from Java and shipping to the Eastern Islands.[21] The Government's plan to discontinue pre-shipment inspections could increase greatly port congestion and shipping costs, and will need close monitoring (see Chapter 5). A similar threat is posed by proposals for new private container handling facilities at Batam.

Box 4.4: Regional Dimensions of Transportation; Inland Waterways and Ferries

Inland waterways provide the basic transport infrastructure in many isolated parts of the country, notably Kalimantan. Ferries are the key links in the road network between islands. The public sector is no longer involved in the operation of inland waterway transport services, but continues—through DGLC and PT ASDP—to provide and manage inland waterway and ferry terminals. It is also the principal operator of ferry services, although private operators are permitted to serve some trunk routes.

There have been two important developments lately: the sinking, with considerable loss of life, of a PT ASDP ferry in Aceh; and severe congestion on the Java-Sumatra ferry route linking Java and Sumatra (truck queues over 3KM long). These problems are symptomatic of more fundamental regulatory issues that have inhibited private investment in new vessels and contributed to a poor reliability and safety record.

If the Government wants to promote development in the Outer Islands, major investments in larger and faster vessels and efficient terminals are urgently needed. At present, the main proposal on the table is the high-tech option of replacing ferries with inter-island bridges. A simpler, cheaper solution would be efficient private investment in ferries, assisted greatly by reduced government intervention.

4.67 **Civil Aviation.** The civil aviation subsector has been able to cope reasonably well with sustained rapid growth in demand (international and domestic, passenger and freight). This is due in part to the priority GOI has accorded to investments in airport infrastructure (notably at Soekarno-Hatta) and in part to domestic tariffs having been regulated at levels that have permitted profitable airline operation, albeit at less than best practice performance levels.[22] Another contributing factor has been the rise of private airlines, which were permitted to operate jet aircraft and allowed increase access to trunk routes after Sempati's ownership changed. In general, GOI has generally actively encouraged increased calls by foreign carriers, but the proposal that foreign cargo-only flights would be permitted to land only at Batam and certain other areas, with onward domestic transport being handled only by national airlines, would be a costly reregulation.

4.68 Domestic airlines' fleet development plans have been constrained and costs raised by pressures to buy (or lease) specific equipment. On airport operation, there have recently been several unsolicited private proposals for airport development (*e.g.*, Medan, Solo, Lombok, Bali). As yet, MOC has not established clear principles and rules to govern such proposals; such a framework would increase the benefits of private participation and competitive bidding on well-specified proposals. In addition, the sector faces major challenges in terms of human resource needs (*e.g.*, pilots, licensed aircraft maintenance engineers, air traffic controllers, communication and maintenance technicians for navigational aids). MOC has been attempting to meet these through its civil aviation training facilities, but this is proving inadequate in terms of quantity and quality. Finally, there are on-going safety issues. The FAA recently found DGAC's supervision of airline maintenance procedures to be unsatisfactory,[23] and ICAO and others have warned that urgent action is needed if the Air Traffic Services system is to cope safely with projected rapid traffic growth.

Endnotes

1. The legislation provides for substantially greater local revenues, notably (maximum) taxes of 5% on gasoline and 20% on ground-water use. Both would improve efficiency by reflecting social costs more accurately.

2. Partly this is compensated by self-generation, which is estimated at 70% of PLN's capacity.

3. There appear to be four main reasons: i) the 1994 base tariff was too small because it substantially overestimated the increase in power demand in 1994; ii) the formula does not pass through 100% of price increases; iii) the formula has not been applied as intended; and, iv) there have been delays in implementation.

4. In the absence of a tariff increase, PLN will incur losses on power purchased from these plants even before provision is made for transmission and distribution costs (Section C.3).

5. For example, delegation of authority will be effective only if it is accompanied by participation of users and professional managers.

6. This Presidential Instruction of April 1994 lays out rules and procedures for implementation of the GOI Budget, including procurement. The regulations cover: all development and recurrent expenditures; central and regional governments; and unlisted state enterprises.

7. For example, a contracted garbage collector currently has to rely on the *Dinas Kebersihan* to collect fees for his services. If he collected the fees directly, he would get the funds sooner and in larger quantity.

8. Currently, much training is attended simply because a minimum number of days per year is mandatory, or because an attractive pay premium accrues during their training.

9. The great bulk of the spending is done at the provincial and national levels; little is done at the *kabupaten* and *kecamatan* levels.

10. There are 17 state transport enterprises, including 2 airlines, 2 airport corporations, 3 shipping lines, 4 port corporations, 1 ferry corporation, 2 bus corporations, 1 railway corporation and 1 freight-forwarder.

11. See World Bank (1996c).

12. These include issues related to design specifications, procurement, supervision, timing of construction and contractors (see World Bank 1996c).

13. There are currently 531KM of toll roads now in operation; 162KM (including 59KM for which financial closure has not yet been achieved) are under construction; and approximately 1021KM are under negotiation.

14. Informal information suggests that official statistics considerably understate the extent of the problem.

15. A better option would be to structure the tax on the basis of gross vehicle weight and axle configuration, rather than on engine capacity and year of manufacture, as at present.

16. For instance, adoption of several different electronic signaling technologies on the same network.

17. This mainly comprised converting PJKA—formerly a Departmental Agency—into Perumka, deregulating its freight and "commercial class" passenger tariffs, and enacting a new Railway Law (which is not yet implemented by new Government Regulations).

18. The new financial relationship will involve GOI: (a) compensating PTKA for its public service obligations (essentially economy class passenger services that GOI requires PTKA to operate at tariffs set by GOI); (b) paying Perumka for the costs it reasonably incurs in operating and maintaining the main infrastructure; and (c) levying track access charges from PTKA and other users (the level of these charges will be progressively increased having regard to the level of road user charges).

19. On other routes, particularly between Java and Eastern Indonesia, imbalanced and fluctuating general cargo flows have limited the impacts of deregulation; tariffs remain relatively high, and the frequency and reliability of services is sub-standard.

20. There are three state-owned shipping lines (Pelni, Djakarta Lloyd, Bahtera Adhiguna) each depend on GOI financial support (*e.g.*, Pelni for passenger ships; Djakarta Lloyd for container ships) or benefit from allocated state traffic (*e.g.*, Bahtera Adhiguna's Bukit Asam coal traffic).

21. The causes differ considerably by type of traffic and port. For instance, movement of containers through Tanjung Priok has been impeded by delays in the construction of the third container terminal (being developed as a public-private partnership) coupled with sub-optimal productivity at the two existing terminals operated by PT Pelindo II. In the smaller ports, problems include outdated breakbulk handling methods/lack of mechanized equipment attributable to lack of appropriate incentives for stevedoring companies.

22. Tariff competition on domestic routes is not permitted, although limited discounting does occasionally occur, and airlines have extremely limited scope for offering special fares (*e.g.*, no standby fares, no differentiation by season and time of day).

23. Suspension of Garuda's flights to the US was threatened, but the immediate problems have been overcome.

5
"SOFT" INFRASTRUCTURE TO SUSTAIN RAPID GROWTH WITH EQUITY

A. Summary and Overview

5.1 Continued improvement in "soft infrastructure" (the incentive framework, business practices, and legal and institutional arrangements) is critical to rapid growth and improved equity. Soft infrastructure determines risks and rewards of various activities, and thus investment, employment, and the efficiency with which resources and technology are used. It also influences equity by determining the degree to which public resources and concessions are developed for the benefit of all Indonesians, including future generations. Continued improvement in soft infrastructure will depend not only on completing the unfinished agenda of trade deregulation but also on reforms of domestic regulations and on institutional improvements.

5.2 In the past, deregulation successfully cut costs and increased national efficiency, labor demand, and international competitiveness. Reductions in protection reduced the diversion of capital and other scarce resources into inefficient, high-cost industries. Cuts in regulations reduced incomes of those who benefitted from rules rather than business skills, and reduced the costs involved in contacts with the bureaucracy. However, a widely held perception still exists that aspects of the business environment significantly raise the cost of doing business in Indonesia, lower efficiency, undermine international competitiveness, and contribute to inequity. This Chapter considers ways to reduce real and perceived costs and to increase efficiency and equity further through reforming policies and regulations. For simplicity, the analysis is organized into five sections:

(i) completing deregulation of international trade;

(ii) continuing domestic deregulation;

(iii) strengthening the management of natural resources;

(iv) strengthening financial sector performance; and

(v) improving governance to reduce "invisible" costs.

5.3 To further increase the efficiency, reduce business costs, and improve equity, the Government could:

- continue trade deregulation:

  (a) implement the announced program of tariff reduction through 2003, catch up on delays that have occurred, and avoid selective exemptions and further delays;
  (b) bring tariffs for motor vehicles, chemicals, metal products, agricultural products and alcoholic beverages in line with the program of tariff reform, and move to excise duties to tax the consumption of socially undesirable goods such as alcohol, irrespective of whether they are imported or domestically produced;
  (c) abolish quantitative import controls and related domestic controls, especially in agriculture; and
  (d) remove quantitative controls and taxes on exports;

- reduce impediments to intra-country trade, such as retribution taxes *(retribusi)*, quantitative controls on the movement of goods, and monopolistic marketing arrangements;

- establish clearer property rights (for water, forestry, land and minerals) and charge appropriate fees to improve resource management and sustainability, and to ensure the public at large benefit. In forestry, this includes opening the log market to more competition, monitoring and enforcing sustainable utilization practices and strengthening property rights;

- increase market discipline and regulatory supervision in the financial sector to cut the cost of finance and reduce potential instability; and

- improve institutions and governance to reduce invisible costs, improve confidence in the legal environment and strengthen equity.

B. Completing Deregulation of International Trade

5.4 Impediments to trade are undesirable because they divert the nation's scarce capital, labor and management into uncompetitive activities, thus lowering overall growth. Impediments to imports raise the cost of doing business in Indonesia and reduce international competitiveness. They protect high cost production of import substitutes and disadvantage non-protected activities, including export activities. They also "tax" consumers. Export barriers hold down non-oil exports and disadvantage regions of the country that produce such goods. They effectively "tax" efficient producers of basic commodities and divert resources into less competitive industries, which lessens national efficiency, even if the protected firms are using the most up to date techniques at the "micro" level.

5.5 Sustained implementation of tariff reductions and relaxation of non-tariff import barriers would reduce Indonesia's production costs and strengthen its international competitiveness. Indonesia is publicly committed to the reduction of trade barriers, as indicated by the President's statement that "we in Indonesia sincerely believe that all APEC Economies ... can benefit from freer trade and increased economic integration" (APEC Leaders Meeting, Nov. 1994). The challenge is to sustain the reform effort and to continually support this commitment with actions. Only then will Indonesia be able to achieve its potential for sustained growth over the coming years and enjoy the benefits that export growth brings in terms of jobs, lower prices and improved quality of goods.

B.1 Customs Tariffs

5.6 Indonesia's trade deregulation has reduced the cost of many traded goods and forced producers to become more efficient. The average tariff (plus surcharge) was cut from 22% in 1990 to 19.5% in 1994 and 15% in 1995. The tariff reform program announced in 1995 basically establishes a three tier structure of tariffs by 2003—0%, 5% and 10%, which effectively multilateralizes ASEAN commitments. Exemptions were limited to motor vehicles, chemicals, metal products, selected agricultural products, and alcoholic beverages. The program was strengthened in 1996 by:

- the announcement of a schedule for implementing the tariff reductions over the next seven years (see Table 5.1);

- a reduction, by 5 percentage points, of tariffs for over 1000 items (9-digit Harmonized System (HS) tariff codes);

- further reductions for selected capital goods, including outboard motors, furnaces and stoves, and machinery for use in paddy fields; and

- the merger of import surcharges with customs duties.

As a result of ongoing reform, the average tariff (including surcharges) is now 13.1% (see Table 5.2). Furthermore, the schedule for future reductions provides investors in most activities with a clear indication of what tariffs will be, so they can more objectively assess the costs and likely returns from projects.

Table 5.1: Schedule of Customs Tariff Changes (*ad valorem* rates) [1]

1995 Early	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
0	0	0	0	0	0	0	0	0	0
5	5	5	5	5	5	5	5	5	5
10	5	5	5	5	5	5	5	5	5
15	10	10	5	5	5	5	5	5	5
20	15	15	10	10	5	5	5	5	5
25	20	15	15	10	10	10	10	10	10
30	25	20	20	15	15	10	10	10	10
35	30	25	25	20	20	15	15	10	10
40	30	25	25	20	20	15	15	10	10

[1] Four groups of goods are exempt from this schedule: (a) selected agricultural products (125 items from Chapters 7-9 of the HS code), (b) products of the automobile industry (mainly Chapter 87 of the HS Code), (c) certain chemical and plastics (97 items for Chapter 39) and metal products (Chapter 72) (though these are still scheduled to have a maximum tariff of 10% by 2003), and (d) alcoholic beverages (Chapter 22).

Source: Ministry of Trade and Industry, Decree No. 133/MPP/Kep/1996

5.7 The scheduled tariff reductions are highly desirable. If implemented, they will keep Indonesia's tariffs among the lowest for large developing countries (see Box 5.1), and they will strengthen competitiveness by compressing costs. Efficient activities will benefit from the reduction of protection for less-efficient, less competitive activities. Unless there are exemptions to the maximum customs duty of 10%, the maximum tariff-based effective protection[1] for import competing activities will be quite low by 2003 and hence, the dispersion in (effective) protection for different activities will be small.

5.8 Some slippage in this tariff reform, unfortunately, occurred in 1996. About 800 9-digit textile and clothing items (from Chapters 53 to 63 of the HS Tariff Code) that have tariffs of 20% or more did not have their tariffs reduced by 5 percentage points in 1996, as scneduled. As of mid-May 1997, there were indications of pending measures to reduce—but not eliminate—this backlog. Slippage maintains protection for a few at the expense of others. It also increases uncertainty and encourages other enterprises to pressure government to delay the scheduled reductions in their protection. Second, the schedule of tariff reductions for chemicals, metal products, selected agricultural products and automobiles is yet to be detailed. The importance of these two issues is highlighted by the fact that much of the large investment approvals of recent years has been in the sectors that continue to enjoy import protection—*e.g.*, chemicals, automobiles and metal products. Without cuts in their protection, there is a danger of encouraging high-cost production in these sectors.

Table 5.2: Distribution of HS Tariff Codes by Rate (%)

Tariff Rate (incl. surch.)	*Beginning 1996*	*End 1996*	*2003 Target* [1]
0	14.5	19.2	19.2
5	30.1	28.4	42.9
10	7.5	8.3	36.7
15	11.7	11.2	0
20	3.8	11.4	0
25	19.4	14.3	0
30	11.1	5.6	0
over 30	1.4	1.3	1.2 [1]
Simple ave.	14.6	13.1	6.3

[1] The 2003 target and average have been computed assuming that alcoholic beverages and automobiles are the only items with tariff over 10% by 2003. The rate for the passenger motor vehicles is assumed to be 99%, and that for alcoholic beverages 170%.

Source: Ministry of Trade and Industry Deregulation Package of June 4, 1996 (Decree No. 133/MPP/Kep/1996) and Bank staff estimates.

5.9 It would be desirable for the Government to:

- keep to the announced schedule for tariff reductions and avoid exemptions;
- finalize programs for the excluded categories (chemicals, metal products, selected agriculture products and automobiles), to bring their tariffs in line; and
- subject luxury goods and alcoholic beverages, to a high excise tax levied on both imports and domestically produced goods, in place of a high tariff. This would avoid giving a high incentive for local production.

B.2 Non-Tariff Import Barriers: Licensing and Local Content Regulations

5.10 Non-tariff import barriers also raise costs and reduce the efficiency of resource use. For example, import licensing, inevitably confers special privileges and shields those with licenses from competition. Users would benefit from the added market efficiencies that the removal of these licensing practices would yield. Specialization generally generates productivity gains, which suggests that national interests would be well served by eliminating import licenses and allowing enterprises to specialize in either production or importation, without having to engage in both at the same time. It is important to ensure that such impediments to competition and efficiency continue to be reduced.

5.11 Incremental progress was made during 1996, with:

- moving soybean cake and nine other tariff codes (including tractors, motors and electric generators, displacement and rotating pumps) from the list of goods restricted by producer-importer licenses to general import licensing;
- allowing tourists to enter the country with their automobiles at a few locations;
- simplified import procedures for capital goods and basic materials; and
- regulation on imports of fishing vessels were changed (see Box 5.3).

However, further removal of non-tariff import controls would benefit the vast majority of Indonesians.

Box 5.1: Trade Policy Indicators for Selected Countries

- Indonesia's program of tariff reductions, if implemented on schedule, will keep tariffs close to the lowest rates among rapidly growing large developing countries.
- Indonesia continues to have a large number of non-tariff barriers to trade (Box 5.2).

Country	*1991-93*	*Average tariff (unweighted) (%) Post-Uruguay Round*
China	30.6	16.6
India	42.6	30.9
Indonesia	19.9	[1]6.3[2]
Korea, Rep. of	10.0	7.7
Malaysia	11.2	6.4
Pakistan	56.2	na
Thailand	36.9	26.1

[1] Including surcharge.
[2] Target for 2003, as given in Table 5.2. This goes beyond Uruguay Round commitments.

Source: UNCTAD (1994), Min. of Trade and Industry, Deregulation Package, June 4, 1996, (Decree No. 133/MPP'Kep/1996), and Bank staff estimates.

5.12 Non-tariff import barriers (Box 5.2) are heavily concentrated on agricultural commodities and selected "strategic" activities. The Ministerial Decree of June, 1996, listed 206 nine-digit HS tariff codes that are still subject to some form of non-tariff import control. These regulations distort prices and business opportunities, thereby increasing costs and causing losses in efficiency as resources get attracted to protected activities. They also raise costs to consumers, often hitting low income consumers especially hard. For example, BULOG's monopolies over imports of rice, sugar, wheat (and associated restrictions of flour imports and related domestic activities) and soybeans raise average prices and "tax" consumers. They also raise costs to user activities, such as agro-processing, making them less competitive in export markets. Industries producing for the domestic market generally enjoy protection on their outputs and hence can pass the additional cost on to consumers through higher prices (see Table 4.4 in World Bank 1994a). Removing non-tariff import barriers would benefit all users, including exporters and consumers. For example, non-tariff barriers kept sugar prices at least 20% higher than world prices during the 1980s and a quality-adjusted differential of 27% prevailed in 1994. Such price effects are particularly important for poor consumers who spend much of their income on food.

5.13 Some regulatory policies under discussion during the past year would offset progress in deregulation that has already been made. For example, one such proposal was to have most air freight pass through Batam. Even if there were facilities at Batam to handle trans-shipment of all air-freight, this would increase input costs and greatly handicap Indonesia's export effort.

Box 5.2: Key Non-Tariff Import Barriers

Import monopoly by BULOG: rice and rice flour, sugar, wheat and wheat flour, soybeans, onions, shallots, garlic, leeks, etc.

Other import monopolies (sole importer arrangements): petroleum and other oil and gas products, fertilizer, cloves, insecticides.

Restricted by licenses to producers: retreaded or used tires, paper and paperboard scraps.

Restricted by licenses to general importers: dairy products, hand tools, pumps, electric motors.

Local content plans and other special arrangements: motor vehicles.

Import bans: waste of selected plastics, selected printed matter, videos.

Source: Ministry of Trade and Industry, Decree No. 133/MPP/Kep/1996 (June 4).

5.14 Local content programs are a form of non-tariff protection. The most visible current example is motor vehicles and the "National Car". Policy changes introduced in 1996 exempt from luxury sales tax as well as from customs duties:

- any manufacture of commercial vehicles, vans, or sedan cars (with an engine capacity of less than 1600cc), that have reached 60% local content (Government Regulation No. 36/1996, June 4, 1996)[2]; and

- Timor Putra (the maker of the "National Car") and its joint venture partner, KIA Motors of Korea, in advance of achieving 60% local content, as long as it achieves 20% local content by the end of the first year (1997), 40% by the end of the second year and 60% by the end of the third year (Presidential Instruction No. 2/1996; Decree of the Minister of Industry and Trade No. 31/MMP/SK/2/1996, dated February 19, 1996; and Presidential Decree No. 42/1996, dated June 4, 1996).

5.15 These changes have given rise to, or at least coincide with, efforts by existing manufacturers to increase their local content. However, the cost of these changes, in terms of fiscal revenue and investment of resources in operations that are not internationally competitive, is yet to be seen. There is a risk that those policy changes could leave Indonesia as a high-cost, producer of automobile and auto parts that does not participate in the globalizing, increasingly efficient market for "World Cars". This could have been avoided by introducing general tariff cuts that didn't discriminate between producers, as this would have increased competition and promoted efficiency. The removal of luxury taxes for motor vehicles with high local content is a regressive tax change that effectively increases protection of these producers. Passenger motor vehicles are clearly luxury goods and should be subject to luxury sales taxes in the Indonesia interests of equity.

5.16 Pressures to extend similar provisions to other industries may increase over the next few years. Shipbuilding already appears to have a local content scheme, as buyers are obliged to purchase locally built ships as part of the agreement for their receiving import licenses (see Box 5.3). So does the dairy industry (Erwidodo & Trewin). Local content schemes often appear attractive to political leaders as a means to develop enterprises that will eventually be able to compete with imports. However, like other quantitative

import restrictions, the cost of these arrangements tends to be hidden. Almost without exception, industries that are fostered by such arrangements tend to require continued protection to be financially viable. Furthermore, the outputs make high cost inputs, raising costs for the users of these products, thus reducing their international competitiveness.

B.3 Export Restrictions

5.17 Export restrictions (export bans, "regulated" exports, "supervised" exports, and export taxes; see Box 5.4) still affect nearly 2000 items (mostly forest products and agricultural commodities), reducing non-oil exports. Export barriers also disadvantage producers of primary goods and favor domestic users of these goods. Moreover, though frequently intended to foster downstream activities and add value prior to resource-based goods being exported, the net result may be little value added.[3] The combined effect of export barriers on logs, together with domestic controls on logging, is one example (see paragraphs 5.33 to 5.35 and Box 5.8). Similarly, the export ban on rattan has ultimately reduced supplies, as land, labor and capital have been diverted to other uses (*e.g.* rubber and cocoa), and led to a crisis among rattan furniture producers (see World Bank 1996a, Box 4.1).

5.18 Export restrictions also often have unintended equity and regional effects, as the costs often fall on outlying regions, where these goods are produced. They decrease

Box 5.3: Import Ban on Vessels Replaced by Unclear Licensing and Local Content Guidelines

Import Ban. Indonesia banned the importation of vessels (including fishing vessels) for many years, in an effort to foster shipbuilding. This tended to increase the costs of inter-island shipping and the fishing industry. This import ban on vessels reduced national efficiency and raised costs, in particular, raising prices to the Eastern Islands of goods they buy elsewhere, and lowering the prices that Eastern Island exporters receive. Higher costs are part of the reason fish production is still below potential and foreign vessels poach in Indonesian waters (World Bank 1996a, Box 2.3). Indonesia's fishing industry has the potential to expand beyond its present level, with benefits for nutrition, export earnings and employment, especially in the Outer Islands. Recorded fish production was only $1.4 billion in 1995, compared with a sustainable harvest of about four times this much according to Government assessments. (However, this estimate of sustainable harvest may be high, as there is evidence that some parts may already be over-fished (Tsamenyi and Bateman)). Nonetheless, to be internationally competitive and expand, the transport and fishing industries need access to vessels at the lowest cost possible, and this means free access to imports. Similarly, lower cost ships would help integrate markets within Indonesia, thereby increasing efficiency and benefiting the Eastern Islands.

Licensing and then Local Content. In mid-1996, the ban on vessel imports was replaced by an import licensing system. When first announced, this appeared to be a conventional use-linked import licensing arrangement and hence a significant improvement over the import ban. However, subsequent refinements prohibit leasing after 1999 and suggest that fishery operators may have to purchase a certain number of local vessels for each one imported. As the system is not yet fully operative, it is still unclear whether this change will reduce the implicit tax on users. The new system could actually increase costs in the transport and fishing industries, which would further hamper competitiveness and limit production.

Source: Decree of the Ministry of Agriculture No. 508/Kpts/PL810/7/96

economic opportunities and incomes in these regions which conflicts with the national objective of increasing development in the Outer Islands.

5.19 In 1996, no progress was made in reducing export controls. Instead, Indonesia focused efforts on improving export facilities, including customs, rebates of VAT, taxation, and lower credit costs for selected producers of selected products. To qualify, producers must already be established, have a good credit and taxpaying record, and manufacture one of the following—textiles and textile products, electronics, wood and rattan products, footwear and leather products, paper products, processed food, vegetable oil, processed rubber, toys, fish and frozen shrimp. Such an initiative does not address the fundamental problems posed by export constraints and it excludes many potential exporters.

5.20 Indonesia did manage to increase the percentage of textile quotas utilized to over 80% in 1996. But until these quotas are transparently auctioned and made more transferable, this percentage is unlikely to be close to 100. Moreover, until this change is made, exports will not be produced as efficiently as possible, because the producers are firms that happen to receive export quotas rather than the most efficient firms. Similarly, if freed from other impediments, downstream activities will develop without the implied subsidies arising from export controls on their inputs, if they are economically efficient. Moreover, by eventually reducing the supply and quality of materials in the domestic market, export controls can initially help but later hurt users. This has happened with rattan (World Bank 1996a, Box 4.1).

Box 5.4: Key Export Barriers

Export Bans: Iron and steel waste and scrap, copper waste and scrap, live fishery products, protected wildlife and natural vegetation, hides and skins of reptiles, sub-standard rubber and remilling rubber materials.

Regulated Exports - exports that require government approval: Soya beans and soybean flour, rice and rice flour, wheat and wheat flour, sugar, live cattle, selected fish and fish products, urea, gold, silver, petroleum and natural gas, lead, and tin.

Supervised Exports - restricted to approved exporters: Textiles and textile products to quota countries, rattan, wood and wood products, products of sandalwood, coffee, and manioc for export to Europe.

Export Taxes: Logs and sawn timber ($250-4800/cub.m.), rattan ($15/kg), hides and skins ($4/kg or $100 each), wet blue or crust leather (30%), palm nuts (4%), cinchona bark (30%), sands (10%), iron ore (10%), ores and concentrates of copper, lead, tin silver and platinum (10%), natural and waste cork (5%), aluminum waste and scrap other than alloys (30%), and crude palm oil (40-75% of export price less base price).

Source: Ministerial Decree No.124/MPP/Kep/5/1996, dated May 31,1996
Decree of the Minister of Finance, No 666/KMK.017/1996, Dec. 2, 1996

C. Further Domestic Deregulation

5.21 Indonesia has extensive regulations and restraints on domestic competition that increase the cost of doing business, reduce efficiency and limit economic opportunities, often for the poor. These include, marketing controls, pricing, industrial licensing, public sector dominance in certain activities, cartels, *ad hoc* instruments in certain industries, and controls and "taxes" on intra-country trade. Many of these have been discussed in previous reports

(*e.g.*, World Bank 1995a, pages 45-50). Reducing them would lower costs and make Indonesian enterprises more competitive internationally. The increased competition and lower costs would also provide consumers with better quality goods at lower prices.

5.22 This section focuses on some other impediments to intra-country trade, as an example of how these controls limit economic opportunities and create inefficiency. Discussion is confined to three issues—local government taxes and fees on the movement of goods, such as retribution taxes (*retribusi*), quantitative controls on the movement of livestock, and uncompetitive marketing arrangements.

5.23 Impediments to trade between different regions of the country fragment markets, protect inefficiency, implicitly tax users, and raise the cost of transport (Box 5.3 and World Bank 1996a, Box 2.3). They reduce national efficiency. For example, commodity-specific *retribusi* imposed by local governments, fragment markets by acting as intra-country trade taxes (see Box 5.5), create opportunities for rent seeking, and frustrate growers and transporters. They disadvantage growers in outlying regions by taxing them, along with consumers. In addition, they actually yield relatively little tax revenue to local governments; much of the potential revenue never reaches government accounts and costs of collection are high compared to actual revenues. Moreover, their cost tends to be disproportionately borne by the poor, who produce relatively low value goods. Recently introduced new laws on Non-Tax Revenue and Local Tax Revenues will help, but the effectiveness with which they can be implemented is yet to be seen.

5.24 Quantitative controls on the movement of livestock also exacerbate differences in prices between producer areas and large domestic markets (see Box 5.6). They reduce livestock prices in the Eastern Islands and tend to increase livestock prices in Java and Kalimantan. These quantitative domestic controls thus have all the losses in efficiency associated with quantitative import controls, except that these losses and distributional effects are all internal to the country. By suppressing prices in the Eastern Islands, they reduce production and incentives for livestock management in these areas, encouraging producers to move into other activities such as reverting to subsistence agriculture. Moreover, as the surplus areas are commonly the Eastern Islands, these controls are inconsistent with the Government's stated desire to foster economic development in the Outer Islands. Overall development and regional equity would both be enhanced by removing these controls.

5.25 Non-competitive marketing arrangements for agricultural products often result in lower farmgate prices. Farmgate prices are often kept low by a cartel of buyers/traders, thus reducing incomes for the poor. However, it is quite difficult to document these practices with much precision, as they are location- and time-specific and change frequently. For example, oranges and cloves have been commonly cited as examples of commodities where monopolistic or oligopolistic marketing practices, supported by government regulations, disadvantaged growers (World Bank 1993a, Box 3.1). A succession of "sole-buyer" marketing arrangements for oranges, starting in 1988, has been so unsuccessful in meeting the needs of growers that many trees have not been maintained. Similarly, the monopoly clove marketing arrangement suppressed farmgate prices, and the farmer's share of the cigarette manufacturers' price (*Sondakh*), and many trees have been cut down. However, these are far from the only commodities to suffer from uncompetitive marketing arrangements.

5.26 The *Tengkawang* nut (the source of an oil used in cosmetics) price fell sharply in 1991, under the influence of monopoly purchasing. The same firm had control of

exports and the sole processing plant. More recently, moral and social pressure has restored farmgate prices, but not before farmers began to cut the trees down for timber. In South Sumatra, a central purchasing authority was established for rubber, and private trade was excluded; as the result, farmgate prices fell about Rp.400 per kg. below prices that private traders were said to be offering.

5.27 In other cases, government actions have increased domestic competition and farmgate prices. Government sponsored bidding in rubber markets in Sembadu and Karangan (West Kalimantan) resulted in these markets achieving higher prices than those in neighboring ones, thereby illustrating the value of competitive marketing systems with transparent price information systems. Growers benefitted from a combination of improved market information and more competitive markets.

Box 5.5: Commodity Specific Retribution Tax (*Retribusi*)—an Inefficient and Distortionary "Tax"

The retribution tax *(retribusi)* is a specific tax or fee levied by local government on a wide range of goods and services. In the case of goods, it is generally levied on the weight transported. Thus, the *ad valorem* equivalent, which is what is important for incentive effects and resource allocation, tends to vary inversely with the value of the good. These taxes also vary substantially, from one local government area to another. Hence, there are widely different percentage taxes for different goods and for the same good produced in different regions. For example, in Timor Tengah Selatan in 1996, it was Rp.1500-6000 per kg (between 9 and 24% of farmgate price) for garlic, Rp.1,500 per kg (1%) for red beans, and Rp.500 per kg for unshelled candle nut. *Retribusi* on cocoa in 1995 was Rp.85 per kg in Luwu, Rp.50 per kg in Mamudya and Rp.100 per kg in Kab. Ende, South Sumatra.

In accordance with *Keputusan Menteri Dalam Negeri* (Ministry of Home Affairs Decree) No 48, 1984, amended by Kepman 29/1986, the following goods are supposed to be exempt; plywood, sawn wood, rattan, rubber, oil palm and products, coffee, shrimp, tuna fish, tongkol/cakalang fish, cassava chips, maize, and cocoa beans. However, many local governments do in fact impose *retribusi* on rubber and cocoa, for example.

Inefficiency in Production and Distribution. *Retribusi* on specific commodities, such as garlic, act like a tax on the trade between different regions within Indonesia. Hence, they fragment markets and distort both production and consumption decisions. Producers are discouraged from producing goods with high *retribusi*, while consumers are discouraged from using such goods. Hence, the different rates distort resource use between different products. Moreover, the fact that *retribusi* is higher on goods with a low value per kg means that it falls disproportionately on areas and individuals that produce low value goods. These producers are often the relatively poor.

Inefficiency of *Retribusi* Tax Administration. The *retribusi* appears to be an inefficient way to raise local government revenue. In a study of one province, about 80% of potential revenue was uncollected or diverted to raise the income of those involved with its administration. Over half of the revenue actually collected is needed to pay for the costs of collection.

In essence, commodity specific *retribusi* tend to give rise to malfeasance, contribute little to local government revenue, and discourage the production and trade of agricultural products in which Indonesia is internationally competitive.

Source: Garcia-Garcia.

Box 5.6: Impediments to Intra-Regional Trade: The Case of Livestock

One of the products that many of Indonesia's Outer Islands can produce competitively is livestock. But their ability to sell livestock to other parts of the country is limited by quantitative controls and high costs of shipping (see Box 5.3). Both those impediments need to be removed for livestock production and incomes in the Outer Islands to reach their potential.

Restrictions on the shipment of cattle, goats, sheep and pigs from the Eastern Islands are of particular concern. Central government regulations decreed by the DG Livestock, determine how many of each type of livestock can be shipped from each region to each other part of the country each year. As part of this, Government reduced the number of cattle that could be shipped from NTT from 67,000 in 1993 to 59,000 in 1996, and none can be shipped to the lucrative market of East Kalimantan. NTT was restricted to shipping 30,500 to Jakarta, 25,000 to West Java and 3,500 to Irian Jaya. The reduction for South Sulawesi was even greater, from 47,500 to 19,000. No goats, sheep or pigs can be shipped from NTT or from North Sulawesi. These controls reduce farmgate prices and widen the disparity between prices in surplus and deficit areas. In addition, shipping is restricted to licensed traders that hold a permit to ship livestock, and each shipment must be accompanied by a livestock ownership letter. The permit is reported to cost about Rp.4,000 per head, retribution tax about Rp.11,000, and the "cost" of acquiring all the signatures needed on the letter of ownership (in South Sulawesi) about Rp.45,000. Together these add about Rp.60,000 per head to the cost of selling cattle (*i.e.* about 5%).

Higher prices for privately owned resources, such as livestock, would result in increased production and improved management. Relaxing these restrictions on intra-country trade in livestock would benefit Outer Islands and would improve the efficiency of resource use within the country as a whole.

Source: Directorate General, Livestock, Decree No. 12/TN.320/Kpts/DJP/1996; Project Documents.

5.28 In 1996, the Government also began to deregulate sugar markets by weakening BULOG's monopoly. New sugar mills in Eastern provinces are now allowed to sell 75% of their output to buyers other than BULOG, while the percentage for new mills in Western provinces is 50% (BULOG Decision No. 128/KA/03/1996, dated March 29, 1996). They had previously been required to sell all their output to BULOG. This change will tend to increase competition but the effects will be limited unless the licencing of sugar distributors is also relaxed. Then, increased competition throughout production and distribution would compress margins and improve quality, thus benefitting consumers and agro-exporters that use sugar. Moreover, as older mills in Java are taken out of production, their land can be freed up for more efficient use in rice production.

5.29 Another notable development is the announcement of Government Regulation No.41/1996 in mid-June 1996, that foreigners would be allowed to own land in Indonesia. However, the form of ownership is weak (*Hak Pakai*, essentially a 25-year lease, entendable for another 25 years, for foreigners residing in Indonesia) and it seems to have had no noticeable impact to date.

5.30 A significant, detrimental development in early 1997 was the freeze on foreign investment in the palm oil sector. This limits competition and growth in the sector, thereby protecting existing investments in the sector and "taxing" buyers of palm oil. This change is inconsistent with the significant progress to date in opening the foreign investment regime and it undermines foreign investor confidence. The objectives of growth, export expansion and

employment would be better served by continued openness to foreign investment. In particular, growth and employment in downstream activities will be adversely effected by this change in policy.

D. Managing Natural Resources

5.31 Maintaining international competitiveness in natural resource-based activities depends on sound, sustainable management of the natural resource. Improved equity, by ensuring that all Indonesians benefit from the use of those resources, also depends on sound management. In turn, sound sustainable management depends heavily on the establishment of property rights, enforcement under laws and competitive pricing for concessions.

5.32 In Indonesia, natural resources (*e.g.*, water, minerals, and forests) are ultimately controlled by the Government. This poses a challenge for Government to not only ensure that externalities[4] are taken care of, but to simulate market outcomes as if there were private property rights in determining (a) prices paid to the Government for using these resources, and (b) sustainable and economically efficient maintenance of, and investment in, these resources. As illustrated in Box 5.7, it is very difficult to maintain public ownership and supervise use to simulate an economically efficient outcome.

5.33 With every resource, such as a forest, there is a fundamental choice to be made between public ownership and supervised use and maintenance, and private ownership with market incentives guiding use and maintenance. If the resources were privately owned, the owner would have incentives to use them efficiently and to manage them well, since he could always sell the forest that remains. Private ownership need not result in the destruction of the resource. Rather it provides built-in incentives for investment and maintenance, especially if there are no externalities.

5.34 The Government's approach to resource management/use has varied from sector to sector. In the case of oil and gas, government, through Pertamina, has been heavily involved in every phase of resource use. The revenues from oil and gas have contributed greatly to public revenue. Revenues have been increased by standard contracts, auctioning concessions and output management. With minerals, government has generally endeavored to ensure that the resources are developed in a manner consistent with national interest by licensing individual developments. From the late 1970s until the 1990s, the particular policies, together with investor perceptions regarding likely returns and risks, resulted in very little mining development. In recent years there has been rapid expansion of copper and coal production and this seems likely to continue, provided a sound regulatory environment is sustained. There has been no clear mechanism for pricing, allocating and managing water resources. Underground water has not been managed; effectively it is a"free" good except for well costs. This approach can lead to over-exploitation of the aquifer. In Jakarta, the use of well water is taxed but over-exploitation seems to remain a problem (Chapter 3 and World Bank 1995a).

5.35 Government has controlled the use of forestry resources though the ban/prohibitive tax on log and sawn timber exports, the granting of time specific (usually 20-year) concessions to users of logs and the establishment of royalties and fees to finance replanting programs (Box 5.8).

5.36 Indonesia has had mixed success with this array of approaches. While the system for oil and gas seems to have operated effectively, that for water and forestry has been less so. The largely unfettered exploitation of underground water does not result in this resource being well maintained and is not sustainable in the face of ever-increasing use. In Java, the competition between rural and urban uses for limited water is increasing.

Box 5.7: Public Ownership and Regulations Can Have Perverse Effects

Sandalwood. Government has long tried to regulate the cutting and trade of sandalwood by declaring all sandalwood trees to be government property and setting rules on how many trees can be felled, the characteristics of trees to be harvested, and the price to be paid. As the trees don't belong to farmers and the administered price has been far below market levels (about Rp.200/kg, compared with Rp.11,000/kg), there has been a strong incentive to cut trees down and smuggle the wood onto the market. The incentives for smuggling are so great that police in Kupang are reported to have intercepted a group attempting to smuggle sandalwood as a body in a coffin (Jakarta Post, December 12, 1996). Moreover, there is no incentive for individuals to plant sandalwood trees, as they are prevented from owning them. Not surprisingly, corruption thrives and the policy has not been successful in preserving sandalwood resources.

Jelutung. Jelutung trees similarly belong to government. Persons, villages and companies are granted short-term licenses to tap the trees. The licensees have an incentive to extract as much from the trees while their permit lasts and have little incentive to care for and maintain the trees. Hence, the long-term productive potential of the trees declines, and there is little investment in the establishment of new trees. In addition, illegal tapping seems common. It is true that law enforcement agencies have the right to confiscate illegally tapped jelutung, but it is widely recognized that a mutually beneficial arrangement can usually be reached whereby trade continues.

Duku. Duku trees are owned by farmers. Hence, farmers have the right to benefit from their output in perpetuity. Farmers and traders who purchase the fruit in advance of harvest time do incur the costs of enforcing their property rights, but the consequences of private ownership are striking. Duku trees tend to be well maintained, there has been investment in new trees, and production is expanding.

Source: Garcia-Garcia and World Bank project documents

Moreover, inappropriate agriculture and other developments in upper watershed areas, combined with poor solid waste management, contribute to frequent flooding in several urban areas on Java and to the spread of waterborne diseases from poor water quality. Institutional arrangements need to be developed to improve allocation, reduce pollution through better enforcement of standards and implement cost recovery pricing. Such fees will be permitted with the new Non-Tax Revenue Law, but will be hard to enforce. Integrated river basin management, which considers water resources comprehensively, could be developed and implemented. Better flood and pollution control would reduce contamination of shallow wells in urban areas and lower heath risks, while integrated management of surface and groundwater would improve water availability and promote aquifer recharging.

5.37 Air quality has fallen to the point where it could be considered a health hazard, and now has brought some efforts at clean-up (World Bank 1994a, 1995a). Efforts to establish effective controls on air pollution need to be continued, as poor air quality has widespread detrimental effects on Indonesia as a whole.

5.38 Efforts to manage the use and maintenance of forestry resources have not led to sustainable outcomes or economically efficient use of the resource (Box 5.8). The effective tax on log production and subsidy to domestic log processors (inherent in current

Box 5.8: Forestry: Illustrating the Importance of "Soft" Infrastructure

Export licensing and prohibitively high export taxes (earlier export bans) on raw logs and sawn products are the central feature of trade policies affecting the use of forest resources in Indonesia. The main purpose of these policies was to expand domestic processing of forestry resources with a view to increasing value-added prior to their being exported. In addition, plywood producers have received favorable tax provisions and timber concessions are allocated in a non-transparent fashion to firms with existing plywood capacity.

The result has been the establishment of a large export plywood sector that uses logs relatively inefficiently with little value added at world prices. The prohibitive export tax on sawn timber even redirects logs of high-valued species to plywood production. The policies restrict entry by new and alternative users of forestry resources, inhibit competition and suppress the price of logs. The low log prices have enabled existing plywood plants to supply their products to the international market at competitive prices without using logs very efficiently. The gap between what an open market price for logs and what users are currently charged (including the 10% increase in royalty fees introduced on April 1, 1997) implicitly provides concessionaires with a subsidy estimated to be at least $600-1200 million per annum (*i.e.*, $25-50 per cubic meter of log). As the forests are publicly owned, this is effectively a loss is public revenue.

The policies also militate against concession holders utilizing and managing forest resources sustainably, because (a) the term of concessions is too short at 20 years; (b) concessionaires are not able to transfer their licenses (thus removing an incentive for them to keep a working concession in good condition for a potential buyer); and (c) there is a history of concessions (or parts thereof) being re-allocated with little warning, thus creating uncertainty and encouraging short time horizons on the part of concessionaires. In addition, local communities generally have no share in forest proceeds and hence they have an interest in converting forest land to other uses, rather than seeing forestry resources managed sustainably. The Ministry has taken over some concessions in which cutting exceeded sustainable yields substantially. Felling rates in natural forest are officially reported to have fallen to around 22.5 million cubic meters annually. Actual output has declined, suggesting previous overcutting has let to higher costs. However, unofficial estimates based on forest product outputs still suggest that the actual amount felled was larger than 22 million cubic meters. Either way, the amount being felled is well above the Ministry of Forestry's estimate of sustainable yield from remaining natural forests of about 22 million cubic meters annually.

Indonesia has committed itself to attainment of sustainable management of its natural forests by year 2000, which is the best course for Indonesia from the economic, environmental and social points of view. A number of important steps have already been taken: the number of operating concessions has been reduced; the Ministry has introduced more rigorous accounting standards for concessionaires; Ministry efforts to control illegal logging and log shipments seem to have had some success; and the Reforestation Fund may come on-budget under the new Non-Tax Revenue Law. However, the problem in Indonesia is that the pace and scope of reform do not match the very rapid declines in both the area, and the condition, of Indonesia's natural forests, and unlike the situation which prevails in other sectors, where reform can be implemented over extended time frames, this is not an option in forestry. The resource will be lost or badly damaged, unless timely action is taken.

Clearly, there is a strong case for reform of the "soft" infrastructure governing the use of forestry resources to: i) increase competition and bring private costs into line with social costs; ii) improve sustainability, (iii) capture more of the revenues publicly so they benefit all Indonesians.

prohibitive export taxes on raw logs and sawn products), have undermined incentives to regenerate the forests and manage them efficiently. They have also enabled log processors (such as plywood producers) to sell internationally without using logs as efficiently as possible and without much value added. Cutting has exceeded the Government's estimates of sustainable harvest and output is now falling. The test of Government management of a public owned forest is to achieve a degree of sustainability that simulates private ownership, and receive returns equivalent to what a private owner would get.

5.39 To increase the efficiency and sustainability with which forestry resources are used, the Government could:

- open the log market to more competition, by auctioning concessions among alternative competing users, removing the prohibitive export tax on higher valued sawn timber, relaxing export licencing, and raising royalties (IHH);
- utilize more effective instruments for monitoring and enforcing sustainable practices in field operations, such as the use of performance bonds (subject to confiscation of the bond and the concession, if performance is unsatisfactory), and streamline and strengthen enforcement capacity in the field; and
- improve property rights by ensuring that (a) concessions are allocated to users under terms that encourage a long-term approach to the resource (lengthening the concession period, and introducing a right of transferability), and (b) forest dwelling and adjacent communities receive access to the benefits of sustainable forest production, in preference to encroachment onto regenerating forest lands.

5.40 Some logging concessions in Indonesia already operate with the high standards conducive to sustainability. As an interim approach, the Government could identify other operations with similar operating conditions, and require that within a given time frame, all such operations at least reach the standards of the model operations. Such a standard would not be based on theory or untested research, but on field operations of the best firms. Provided a sufficient number of concessions were included, this would generate a significant improvement in the state of forests and forest operations in the country. Further inducement could be offered, via simplification of regulatory and reporting process. Some experimentation has already occurred in Indonesia with this approach, with considerable success.

5.41 Another closely related issue is land resource management. A high-priority issue has been the use of location permits. The permit system is highly inequitable since it gives the holder of the permit (typically a developer) a monopoly purchase right (hence leading to lower bid prices), and leads to inefficient use of land (see World Bank 1996a, Chapter 2). GOI took a step towards addressing these problems when it suspended issuance of new location permits in the JABOTABEK area in late 1996. At that time, permits had already been issued for 120,000 hectares, enough to build around 6 million houses. However, in February 1997, GOI decided to end the suspension, stating that small developers needed the permits, especially to build low cost housing. GOI would do well to reconsider the concept of the location permit especially now, when the property market is particularly risky (see Box 1.1).

E. Strengthening Financial Institutions

5.42 There have been large advances in the range and quality of financial services in Indonesia since deregulation of this sector began in a major way in 1988. Nevertheless, the high cost of local credit continues to be a chronic complaint among Indonesian businessmen. They point towards: high borrowing rates ("prime" rates of 10% or more in real terms); limited access to long-term finance; and the lack of liquidity of many listed stocks. Other structural aspects of doing business in Indonesia also add to financial costs. For example, many businesses are highly leveraged, and there are well-known difficulties in enforcing contracts and exercising collateral (see Section F.2 and World Bank 1996a, pp 50-52). In these circumstances, the typical businessmen has a good possibility of "walking away" from a project without major financial loss, even in

the worst case scenario. As a result, the risk of default is high and banks must charge high rates to cover bad debts. Pressures also arise for government assistance to support weak institutions, which loosens monetary and fiscal policy. Policies to overcome such "moral hazard" problems are an important part of improving Indonesia's soft infrastructure.

5.43 In general, the authorities have continued to make headway in institutional development of the banking system during the past year (Box 5.9). Also, banks' classified assets continued to decline in relation to total assets. Indeed, by end-1996 reported classified assets (as a percent of total credits) were less than two-thirds of that recorded three years earlier. However, classified assets still rose in absolute amount (Box 5.10), and the announcement in April 1997 concerning required lending to small business (Box 5.9) is likely to be a step backwards in strengthening the portfolios of many banks.

5.44 At the macro level, there continue to be concerns that the financial system could fail to act as a shock absorber in the event of some large macroeconomic disturbance. Concerns in this regard have been discussed in previous World Bank Country Economic Reports (World Bank 1996a, Chapter 2, and World Bank 1995a, Chapter 1).

E.1 Improving Banking Institutions

5.45 In an approach that has been successful to date, the Government has relied upon a case-by-case approach to solving banking problems. However, the Government could increase the pace of progress by adopting a more transparent, market-oriented strategy. The key to success would be timely actions to penalize (ultimately, by closing) chronic offenders without causing serious runs on banks or the currency. Reforms would be helpful in three types of institutions—Bank Indonesia, the state banks, and the private banks.

5.46 **Bank Indonesia.** The Central Bank has primary responsibity for supervision of the nation's banking system. It is widely recognized that there has been significant progress since deregulation in 1988, including last year (Box 5.9). As next steps, the following could be considered:

- Stronger enforcement of Bank Indonesia's existing regulations, together with a shift in Bank Indonesia's approach to classifying credits, away from its current approach of waiting until payments are late,[5] in favor of genuine credit assessment.[6] It would also be helpful to look carefully at banks' procedures for valuing collateral (which is a credit in calculating required provisioning for bad debts), given difficulties in exercising collateral.

- An extension of Regulation No. 68/1996 to provide a well-defined threshold for Bank Indonesia intervention in weak banks, clear guidelines for access to Bank Indonesia assistance (*e.g.*, amount of direct and indirect credit, terms, collateral, limits in relation to capital, etc.), stronger sanctions for repeat violations, and higher capital requirements for non-foreign exchange banks.

- Accelerated implementation of Bank Indonesia's new payments system and publication of the cost and terms of assistance to troubled banks in Bank Indonesia's Annual Report. Also, Bank Indonesia's own financial statements could be disclosed in more detail.

5.47 **The State Banks.** Despite increased competition since 1988, the state bank's efficiency seems little changed. For example, their reported interest margins actually widened from 1988 through 1994 and their costs (notably bad debts expense) increased (Kenward). Credit assessment procedures appear to have changed little. Major changes will be needed to address these weaknesses, which are essentially ones of corporate governance. As suggestions in this regard:

Box 5.9: Recent Institutional Developments in Banking

The most high profile recent development during 1996 was BNI's partial privatization, which raised almost Rp.1 trillion of new capital on the local market. Several private banks also went to the market for major rights issues during 1996 and early 1997, to strengthen their capital in line with Bank Indonesia's regulations. Concerning mergers and acquisitions, near mid-1996 Bank Indonesia announced that it had helped 27 banks with management or financial problems during fiscal year 1995/96, including 17 commercial banks and 10 BPRs. On the basis of informal World Bank estimates, this would bring to approximately 30, the number of commercial banks experiencing some form of management change during the past 3 years. Bank Indonesia's policy of strictly limiting new licenses, is one arm of this policy, as it forces prospective new owners to buy into existing banks, rather than establishing new ones.

In December 1996, the Government released Regulation No. 68/1996, concerning liquidation of banks. This puts in place a procedure for closing and liquidating banks, but is mainly concerned with the process of liquidation/closure (and with establishing the authority of "settlement" and "liquidation" teams) after the decision has been made to close a bank. It does not address the larger, prior problem—namely, actually making the decision to close. In particular, the Regulation leaves Bank Indonesia and Ministry of Finance with great discretionary authority as to when a bank should be closed.

In November 1996, the management of Bank Indonesia decided to step-up its use of Cease and Desist Orders (CDOs). During the past 5 years, Bank Indonesia has issued CDOs 85 times, of which 35 were against commercial banks, including state banks and very large private banks. The CDOs range from light sanctions to severe penalties, such as placing a bank's management on a "blacklist" and excluding a bank from the clearing system (effectively closure).

In another very positive development in early 1997, the Governor of Bank Indonesia announced that the central bank had recommended to the Ministry of Finance that 22 Smallholder Credit Banks (BPRs) be liquidated and that another 21 be closed. He also has announced that Bank Indonesia will sell its shares in commercial banks.

In early April 1997, Bank Indonesia announced new regulations concerning banks' credit portfolios. On the positive side, foreign and joint venture banks would no longer be subject to the requirement that 50% of their credits be extended for export credits. Also, violations for domestic banks' not placing 20% of their credits with small businesses were removed from the (CAMEL) bank rating criteria. Instead, all banks are expected to increase the proportion of new credits that are extended to small businesses (KUK); for foreign banks, to 12.5% of the 1997 incremental rise, increasing to 22.5% in 1999. For domestic banks, the increase is 20% to 22 1/2%. For enforcement, a system of (modest) penalties (which are expected to be tax deductable) was also introduced for firms that do not meet the targets, with the proceeds to be used to reward firms that exceed the targets. Finally, new limits on short-term borrowing by banks were announced in March 1997 (see Chapter 1).

- More high-level political support is needed to assist with the collection of state banks' bad debts. Consideration could also be given to more imaginative sanctions against state banks' bad debtors, for example; publishing the names of the largest bad debtors, and seizing their exports at a foreign port-of-entry, as is being done by some private banks.
- Going-public is a step forward. However, selling small ownership stakes alone is unlikely to lead to significantly improved performance. Continued restrictions on operations and other interim solutions (see immediately below) are likely to be needed until the state banks fully comply with Bank Indonesia regulations.

Box 5.10: Update on Banks' Classified Assets

The quality of commercial bank portfolios continued to improve during 1996, albeit slowly (see accompanying Table)[a]. Classified assets (measured as a percentage of total credits), which have been on a marked downward trend since end-1993, declined to less than 9% by end-1996. Bad debts (the most serious category of classified assets, the others being "substandard" and "doubtful") seem stuck at around 3.0%.

Commercial Banks' Classified Credits (end-of-period)

	1993	*1994*	*1995*	*1996*
All Banks: Total Credit[1]	177.5	217.0	267.8	331.3
Of which: Classified (as %)	14.2	12.1	10.4	8.8
Bad (as %)	3.3	4.0	3.3	2.9
State Banks[2]: Total Credit[1]	94.1	104.1	120.9	138.9
Of which: Classified (as %)	19.8	18.6	16.6	13.4
Bad (as %)	4.2	5.9	5.3	4.6
Private FX Banks: Total Credit[1]	55.3	78.1	103.1	139.4
Of which: Classified (as %)	5.2	3.7	3.7	4.3
Bad (as %)	1.6	1.3	1.0	1.2
Private Non-FX Banks: Total Credit[1]	9.8	12.0	13.8	18.0
Of which: Classified (as %)	22.3	16.0	13.8	11.1
Bad (as %)	5.1	5.1	3.2	2.5

[1] In trillions of rupiah
[2] Excludes BPDs

Source: Bank Indonesia

At the state banks, classified assets declined to 13.4% of total credits, mainly due to the write-off of some Rp.1 trillion at Bank Rakyat Indonesia, and a major push by BNI in preparation for privatization. Bad debts at the state banks also declined a little, to 4.6% of total credit by year-end.

Among the private banks, there has been a partial reversal of the improvement achieved during 1994 and 1995. In particular, the private foreign exchange banks' situation deteriorated, with classified assets rising from 3.7% of credits at end-1995 to 4.3% at end-1996, their highest level in more than 2 years. The rupiah value of classified assets at these banks has doubled in less than 2 years.

[a] These data, which are based upon monthly self-assessments by the banks, should be regarded as a lower bound on the underlying "true" amount of classified assets. International experience with banking crises inevitably shows that reported classified assets understate portfolio weaknesses.

- For banks not ready for some form of privatization, interim solutions are needed to promote better corporate governance, such as adoption of strategic partners, emphasis on core activities, etc.
- Closures, mergers and downsizing of state banks could be given more consideration, possibly in conjunction with "unbundling" of some activities that could be competitively sold-off to the private sector.
- A policy of "no-regulatory-forbearance" is needed vis-a-vis the state banks, especially

as concerns the schedule for strengthened capital requirements. This could be costly for the Government, but the cost should be borne by the Budget, in an explicit line-item.

- In the long-term, the only real solution seems to be full privatization, which may require amendment of the Banking Act and a different state philosophy towards banking in Indonesia.

5.48 **The Private Banks.** Competition among these banks is intense, and interest margins have come down appreciably with deregulation (Kenward). This market-based solution for improving efficiency has been very effective, but it needs to be supported with more pressure from Bank Indonesia to close down chronic regulatory offenders. The main concern vis-à-vis private banks is systemic risk that arises from moral hazard. To address this issue, the following would seem desirable:

- Stricter enforcement of key Bank Indonesia regulations (*e.g.*, legal lending limits, higher capital requirements, measurement of capital net of underprovisioning, etc.), strengthened bank supervision, and greater use of sanctions (*e.g.*, fines, tougher bank rating penalties, reduced access to Bank Indonesia credit, etc.) for offenders. A good model might be the substantial fines announced by Bapepam near the middle of 1996, on companies (including 3 banks) for failing to submit their financial statements on time.

- Transparent, pre-announced rules for Bank Indonesia's intervention in troubled banks, together with consistent enforcement of these rules.

- A sizable, phased increase in capital requirements for non-foreign-exchange banks, which could force some consolidation in this sub-sector and reduce moral hazard problems.

- Spontaneous consolidation would be facilitated by clarification of circumstances whereby foreigners may buy into troubled domestic non-foreign exchange banks.

- Regulations regarding mergers of listed companies.

E.2 Non-Bank Financial Institutions

5.49 **The Bond Market.** Indonesia's private bond market is small in relation to GDP, but it is not much smaller than almost all the others in East Asia. By contrast, there are no domestic government bonds (because of the "balanced budget" regulation that prohibits local borrowing) which makes the overall bond market very small relative to Indonesia's neighbors.

5.50 There are good reasons why Indonesia's private domestic bond market is small. Historically, it is hampered by high interest rates, significant risks and virtually no secondary trading.[7] Consequently, private sector purchasers are often reluctant to take-up long-term instruments at rates that issuers can afford. Until inflation and risk come down significantly and in a lasting way, development of Indonesia's bond markets is likely to be disappointing. Nonetheless, smaller steps could be taken to build upon the successes of 1996, which was a relatively strong year (Box 5.11). For example; ease restrictions on institutional investors, while increasing their independence; and develop secondary trading in bonds (see Box 5.11).

5.51 It should also be noted that ready access to offshore markets provides a low cost alternative to domestic bonds for larger, creditworthy firms. Firms can raise large amounts of funds offshore with 5-7 year bank credits (or bonds), often with very thin spreads. If firms wish to avoid exchange rate risk, the proceeds can be swapped back into rupiah, yielding a total cost roughly equal to bank deposit rates. For those firms willing to

Box 5.11: Capital Market Developments

Indonesia's capital markets had a strong year in 1996, reflecting the robust expansion of the non-oil, non-agricultural economy and a rising wave of external confidence. For example, the number of companies listed on the stock exchange increased by 19, and funds raised rose by more than 40%. Market capitalization rose by about 40%.

Capital Market Developments

	Stock Exchanges					*Bond Markets*	
	Companies[1]	*Shares*[2]	*Capitalization*[3]	*Foreign* Owned[4]	*Foreign* Trading[5]	*Issues*[1]	*Value*[2]
1988	25	0.2	0.5	-	-	9	0.9
1990	132	8.0	12.4	-	-	23	2.1
1992	162	11.2	24.8	25.4	-	34	3.9
1994	231	26.5	103.8	29.6	67.1	46	6.7
1995	248	35.4	152.2	27.7	58.9	50	8.7
1996	267	49.8	215.0	25.5	52.2	55	11.5

1 Number of listed companies/issues, end of period.
2 Cumulative value of funds raised in trillions of rupiah.
3 The value of all listed shares, at current prices, in trillions of rupiah, JSE only.
4 In percent of capitalization, JSE only.
5 Share of turnover accounted for by foreigners.

Source: Bapepam.

After expanding strongly through April, the Jakarta Stock Exchange Index turned downwards for about 4 months, in a slide that was similar to other countries in the region. Social disturbances at the end July barely affected the market. The index recovered strongly in the final months of the year, ending 1996 on a high note. Record levels were recorded in early 1997, but all these gains were erased by April.

Other important developments during the year include a trend towards lower foreign ownership of listed companies, and a continuing drop in the share of trading accounted for by foreigners. This seems to be partly due to the rapid expansion of newly-established open-ended mutual funds, whose transactions are defined to be domestic. In other developments, the share of the market accounted for by state-owned enterprises continues to rise, reflecting the Government's privatization program. Following BNI's IPO (see Box 5.9), the share in total market capitalization rose above 25%.

Performance of the bond market—which, as noted in the main text, is small in relation to GDP because there is no domestic government debt—was less impressive than the stock market, but it improved upon 1995. There were 5 new issues (versus 4 in 1995) and the value of outstanding issues rose by almost one-third. Of this, more than one-third was accounted for by PLN, which floated bonds worth a total of Rp. 1 trillion in 2 separate issues, reflecting the company's need for liquidity (see Chapter 4).

carry the exchange rate risk, the cash flow costs are reduced markedly because of lower interest rates in major foreign currencies. These possibilities add significantly to the competitive nature of Indonesian financial markets.

5.52 **The Stock Markets.** Long-term development of Indonesia's stock markets is also hampered by high-risk factors. Returns must compete with high yields on safer, rupiah-denominated, short-term, fixed-income assets. From a longer-term perspective,

Indonesia should continue policies that reduce the risks of holding rupiah-denominated assets and strengthen local auditing standards and disclosure procedures. Other measures that could be taken in the meantime to build upon the progress during 1996 (see Box 5.11), include: i) continue with the privatization program; ii) ease restrictions on the amounts that institutional investors can place in the stock exchanges, while ensuring fund managers' independence in making portfolio decisions; iii) improve the quality of information and disclosure requirements; iv) strengthen monitoring of developments (for example, of short-term stock price movements) and control over insider-trading; v) change the tax system to "level the playing field" for all financial assets (*e.g.*, taxation of pension funds' income from open-ended mutual funds); vi) introduce scriptless trading as soon as practical; vii) strengthen institutional linkages between the Jakarta Stock Exchange and off-shore bourses, and (viii) expand training of professional staff.

5.53 **Pension Plans.** The state-run social security program, JAMSOSTEK, suffers from a number of institutional and governance problems. About 40% of total assets are not accounted for; administrative expenses are high, despite some recent declines; real returns on investments are virtually nil; membership records are poorly maintained; and members' contributions are at risk, in part because there is no segregation of assets and earnings between different programs (Leechor). Of particular concern are the opportunities for misallocation of funds because the program is not subject to competitive forces or adequate regulation (Leechor).

5.54 The best option is to make enrollment voluntary in JAMSOSTEK, while pursuing deeper reforms (Leechor). If the reforms are not successful within a well-defined period of time, the program should be abolished. As the first step in reform, mandatory participation should be abolished for companies with approved pension plans. Companies without approved pension plans would have the right to chose any accredited pension service company to set up and administer a program. On the civil service pension plan, the most important issue concerns the extent of the Government's unfunded liabilities (Leechor), which are estimated to be the same order of magnitude as (net) external public debt (measured at current exchange rates). Among the options to reduce this potential budgetary burden are the following (Leechor): i) better investment results, which could be assisted by independent external investment advisors; ii) lower administrative expenses; iii) basing pension benefits on the average salary of the final 3-5 years of service, not the final month; iv) linking cost of living adjustments for retirees to prices, not wages; and, v) raising the retirement age (in stages), as currently seems to be under consideration.

F. Improving Governance to Reduce Costs

F.1. The Importance of Good Governance

5.55 In all countries, good governance is important to hold down costs of doing business, to sustain investor confidence, maintain international competitiveness and improve equity. The consistent and predictable application of rules and contracts over time is vital for investor confidence and investment productivity. World Bank survey information suggests that "credibility" of public policy—the absence of unexpected changes in rules and policies, and the consistency with which rules are enforced and property rights protected—has an important positive effect on the level and pattern of investment (World Bank, 1997). In low credibility environments, investors tend to "wait and see". Investors are

Box 5.12: Consensus Regarding the Importance of Good Governance

"The Government is fully aware of the danger of these issues [corruption, collusion and manipulation]. The Government and law enforcement agencies will continue to take firm action to eliminate all the malfeasance."

President Soeharto, Republic of Indonesia, Statement on the Draft State Budget for 1997-98, Jan. 6, 1997. Jakarta, Indonesia, October 29, 1996.

"Business and development are becoming more complex, because of rapid changes in dimensions of ethics and morals, and a new phenomena is becoming a global imperative. It is called "good governance" and it brings together sound and fair business practice. In other words, in politics, economics and business it is not enough to attain political and economic leadership; it should be combined with moral leadership."

Mar'ie Muhammad, Minister of Finance, Republic of Indonesia, Speech at the 42nd Anniversary of the Airlangga University, Surabaya, Indonesia, November 11, 1996.

"Let's not mince words; we need to deal with the cancer of corruption....Corruption diverts resources from the poor to the rich, increases the cost of running business, distorts public expenditures, and deters foreign investors....We all know that it is a major barrier to sound and equitable development. Solutions, however, can only be home-grown. National leaders need to take a stand."

James D. Wolfensohn, President, The World Bank Group, Address to the World Bank Board of Governors, Washington, D.C., October 1, 1996.

reluctant to enter into situations where costs are incurred much earlier than returns are received. This reduces growth by lowering both the level and quality of investment. Investment tends to be in shorter-term projects which require little up front, fixed capital or equity; often they are financed through local bank credit on which defaults are easy.

5.56 Without effective institutions and good governance, businesses can have their competitive position adversely affected by the selective imposition of regulations, taxes and laws. Their cost can rise simply as a result of delays by public officials. Faced with such possibilities, businesses or individuals may be eager to pay for a favorable interpretation of rules or to get a speedy settlement. Informal payments may be common to obtain even ordinary services such as a driver's license, an identity card or a passport. Law enforcement authorities can accept payments to overlook violations or to limit penalties, and teachers can inflate grades in return for gifts. Those with connections gain over those who are the most efficient. Costs increase due to the introduction of unnecessary delays or requirements, and output may suffer. Moreover, these practices impose a disproportionate burden on the poor and small businesses, which are not able to spread these (largely fixed) costs across larger output. Such practices result in inefficiencies and unfairness, that are a major source of dissatisfaction.

5.57 Governments' purchases and sales are another area where good governance is important. Through its purchases and sales, Government can distribute subsidies and create room for private profit at public expense. For example, the sale of concessions without auctions, or granting of a concession with low royalties, can generate private income at national expense. Similarly, a privatization process can favor those with inside information and connections, as occurred in the former Eastern bloc and before recent reforms in Argentina (Celarier).

5.58 The way policies and regulations are administered can also create benefits for some and costs for others. When the state controls the supply of credit and interest rates, additional fees are often paid for by those seeking loans (see Box 5.13, de Melo, Gur and Sadler, and Webster). When spending on subsidies is too low to satisfy or supply all who qualify, public officials may use discretion in allocating services. This problem has periodically arisen with public housing programs in the United States.

5.59 **The Indonesian Context.** Indonesia has an outstanding track record in macroeconomic management. Surveys give Indonesia high marks for there being little "risk of expropriation with no compensation" (Knack and Keefer), reflecting the nation's commitment to respecting its international agreements.

Box 5.13: Trade Credit in the Village

Despite Bank Rakyat Indonesia's extensive, well-regarded Unit Desa System (see Box 2.6 in World Bank 1996a), formal credit institutions do not always work well in the villages. Nonetheless, the demand for credit is high there, causing alternative delivery systems to evolve. Unfortunately, these tend to be very expensive and most of the cost can fall on the poor, as illustrated by the following examples.

In the province of Jambi, there is an extensive system of farmers, village traders, provincial traders, industrialists and exporters, dealing, *inter alia*, in *duku* (a popular fruit), *latex* (rubber) and *jelutung* (a milky sap substitute for rubber). A typical trader will sell consumer goods on credit to villagers in remote areas, and buy rubber with credit extended to farmers/tappers. On the selling side, the trader offers, for example, cigarettes, sugar and rice, at different prices—one for cash and a higher one for credit. The difference in price implies an interest rate of almost one per cent per day. On the buying side, the trader also provides credit to the tapper, who repays when he delivers rubber to the trader; the implicit interest rate is believed to be similar to that charged by the trader for consumer credit.

Why does the farmer (or the trader) not use formal institutions? Clearly, in very remote regions, these are not available. But even where available, other considerations interfere. For example, a garlic trader in a village in NTT can obtain credit from a major bank at 2% per month, which is reasonable by Indonesian standards. But he may also have to pay an additional, informal "facilitation fee" to the local bank official for processing papers and arranging eligibility. This can amount to 3% per month for short-term credit. Such fees normally have to be paid up-front, but cost falls with the size of the loan—for example, for a loan of Rp.1 million he must pay Rp.200,000 (20% of the loan); for Rp.5 million, the fee is Rp.500,000 (10% of the loan).

The facilitation fee paid by the garlic trader has important economic effects, including adverse distributional effects on the poor. It discourages investment and raises the cost of holding stocks, thereby increasing the bunching of sales at harvest time and amplifying price fluctuation over the season. When facilitation fees are "folded" into the loan, the risk of the loan naturally rises, with the bank bearing the cost of increased defaults.

Source: World Bank Staff.

5.60 However, a widely-held perception exists that the invisible costs of doing business in Indonesia are very high. A survey done by the Overseas Research Department of the Japan External Trade Organization, conducted in late 1995, indicated that more than 50% of Japanese firms operating in Indonesia cited "complexity of administrative procedures" as the most difficult problem faced by their businesses. This problem was not even among the top five problems faced by Japanese firms operating elsewhere in major ASEAN countries.[8] Similarly, the Index of Bureaucratic Effectiveness consistently ranks

Indonesia relatively low on "Contract Enforceability" (Knack and Keefer). In recent years, Indonesia's ranking has been comparable to Mexico, Colombia and Russia.

5.61 Three examples of ways in which public administration can raise the "invisible" costs of doing business in Indonesia are: (a) "facilitation fees" that small scale borrowers often pay for credit (see Box 5.13), (b) payments made to local government officials in lieu of *retribusi* (see Box 5.5), and (c) "fees" paid to acquire the signatures needed for transporting livestock (see Box 5.6). Small scale enterprises and the poor are particularly disadvantaged by such costs and feel unfairly treated. Another example, affecting equity, is the sale of concessions or public assets through negotiation, rather than in a transparent competitive auction to the highest bidder (see Box 2.5). Without such an auction, the concessionaires can pay too little and hence the state receives too little.

Box 5.14: "Good Governance" and Cultural Norms

Comparing the quality of governance in different countries is difficult because social customs vary. In particular, western countries have tended to place high value on rule-of-law concepts, whereas other cultures may rely more heavily on business associations and the quality of personal relationships. In Asia, indeed in many parts of the world, the practice of providing gifts for services performed—and the exchange of gifts—is a long-standing custom. It is practiced as much in private sector transactions as in public-private transactions, and there are elaborate social customs within which gift-giving and exchange of services are common. Hence, while some cultures would interpret certain payments as a gift for service that circumvents an inefficient bureaucracy or an ineffective legal system; others see the same payments as bribes.

Inevitably, the visibility of this issue will rises with economic development, as has already occured in some Asia societies. As society becomes more open, the public and the (local and international) news media create expectations and set standards that are increasingly in favor of "rule-of-law" institutions; civil service salaries rise to levels that obviate the need for supplementary income; middle-class taxpayers come to demand better service from cumbersome, government bureaucracies; and side payments fall out of favor.

5.62 **The Case of Customs Services.** Customs administration is of particular current interest as an example of governance in Indonesia. In 1985, Government placed customs administration in the hands of a private company, *Societe General de Surveillance* (SGS), and significantly improved the timeliness and predictability with which imports were cleared and the amount of customs revenue collected. In 1995, customs administration was passed to PT *Surveyor Indonesia*, a state-owned company in which SGS maintained a 20% share. However, this arrangement come to an end on April 1, 1997 when the responsibility for customs inspection was returned to the Directorate General of Customs and Excise. As part of this change, the pre-shipment inspection system of the past 12 years was replaced by a post-shipment inspection[9].

5.63 Spokespersons for importers were so concerned by the prospect of additional hidden costs and reduced predictability of service that their association spoke of paying the costs associated with continuing the pre-shipment inspection. The Indonesian Importers Association also proposed that the Government maintain the current pre-shipment system until 2000, to allow time to adequately prepare customs officials. Whether importers' concerns are realized will depend on the efficiency, transparency and timeliness of customs administration and this cannot be fully assessed in advance.

5.64 In an effort to avoid a deterioration in customs administration, it would be desirable to monitor performance closely over the next year or two. Ideally, there would be independent evaluations of custom's performance on a regular basis. If there is a deterioration, it is essential that actions be taken quickly to restore quality service; otherwise, opportunities for growth and employment expansion will be forfeited, by increased costs of imported inputs.

5.65 Even now, the growing concentration of non-resource-based export-oriented enterprises in Export Zones (or under bonded manufacturing provisions) suggest that there are hidden costs associated with importing or exporting goods. Otherwise, it seems reasonable to expect that a larger share of such enterprises would locate outside these areas and supply both the local and export markets. Cost associated with customs administration are likely to be part of this. But so too are delays with refunding VAT to exporters. The importance of timely refunds is acknowledged by ongoing efforts by taxation officials to reduce delays.

F.2 The Legal System: A Key Institution

5.66 Public confidence in the efficiency and fairness of the legal system is a critical part of good governance. The need to improve the legal system to strengthen its credibility is evident from survey results and workshops and the words of Prof. Dr. Mochtar Kusumaatmadja; "Our legal situation is indeed critical but not desperate" (Regional Workshop, Semarang, 1996). Moreover, reforms are on-going, as evidenced by plans to update 350 laws inherited from colonial times by the end of 1999 (BPHN's National Conference on Legal and Development Plans, 1996).

5.67 The importance of a well functioning legal system is recognized by the inclusion of plans for legal reform in REPELITA VI. In discussing these plans, the Assistant State Minister/BAPPENAS for Legal Development, Social Communication and Institutional Relations, Sutadi Djajakusuma, spoke of building a state based on the rule of law, with a modern body of laws, a responsible and qualified judiciary, and an efficient and affordable judicial process to provide access to justice for the society at large, in particular, the underprivileged (Semarang, 1996). He highlighted the need to (a) reform judicial administration to ensure the speedy resolution of conflicts and an effective appeals system, and (b) improve the skills and performance of legal and judicial personnel by strengthening ethical and professional standards, transparency and accountability.

5.68 One step that has already been taken is the introduction of a new company law in March 1996. The new law sets time limits on the process of company approvals (though initial indications suggest that these are not being observed), strengthens the rights of minority shareholders, sets guidelines for liquidation, and attempts to increase transparency (see Box 5.15).

5.69 The effort to reform the legal system is benefitting from widespread consultations within the country and the Government's use of international experts. For example, preparatory work for the 1995 Company Law involved widespread discussion and contributions from within the country and in this way provides a model for on-going work to follow. External assistance has included the AUSAid Specialized Legal Training Project, the EU-IPR program, and the USAid-funded ELIPS project.

5.70 Priorities for this legal reform effort include:

(i) Strengthening national commitment to the rule of law (*Rechtsstaat*) and the effective working of an independent judicial system. Government needs to show on-going commitment to the transparent

Box 5.15: The Company Law, Law No. 1/1995

Indonesia's new company law came into effect 7 March 1996. This was an important development for two reasons. First, the process of bringing the law to closure elicited discussion and contributions from various camps, which was a marked departure from previous law-making process. Second, the new company law has positive new provisions of interest to foreign investors.

First, the law defines a relatively simple, time-bound (60 days) process for approval by the Minister of Justice, followed by another time-bound (30 days) period for the company to be gazetted. These provisions are laudable, but in practice, the approval times seem to be much longer than 60 days, which can be a problem for foreigners. Also during the waiting period, company directors are personally liable for all company obligations.

Second, the law enshrines the principal of "limited liability" to value of shares held by shareholder. However, shareholders may be personally liable, including for pre-incorporation acts by a founder. The duties of Board members (see below) are clarified, and Directors must declare conflicts of interest and may be disqualified from acting on behalf of the company.

Third, the law requires a dual board structure—a Board of Commissioners and a Board of Directors. The former acts in an executive role, supervising and advising the Board of Directors; it has great access to information and can suspend Directors.

Fourth, the law significantly strengthens the rights of minority shareholders (which were essentially non-existent previously). Indeed, it may have gone too far in this direction, as for instance: they have a "guaranteed price" for share transfers; they have access to considerable company information; and, anyone with more than 10% ownership essentially has veto power.

Five, different classes of company shares are now possible, and there is a provision for the company to buy-back its own shares (up to 10% per year) and thereby change ownership. Also on financial aspects, a company must set aside a percentage of its profits each year in a reserve fund, until the reserve totals 20% of issued capital. This may create a problem for some joint ventures. There are also provisions for liquidation, including automatic dissolution if losses exceed a certain percentage of capital. This provision seems likely to be unenforced or widely circumvented.

Finally, the law requires the Directors to submit an Annual Report to shareholders within 5 months of the end of the fiscal year. The financial statements must, *inter alia*, give details of the salary and benefits of each Board member—a provision that seems to be meeting resistance. Also, each Board member must sign the Annual Report (or give reasons for not doing so) and can be held personally responsible for false or misleading information; this is a very wide potential liability.

establishment and enforcement of laws and regulations, as part of maintaining a consensus on the role of law. Providers and users of judicial services point to the lack of independence of the judiciary as the paramount deficiency in the system.[10]

(ii) Institutional reform of the judicial system. Public opinion and modern business practices demand efficient means of dispute resolution. At present, economic actors are bypassing the courts and formal arbitration systems more often than can be readily explained by the culturally recognized and widely respected "*musyawarah*" concept of reaching consensus and avoiding conflict. This creates uncertainty regarding the equity with which many disputes are resolved. There is a need for improved screening procedures to appoint judges, attorneys and court administrators, accreditation boards for the legal profession, and a code of ethical and professional standards.

Government and NGO sponsored legal aid centers may be one way of providing legal advice to the poor and increasing the equality of access to justice. Similarly, the use of ADR mechanisms (*i.e.*, conciliation, mediation or arbitration) prior to proceeding with civil litigation is in line with Indonesiaš culture. However, conciliation is not currently mandatory under Indonesian law, and legislation in this area is required to clarify the extent and nature of such ADR mechanisms.

(iii) Modernizing laws. Rapid changes in trade, business and technology require new laws to regulate activities and maintain confidence in public policy[11]. Similarly, there is a need to update laws on arbitration, competition, bankruptcy intellectual property rights and secured transactions. There is still a monumental task of overhauling the Civil, Commercial, Penal and Civil Procedure Codes and other fundamental laws dating from the Dutch colonial era. Moreover, this process needs to have widespread public participation, as was done in developing the new Company Law (Box 5.15), to reflect the interests of affected parties, and to ensure credibility and administrative feasibility.

(iv) Capacity building by strengthening human resources. Indonesia already places a high degree of importance to human resource development and there are already about 13,000 law graduates from over 200 law schools in Indonesia every year. However, the Report by the Consortium of seven leading law faculties suggests that the curriculum needs to be made more relevant. Second, ongoing education for law professionals is essential for their skills to remain up-to-date with changes in the law and its application.

F.3 Improving Institutions and Governance

5.71 Despite the perceptions of large hidden costs in Indonesia, foreign investment and GDP growth have been high recently. Nonetheless, Indonesia will need to keep pace with other countries and improve investor perceptions regarding governance in order to reduce risks and ensure that its impressive development record continues into the 21st. century. The challenge is to maintain rapid growth and improve equity and perceptions of fairness, by maintaining clear policies and administering them consistently over time. This challenge is increasingly important because of growing public and international interest or expectations concerning corporate governance (see Box 5.16).

5.72 Reducing the hidden costs of doing business in Indonesia involves changes by both the public and private sectors, and will be a lengthy process. It entails a combination of policy and institutional reform, and changes in the way business is undertaken. World Bank cross-country experience indicates that a successful strategy of policy and institutional reform to reduce the hidden costs of doing business in Indonesia and improve equity is likely to involve five aspects:

- strong, sustained commitment to the program at all levels, by leadership and example;
- policy reform to reduce discretionary authority and increase transparency and competition, as this reduces opportunities for corruption;
- a new civil service pay structure and a system of recruitment, (iter- and intra-) departmental mobility, and promotion that is merit-based;
- increased civil service accountability by strengthened monitoring of public employee performance, and penalties for poor performance, abuse of power or malfeasance; and
- the continued development of a sound predictable legal system, and an effective and independent judiciary.

Box 5.16: Global Developments in Corporate Governance: Implications for Indonesia

As Indonesia becomes increasing integrated in international markets, important changes are occurring in corporate governance world-wide. Most important among these, shareholder activism is on the rise. In the United States, this movement has been led by public pension funds, but their precepts have generally been adopted by a broad range of institutions, and the philosophy is being exported outside the United States. An International Corporate Governance Network has held two annual meetings to date, as a forum for institutional investors to exchange ideas on corporate governance. Their main concerns appear to be:

- Good corporate performance;
- Oversight of the company by its outside board of directors;
- Accountability of management to the company's shareholders;
- Processes for shareholders to vote their stock and for minority shareholders to voice their concerns;
- Close communication between company management and shareholders; and
- More complete and transparant disclosure of information.

Indonesian corporations have already begun to feel some fallout from such heightened investor assertiveness. For example, the Gajah Tunggal Group experienced a large sell-off of its stock during 1996 after pushing ahead with expansion into the textiles sector, despite a negative assessment on the part of analysts. By contrast, Lippo Group sweetened the terms of its re-structuring when analysts re-acted negatively to the initial proposal. Elsewhere in Asia, Telekom Malaysia made an unusually open—and successful—public relations effort, following significant policy revisions in July 1996. Not so in Hong Kong where Tsingtao Brewery lost favor when analysts learned that proceeds from its IPO was being on-lent to other companies in China.

These developments have implications for economic policy-making, if Indonesia hopes to attract its share of quality foreign capital. It is clearly in the national interest to have a stable base of foreign investors who buy and hold corporate stock on the basis of "fundamentals". There are various ways to attract such "quality" investors. At the most general level, the key is transparency and a high degree of ethical conduct. More specifically, during privatizations through IPOs or rights issues, road shows are critical, as is the quality of information thereby provided to the public. Regular follow-up communications are also important regarding, for example, the direction in which a company is headed (without providing inside trading information). Likewise, the quality of investor relations—including through its annual report—are of concern to the serious investor. These considerations also underscore the key role played by Bapepam in ensuring the timely disclosure of accurate data on the financial condition of listed companies. The rise of shareholder activism is also a good reason for GOI to privatize state enterprises—even on a partial basis—as one means to improve corporate governance.

Source: Various Corporate Governance Reports of The Conference Board, New York, 1994-96.

5.73 The continued deregulation discussed in Sections 5.B, 5.C and 5.D is an important part of the second of these five aspects. With a more market-oriented policy environment and less reliance on policy interventions, there is less scope and incentive for corruption. For example, removing non-tariff import barriers would not only reduce direct costs and strengthen competition, but it would simplify import administration and reduce the scope for rent seeking. Similarly, reducing *retribusi* taxes and removing controls on the intra-county

movement of goods would not only increase producer returns by integrating markets, but also reduce elicit payments to policy administrators. Greater reliance on transparent competitive sale of infrastructure concessions would increase revenues and decrease costs of services.

5.74 The other parts of such a strategy are not amenable to straight forward policy or regulatory changes. For example, establishing a merit-based civil service system of pay, promotion, and penalties based on performance represents a major civil service reform. But, simply adjusting pay, without such a reform runs a serious risk of generating little or no improvement. Similarly, continued development of a sound, predictable legal system will not be easy. Success will depend sustained effort and strong leadership from all levels. However, actions to reduce the hidden costs of doing business tend to be self re-enforcing as they create a virtuous cycle. Success raises investment and growth, and this in turn increases accountability, openness and transparency of business practices.

Endnotes

1. Effective protection is the net additional return provided to resources in the industry by policies affecting input costs and output prices compared to what return would be in the absence of these policies.

2. Producers get partial reduction in custom duties for local content rates between 20% and 60%.

3. The official rationales for export controls are: (a) to match exports with quotas imposed by importing countries; (b) to conserve natural resources and endangered species; (c) to promote downstream activities with higher value added; (d) to raise or ensure export quality; and (e) to ensure adequate domestic supplies. However, the only one of these objectives that cannot clearly be achieved by alternative instruments, with fewer adverse side effects, is the protection of endangered species. For example, in cases of quantitative import restrictions imposed by importing countries, the best option would be for Indonesia to use a transparent, competitive auction of the right to fill them.

4. Externalities refers to a situation in which one producer's activity directly affects the costs, output or returns of another. Examples include the depletion of ground-water by a well, upstream pollution affecting downstream users of water. Markets can rarely resolve such externalities effectively, hence Government regulation may be needed.

5. At present, Bank Indonesia's main criterion for determining the quality of assets is tardiness on principal and/or interest. This is a relatively late stage to be classifying an asset, and more emphasis is needed on assessing the capacity of borrowers to service their credits.

6. This would probably require an extensive credit training program for Bank Indonesia staff.

7. There is only an informal, over-the-counter secondary market.

8. The survey covered Thailand, the Philippines, Indonesia, Malaysia and Singapore.

9. The law re-instating Indonesian Customs authority also authorized the establishment of a Committee on Anti-Dumping. This Committee is intended to review and facilitate the formulation of anti-dumping complaints by Indonesian businesses. However, as has happened in other countries, there is a risk that anti-dumping complaints become another form of protection for inefficient, uncompetitive producers. This temptation needs to be resisted to avoid wasteful, investments in uncompetitive activities.

10. Public Opinion Survey, 1996.

11. For example, the cost of delaying the establishment of appropriate regulatory frameworks for telecommunications, securities, capital markets, and international property rights can be very high, as investment can be inefficient and weaken technology transfer.

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INDONESIA

COUNTRY ECONOMIC REPORT

STATISTICAL ANNEX [a]

List of Tables

Population and Employment

National Income Accounts

International Trade & Balance of Payments

External Debt & Capital Flows

Public Finance

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[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 due to different Bank definitions and methodologies in constructing the statistical series.

Monetary Statistics

Agricultural Statistics

Industrial Statistics

Prices

Investment Statistics

Table 1.1

INDONESIA

COUNTRY ECONOMIC REPORT

Population And Growth Rates by Province, 1930-1995

Region	Population ('000)							Average growth rate (% p.a.)					
	1930	1961 /a	1971 /a	1980	1985	1990	1995	1930-61	1961-71	1971-80	1980-85	1985-90	1990-95
Java	**41,718**	**63,059**	**76,086**	**91,270**	**99,852**	**107,528**	**114,733**	**1.3**	**1.9**	**2.0**	**1.8**	**1.5**	**1.3**
DKI Jakarta	811	2,973	4,579	6,503	7,885	8,225	9,113	4.3	4.4	4.0	3.9	0.8	2.1
West Java	10,586	17,615	21,624	27,454	30,830	35,380	39,207	1.7	2.1	2.7	2.3	2.8	2.1
Central Java	13,706	18,407	21,877	25,373	26,945	28,519	29,653	1.0	1.7	1.7	1.2	1.1	0.8
DI Yogjakarta	1,559	2,241	2,489	2,751	2,930	2,915	2,917	1.2	1.1	1.1	1.3	-0.1	0.0
East Java	15,056	21,823	25,517	29,189	31,262	32,490	33,844	1.2	1.6	1.5	1.4	0.8	0.8
Sumatra	**8,255**	**15,739**	**20,809**	**28,017**	**32,603**	**36,436**	**40,830**	**2.1**	**2.8**	**3.4**	**3.1**	**2.2**	**2.3**
Lampung	361	1,668	2,777	4,625	5,905	6,006	6,658	5.1	5.2	5.8	5.0	0.3	2.1
Bengkulu	323	406	519	768	943	1,181	1,409	0.7	2.5	4.5	4.2	4.6	3.6
South Sumatra	1,378	2,773	3,441	4,630	5,370	6,278	7,208	2.3	2.2	3.4	3.0	3.2	2.8
Riau	493	1,235	1,642	2,169	2,548	3,283	3,901	3.0	2.9	3.1	3.3	5.2	3.5
Jambi	245	744	1,006	1,446	1,745	2,016	2,370	3.6	3.1	4.1	3.8	2.9	3.3
West Sumatra	1,910	2,319	2,793	3,407	3,698	4,001	4,323	0.6	1.9	2.2	1.7	1.6	1.6
North Sumatra	2,542	4,965	6,622	8,361	9,422	10,254	11,115	2.2	2.9	2.6	2.4	1.7	1.6
Aceh	1,003	1,629	2,009	2,611	2,972	3,417	3,848	1.6	2.1	3.0	2.6	2.8	2.4
Kalimantan	**2,170**	**4,102**	**5,155**	**6,723**	**7,722**	**9,111**	**10,471**	**2.1**	**2.3**	**3.0**	**2.8**	**3.4**	**2.8**
West Kalimantan	802	1,581	2,020	2,486	2,819	3,237	3,636	2.2	2.5	2.3	2.5	2.8	2.3
Central Kalimantan	203	497	702	954	1,118	1,398	1,627	2.9	3.5	3.5	3.2	4.6	3.1
South Kalimantan	836	1,473	1,699	2,065	2,273	2,599	2,893	1.8	1.4	2.2	1.9	2.7	2.2
East Kalimantan	329	551	734	1,218	1,512	1,877	2,314	1.7	2.9	5.8	4.4	4.4	4.3
Sulawesi	**4,231**	**7,079**	**8,528**	**10,409**	**11,554**	**12,519**	**13,732**	**1.7**	**1.9**	**2.2**	**2.1**	**1.6**	**1.9**
Central Sulawesi	390	693	914	1,290	1,511	1,705	1,938	1.9	2.8	3.9	3.2	2.4	2.6
North Sulawesi	748	1,310	1,719	2,115	2,313	2,480	2,649	1.8	2.8	2.3	1.8	1.4	1.3
South Sulawesi	2,657	4,517	5,181	6,062	6,610	6,983	7,558	1.7	1.4	1.8	1.7	1.1	1.6
Southeast Sulawesi	436	559	714	942	1,120	1,351	1,587	0.8	2.5	3.1	3.5	3.8	3.3
Other Islands	**4,219**	**7,106**	**8,630**	**11,071**	**12,316**	**13,654**	**14,988**	**1.7**	**2.0**	**2.8**	**2.2**	**2.1**	**1.9**
Bali	1,101	1,783	2,120	2,470	2,649	2,779	2,896	1.6	1.7	1.7	1.4	1.0	0.8
West Nusa Tenggara	1,016	1,808	2,203	2,725	2,995	3,371	3,646	1.9	2.0	2.4	1.9	2.4	1.6
East Nusa Tenggara	1,344	1,967	2,295	2,737	3,061	3,270	3,577	1.2	1.6	2.0	2.3	1.3	1.8
Maluku	579	790	1,089	1,410	1,609	1,853	2,087	1.0	3.3	2.9	2.7	2.9	2.4
Irian Jaya	179	758	923	1,174	1,371	1,631	1,943	4.8	2.0	2.7	3.2	3.5	3.6
East Timor	n.a	n.a	n.a	555	631	750	840	n.a	n.a	n.a	2.6	3.5	2.3
Indonesia	**60,593**	**97,085**	**119,208**	**147,490**	**164,047**	**179,248**	**194,755**	**1.5**	**2.1**	**2.4**	**2.2**	**1.8**	**1.7**

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

Source: Central Bureau of Statistics, 'Population Census Reports' year 1961, 1971, 1980 and 1990; 'Statistical Yearbook of Indonesia 1984'; and 'Intercensal Population Survey (SUPAS)' year 1985 and 1995.

Table 1.2

INDONESIA

COUNTRY ECONOMIC REPORT

Distribution of Population by Age Group and Sex, 1961-1995
('000)

Age Group	1961			1971			1980			1985			1990			1995		
	Male	Female	Total	Male	Female	Total	Male	Female	Total	Male	Female	Total	Male	Female	Total	Male	Female	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	10,766	10,120	20,887	10,475	9,977	20,452
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	11,791	11,290	23,081	11,130	10,659	21,788
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	10,998	10,438	21,437	12,038	11,671	23,709
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	9,553	9,367	18,920	10,273	10,006	20,279
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	7,662	8,486	16,148	8,037	9,114	17,151
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	13,962	14,770	28,732	15,060	16,230	31,290
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	9,778	9,475	19,253	12,871	12,351	25,221
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	7,036	7,284	14,320	7,953	7,419	15,371
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	4,615	4,887	9,502	5,235	6,142	11,377
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	3,213	3,749	6,962	3,859	4,257	8,116
Not stated	60	57	117	7	8	15	11	9	20	4	3	7	3	5	8	0	0	0
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	89,376	89,872	179,248	96,930	97,825	194,755
									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	12.0	11.3	11.7	10.8	10.2	10.5
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	13.2	12.6	12.9	11.5	10.9	11.2
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	12.3	11.6	12.0	12.4	11.9	12.2
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	10.7	10.4	10.6	10.6	10.2	10.4
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	8.6	9.4	9.0	8.3	9.3	8.8
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	15.6	16.4	16.0	15.5	16.6	16.1
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	10.9	10.5	10.7	13.3	12.6	13.0
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	7.9	8.1	8.0	8.2	7.6	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	5.2	5.4	5.3	5.4	6.3	5.8
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	3.6	4.2	3.9	4.0	4.4	4.2
Not stated	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	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	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bureau of Statistics, 'Population Census Reports' year 1961, 1971, 1980 and 1990;
'Statistical Yearbook of Indonesia 1984'; and 'Intercensal Population Survey (SUPAS)' year 1985 and 1995.

INDONESIA

COUNTRY ECONOMIC REPORT

Employment by Main Industry , 1971-1995 /a

Main Industry	1971		1980		1982		1985		1990		1995	
	million	%	million	%	million	%	million	%	million	%	million	%
Agriculture, forestry, hunting & fishery	26.5	64.2	28.0	54.8	31.6	54.7	34.1	54.6	35.5	50.1	35.2	44.0
Mining and quarrying	0.1	0.2	0.4	0.7	0.4	0.7	0.4	0.7	0.7	1.0	0.6	0.8
Manufacturing	2.7	6.5	4.4	8.5	6.0	10.4	5.8	9.3	8.2	11.6	10.1	12.6
Electricity, gas & water	0.0	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.3
Construction	0.7	1.6	1.6	3.1	2.2	3.7	2.1	3.4	2.8	4.0	3.8	4.7
Wholesale and retail trade & restaurants	4.3	10.3	6.6	12.9	8.6	14.8	9.4	15.0	10.6	15.0	13.9	17.3
Transportation. storage & communications	1.0	2.3	1.5	2.9	1.8	3.1	2.0	3.1	2.7	3.8	3.5	4.3
Finance, insurance, real estate & business services	0.1	0.2	0.2	0.4	0.1	0.2	0.3	0.4	0.5	0.7	0.7	0.8
Public services	4.1	10.0	7.7	15.1	7.1	12.3	8.3	13.3	9.7	13.7	12.1	15.1
Others	1.9	4.6	0.7	1.4	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Total	41.3	100.0	51.2	100.0	57.8	100.0	62.5	100.0	70.8	100.0	80.1	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' year 1975, 1982, 1985 . 1990; and 'Intercensal Population Survey (SUPAS)' year 1985 and 1995.

Table 1.3

Table 1.4

INDONESIA

COUNTRY ECONOMIC REPORT

Population Distribution by Province and Urban & Rural, 1980-1995

Region	1980		1990		1995		Average Growth Rate (% p.a)			
	Urban	Rural	Urban	Rural	Urban	Rural	Urban		Rural	
							1980-90	1990-95	1980-90	1990-95
Java	**22,926**	**68,291**	**38,335**	**69,183**	**47,854**	**66,880**	**5.28**	**4.54**	**0.13**	**(0.67)**
DKI Jakarta	6,072	409	8,223	0	9,113	0	3.08	2.08	0.00	0.00
West Java	5,771	21,679	12,208	23,170	16,738	22,469	7.78	6.51	0.67	(0.61)
Central Java	4,756	20,611	7,695	20,822	9,460	20,194	4.93	4.22	0.10	(0.61)
DI Yogyakarta	607	2,143	1,294	1,619	1,693	1,223	7.86	5.52	(2.77)	(5.44)
East Java	5,720	23,449	8,916	23,572	10,850	22,994	4.54	4.01	0.05	(0.50)
Sumatra	**5,481**	**22,514**	**9,294**	**27,129**	**12,018**	**28,812**	**5.42**	**5.28**	**1.88**	**1.21**
Lampung	577	4,047	747	5,257	1,046	5,612	2.62	6.96	2.65	1.31
Bengkulu	72	695	240	939	362	1,047	12.73	8.57	3.04	2.20
South Sumatra	1,267	3,361	1,839	4,438	2,185	5,023	3.80	3.50	2.82	2.50
Riau	588	1,576	1,047	2,234	1,340	2,560	5.94	5.05	3.55	2.77
Jambi	183	1,262	433	1,581	644	1,726	9.00	8.26	2.28	1.77
West Sumatra	433	2,973	808	3,191	1,083	3,240	6.43	6.04	0.71	0.31
North Sumatra	2,127	6,224	3,639	6,613	4,568	6,547	5.51	4.65	0.61	(0.20)
Aceh	234	2,377	540	2,876	790	3,057	8.74	7.93	1.92	1.23
Kalimantan	**1,441**	**5,276**	**2,507**	**6,596**	**3,183**	**7,288**	**5.69**	**4.89**	**2.26**	**2.02**
West Kalimantan	417	2,068	643	2,592	788	2,848	4.43	4.14	2.29	1.90
Central Kalimantan	98	856	245	1,151	366	1,262	9.58	8.32	3.00	1.86
South Kalimantan	441	1,622	703	1,894	867	2,027	4.78	4.28	1.56	1.37
East Kalimantan	485	729	915	960	1,162	1,152	6.55	4.89	2.78	3.72
Sulawesi	**1,654**	**8,746**	**2,761**	**9,750**	**3,612**	**10,121**	**5.26**	**5.52**	**1.09**	**0.75**
Central Sulawesi	115	1,169	281	1,422	424	1,514	9.31	8.56	1.98	1.26
North Sulawesi	355	1,760	565	1,913	696	1,953	4.76	4.27	0.84	0.41
South Sulawesi	1,096	4,963	1,685	5,295	2,137	5,422	4.40	4.86	0.65	0.47
Southeast Sulawesi	88	854	230	1,120	355	1,232	10.06	9.11	2.75	1.93
Other Islands	**1,342**	**9,659**	**2,494**	**11,150**	**3,270**	**11,717**	**6.39**	**5.57**	**1.45**	**1.00**
Bali	363	2,106	734	2,043	994	1,902	7.29	6.24	(0.30)	(1.42)
West Nusa Tenggara	383	2,340	582	2,790	687	2,959	4.26	3.37	1.77	1.18
East Nusa Tenggara	205	2,532	372	2,896	497	3,081	6.12	5.94	1.35	1.25
Maluku	153	1,256	352	1,499	513	1,574	8.71	7.79	1.79	0.98
Irian Jaya	237	870	395	1,234	500	1,442	5.23	4.83	3.56	3.17
East Timor	0	555	58	689	80	760	0.00	6.52	2.18	1.97
Indonesia	**32,846**	**114,486**	**55,391**	**123,808**	**69,937**	**124,818**	**5.36**	**4.77**	**0.79**	**0.16**

Source : Central Bureau of Statistics, 'Statistical Yearbook Of Indonesia 1984'; and SUPAS 1985 and 1995

INDONESIA

COUNTRY ECONOMIC REPORT

Gross Domestic Product by Industrial Origin at Current Market Prices, 1983-1996 /a
(Rp. billion)

	1983 base										1993 base			
	1983	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994	1995 *	1996 **
1. Agriculture, Livestock Forestry and Fishery	17,764.7	22,512.9	24,870.9	29,116.0	34,277.9	39,163.9	42,148.7	44,720.8	50,733.1	55,745.5	58,963.4	66,071.5	77,639.3	86,212.1
a. Farm food crops	11,125.9	13,860.2	15,084.9	17,540.2	21,123.8	24,491.9	25,907.5	26,149.2	29,443.0	31,403.5	32,093.4	34,941.0	41,958.0	46,298.6
b. Non-food crops /b	2,670.2	3,693.1	4,224.7	5,118.8	5,633.5	6,196.7	6,666.6	7,604.1	8,717.1	9,422.0	9,014.8	10,587.2	12,676.4	14,085.7
c. Livestock products	1,754.3	2,427.0	2,639.6	3,014.6	3,544.8	3,814.0	4,368.0	5,126.2	6,040.7	7,025.9	6,202.7	7,102.3	7,998.5	9,088.9
d. Forestry	994.2	938.0	1,000.6	1,246.8	1,448.3	1,634.7	1,854.6	2,018.0	2,179.6	2,541.4	6,267.6	6,897.4	7,390.4	7,839.7
e. Fishery	1,220.1	1,594.6	1,921.1	2,195.6	2,527.5	3,026.6	3,352.0	3,823.3	4,352.7	5,352.7	5,384.9	6,543.6	7,616.0	8,899.2
2. Mining & Quarrying	16,107.4	13,570.8	11,502.8	17,266.8	17,161.8	21,822.5	26,119.0	31,402.6	29,907.2	30,749.6	31,497.3	33,507.1	38,045.1	43,893.2
a. Oil & natural gas	15,103.0	12,583.8	10,501.8	15,979.4	15,524.7	19,283.0	21,789.2	26,126.1	23,383.9	23,168.6	23,120.8	23,070.0	24,639.9	26,398.3
b. Oth. mining & quarrying	1,004.4	987.0	1,001.0	1,287.4	1,637.1	2,539.5	4,329.8	5,276.5	6,523.3	7,581.0	8,376.5	10,437.1	13,405.2	17,494.9
3. Manufacturing	9,896.4	15,503.4	17,184.7	21,150.4	26,252.4	30,323.3	38,910.2	47,665.5	56,541.6	67,441.4	73,556.3	89,240.7	109,395.0	133,088.4
a. Refinery oil	358.9	1,863.7	1,915.4	1,819.7	2,025.9	2,148.1	3,575.0	3,806.5	4,321.6	5,210.7	5,540.5	5,855.1	6,599.1	7,060.9
b. LNG	1,871.2	2,423.7	1,968.5	2,097.3	2,948.2	3,298.9	3,714.6	4,714.4	4,383.6	4,253.3	4,253.3	4,584.0	4,799.5	5,050.0
c. Non-oil & gas mfg.	7,666.3	11,216.0	13,300.8	17,233.4	21,278.3	24,876.3	31,620.6	39,144.6	47,836.4	57,977.4	63,762.5	78,801.6	97,996.4	120,977.5
4. Electricity, gas & water	313.9	395.9	647.1	746.9	869.0	1,008.3	1,258.1	1,750.2	2,147.7	2,714.3	3,290.2	4,577.1	5,624.5	6,561.0
5. Construction	4,597.2	5,301.8	5,313.7	6,087.4	7,169.2	8,884.2	10,748.5	12,902.1	15,305.2	18,139.9	22,512.9	28,016.9	34,451.9	42,279.2
6. Trade, Hotel & Restaurant	11,418.7	15,416.8	17,121.8	21,048.3	24,379.2	28,855.5	32,999.7	36,953.8	42,731.5	49,789.4	55,297.6	63,858.7	75,874.0	88,451.2
a. Retail & wholesale trade	9,810.5	12,962.2	14,235.3	17,561.2	20,388.5	24,441.0	27,711.7	30,769.8	35,645.3	41,496.1	44,604.8	51,133.8	60,892.0	70,805.6
b. Hotels & Rest.	1,608.2	2,454.6	2,886.5	3,487.1	3,990.7	4,414.5	5,288.0	6,184.0	7,086.2	8,293.3	10,692.8	12,724.9	14,982.0	17,645.6
7. Transport & Communications	4,098.1	6,100.3	6,406.9	7,442.6	8,139.7	9,305.5	10,999.6	13,908.0	17,099.3	20,728.2	23,248.9	27,352.7	30,778.3	35,553.7
a. Transport	3,693.7	5,538.5	5,769.7	6,638.8	7,227.2	8,280.1	9,693.5	12,327.4	15,133.2	18,183.1	20,101.2	23,191.1	25,523.0	29,299.2
b. Communications	404.4	561.8	637.2	803.8	912.5	1,025.4	1,306.1	1,580.6	1,966.1	2,545.1	3,147.7	4,161.6	5,255.3	6,254.5
8. Banks & Finance	2,358.6	3,496.2	4,036.7	4,795.1	5,322.4	6,666.7	8,287.1	10,157.5	12,499.7	15,256.6	14,005.3	17,817.5	21,232.8	25,531.5
9. Ownership of Dwellings/ Real Estate /c	2,355.5	2,775.0	2,976.0	3,349.1	3,736.0	4,151.1	4,890.8	5,924.7	6,595.9	7,610.6	9,695.1	11,239.0	11,899.2	13,237.1
10. Other Services	8,712.3	11,923.7	12,621.9	13,814.3	14,797.3	17,003.7	19,235.5	22,064.9	26,323.3	33,842.4	37,708.9	40,538.5	47,440.8	54,149.0
a. Public	5,711.5	7,925.1	8,307.3	8,911.8	9,446.2	11,174.2	12,801.4	14,621.6	17,309.4	22,458.0	22,458.1	22,754.9	26,555.2	29,531.5
b. Other Private & Services /d	3,000.8	3,998.6	4,314.6	4,902.5	5,351.1	5,829.5	6,434.1	7,443.3	9,013.9	11,384.4	15,250.8	17,783.6	20,885.6	24,617.5
Gross Domestic Products	77,622.8	96,996.8	102,682.5	124,816.9	142,104.9	167,184.7	195,597.2	227,450.1	259,884.5	302,017.9	329,775.9	382,219.7	452,380.9	528,956.4

* : Preliminary figures.
** : Very preliminary figures.
/a. In 1996, the Government released national accounts series using a 1993 base, based on an up-date of the 1990 Input-Output Table and refined estimates of some sub-sectors.
/b. Includes the former smallholder and estate food crops under the National Accounts with 1983 base.
/c. Using 1983 base, this line refers only to Ownership of Dwellings. Using the new base, it includes Real Estates.
/d. Includes Business Services.

Source: Central Bureau of Statistics

Table 2.1

Table 2.2

INDONESIA

COUNTRY ECONOMIC REPORT

Gross Domestic Product by Industrial Origin at Constant Market Prices, 1983-1996 /a
(Rp. billion)

	1983 base										1993 base			
	1983	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994	1995 *	1996 **
1. **Agriculture, Livestock Forestry and Fishery**	17,764.7	19,300.0	19,799.1	20,223.5	21,213.7	21,918.0	22,356.9	22,714.8	24,225.5	24,569.3	58,963.4	59,291.2	61,766.8	62,937.2
a. Farm food crops	11,125.9	11,985.6	12,286.6	12,415.4	12,974.0	13,488.7	13,558.2	13,484.2	14,526.7	14,355.9	32,093.4	31,407.8	32,851.5	32,959.3
b. Non-food crops /b	2,670.2	3,086.5	3,142.3	3,257.6	3,458.1	3,549.2	3,723.6	3,924.0	4,111.2	4,350.7	9,014.8	9,471.6	9,918.3	10,287.9
c. Livestock products	1,754.3	2,036.5	2,063.7	2,110.8	2,211.7	2,243.7	2,327.7	2,468.3	2,664.5	2,813.5	6,202.7	6,451.4	6,719.8	7,013.8
d. Forestry	994.2	850.7	888.7	967.9	1,013.0	973.8	1,002.7	1,002.9	980.4	996.6	6,267.6	6,300.9	6,303.6	6,412.3
e. Fishery	1,220.1	1,340.7	1,417.8	1,471.8	1,556.9	1,662.6	1,744.7	1,835.4	1,942.7	2,052.6	5,384.9	5,659.5	5,973.6	6,263.9
2. **Mining & Quarrying**	16,107.4	15,480.4	16,308.6	16,365.5	15,892.9	16,663.8	17,531.7	19,317.0	18,957.7	19,370.3	31,497.3	33,261.6	35,502.2	38,033.5
a. Oil & natural gas	15,103.0	14,512.6	15,237.0	15,219.3	14,691.6	15,390.7	16,029.5	17,512.6	16,719.2	16,666.5	23,120.8	23,719.6	23,719.9	23,763.7
b. Oth. mining & quarrying	1,004.4	967.8	1,071.6	1,146.2	1,201.3	1,273.1	1,502.2	1,804.4	2,238.5	2,703.8	8,376.5	9,542.0	11,782.3	14,269.8
3. **Manufacturing**	9,896.4	13,430.6	14,678.1	16,235.3	18,182.3	19,855.7	22,336.9	24,585.0	26,963.6	29,484.4	73,556.3	82,649.0	91,580.7	101,682.5
a. Refinery oil	358.9	766.6	927.2	937.7	981.2	990.0	1,094.2	1,136.7	1,202.3	1,186.8	5,540.5	5,547.9	5,392.1	5,602.7
b. LNG	1,871.2	2,918.5	2,922.8	3,233.2	3,594.5	3,685.1	4,093.1	4,433.1	4,662.7	4,753.3	4,253.3	4,720.9	4,390.3	4,437.7
c. Non-oil & gas mfg.	7,666.3	9,745.5	10,828.1	12,064.4	13,606.6	15,180.6	17,149.6	19,015.2	21,098.6	23,544.3	63,762.5	72,380.2	81,798.3	91,642.1
4. **Electricity, gas & water**	313.9	360.9	429.8	494.6	548.9	615.6	725.7	842.8	928.2	1,022.3	3,290.2	3,702.7	4,276.9	4,816.2
5. **Construction**	4,597.2	4,508.0	4,609.0	4,802.9	5,259.1	5,878.0	6,672.9	7,423.7	8,223.6	9,222.5	22,512.9	25,857.5	29,197.8	32,810.6
6. **Trade, Hotel & Restaurant**	11,418.7	12,398.6	13,398.5	14,356.2	15,656.8	17,338.1	18,568.6	19,576.2	21,009.1	22,850.1	55,297.6	59,504.1	64,113.7	69,005.8
a. Retail & wholesale trade	9,810.5	10,412.0	11,238.0	12,004.9	13,035.4	14,446.8	15,425.3	16,213.5	17,405.8	18,968.8	44,604.8	47,619.5	51,290.4	55,285.9
b. Hotels & Rest.	1,608.2	1,986.6	2,160.5	2,351.3	2,621.4	2,891.3	3,143.3	3,362.7	3,603.3	3,881.3	10,692.8	11,884.6	12,823.3	13,719.9
7. **Transport & Communications**	4,098.1	4,487.0	4,668.5	4,938.5	5,211.5	5,811.5	6,367.9	6,869.4	7,554.9	8,302.2	23,248.9	25,188.5	27,555.0	29,914.0
a. Transport	3,693.7	4,031.8	4,178.2	4,393.7	4,626.0	5,151.3	5,596.4	6,002.7	6,601.3	7,192.1	20,101.2	21,400.2	22,965.1	24,451.6
b. Communications	404.4	455.2	490.3	544.8	585.5	660.2	771.5	866.7	953.6	1,110.1	3,147.7	3,788.3	4,589.9	5,462.4
8. **Banks & Finance**	2,358.6	3,020.3	3,483.1	3,659.3	3,752.2	4,290.7	4,893.8	5,535.1	6,255.7	7,069.6	14,005.3	15,944.6	18,164.5	20,480.4
9. **Ownership of Dwellings Real Estates /c**	2,355.5	2,460.9	2,545.1	2,653.9	2,762.2	2,877.7	2,998.8	3,119.7	3,249.3	3,411.1	9,695.1	10,086.8	10,643.0	11,265.6
10 **Other Services**	8,712.3	9,635.3	10,160.7	10,788.2	11,501.9	12,187.7	12,764.1	13,241.5	13,817.2	14,405.3	37,708.9	39,154.7	40,967.2	42,823.2
a. Public	5,711.5	6,455.1	6,862.1	7,366.1	7,932.1	8,396.9	8,783.3	9,052.1	9,320.0	9,508.8	22,458.1	22,752.0	23,045.9	23,292.5
b. Other Private & Services /d	3,000.8	3,180.2	3,298.6	3,422.1	3,569.8	3,790.8	3,980.8	4,189.4	4,497.2	4,896.5	15,250.8	16,402.7	17,921.3	19,530.7
Gross Domestic Product	77,622.8	85,082.0	90,080.5	94,517.9	99,981.5	107,436.8	115,217.3	123,225.2	131,184.8	139,707.1	329,775.9	354,640.7	383,767.8	413,769.0

* : Preliminary figures.
** : Very preliminary figures.
/a . In 1996, the Government released national accounts series using a 1993 base, based on an up-date of the 1990 Input-Output Table and refined estimates of some sub-sectors.
/b. Includes the former smallholder and estate food crops under the National Accounts with 1983 base.
/c. Using 1983 base, this line refers only to Ownership of Dwellings. Using the new base, it includes Real Estates.

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Expenditure on GDP at Current Market Prices, 1983-1996 /a
(Rp. billion)

	1983 base										1993 base			
	1983	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994	1995 *	1996 **
1. Private consumption	47,063.0	57,201.4	63,355.3	71,988.9	81,045.3	88,752.3	106,312.3	125,035.8	135,880.3	158,342.0	192,958.4	221,514.0	264,888.7	308,469.2
2. Government consumption	8,077.3	10,893.1	11,328.7	11,763.5	12,755.8	15,697.6	17,572.6	20,784.6	24,731.3	29,756.7	29,756.7	31,014.0	35,584.2	40,695.3
3. Gross fixed investment	19,467.9	22,366.9	24,781.9	30,980.2	36,802.6	45,659.8	55,633.4	63,893.9	70,820.2	78,243.2	86,667.3	105,380.6	129,177.0	155,125.0
4. Changes in stock /b	2,793.5	4,836.7	4,243.0	8,165.8	8,006.9	13,171.0	15,071.5	16,847.8	22,404.9	28,286.3	10,545.5	15,681.3	17,285.0	17,651.7
5. Exports of goods and nonfactor services	19,847.0	21,533.9	20,009.9	29,874.3	34,665.6	42,505.0	51,953.1	62,263.8	76,384.4	85,454.3	88,230.9	100,503.7	119,593.5	138,675.2
6. Less: Imports of goods and nonfactor services	19,625.9	19,835.2	21,036.2	27,955.8	31,171.4	38,601.0	50,945.7	61,375.7	70,336.6	78,064.7	78,383.0	91,873.8	114,147.5	131,659.9
Gross Domestic Product	**77,622.8**	**96,996.8**	**102,682.6**	**124,816.9**	**142,104.8**	**167,184.7**	**195,597.2**	**227,450.2**	**259,884.5**	**302,017.8**	**329,775.9**	**382,219.7**	**452,380.9**	**528,956.4**

* : Revised figures.
** : Preliminary figures.
/a. In 1996, the Government released national accounts series using a 1993 base, based on an up-date of the 1990 Input-Output Table and refined estimates of some sub-sectors.
/b. Residuals.

Source: Central Bureau of Statistics.

Table 2.3

INDONESIA

COUNTRY ECONOMIC REPORT

Expenditure on GDP at Constant Market Prices, 1983 - 1996 /a
(Rp. billion)

	1983 base										1993 base			
	1983	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994	1995 *	1996**
1. Private consumption	47,063.0	49,448.0	50,530.0	52,200.4	54,225.0	56,475.7	62,053.2	66,584.0	68,484.5	72,476.2	192,958.4	202,037.5	221,701.3	242,107.5
2. Government consumption	8,077.3	8,991.2	9,241.3	9,225.7	9,924.3	10,965.3	11,317.3	12,112.7	12,819.0	12,829.7	29,756.7	30,442.6	30,850.6	32,027.6
3. Gross fixed investment	19,467.9	19,615.8	21,421.7	22,596.8	25,200.9	28,568.1	32,731.5	34,867.2	36,589.3	38,671.2	86,667.3	98,589.0	112,350.3	126,024.2
4. Changes in stock /b	2,793.5	6,641.3	6,332.8	5,049.1	1,119.9	1,417.1	3,302.8	1,990.4	2,314.2	3,403.7	10,545.5	17,063.2	18,312.1	16,493.8
5. Exports of goods and nonfactor services	19,847.0	19,494.7	22,460.3	25,744.8	26,015.5	28,733.2	28,862.8	34,600.0	39,674.8	42,296.8	88,230.9	96,260.1	104,491.4	111,057.9
6. Less: Imports of goods and nonfactor services	19,625.9	19,109.1	19,905.6	20,299.0	16,504.2	18,722.9	23,050.3	26,929.1	28,697.0	29,970.5	78,383.0	89,751.6	103,937.9	113,941.9
Gross Domestic Product	**77,622.8**	**85,081.9**	**90,080.5**	**94,517.8**	**99,981.4**	**107,436.5**	**115,217.3**	**123,225.2**	**131,184.8**	**139,707.1**	**329,775.8**	**354,640.8**	**383,767.8**	**413,769.0**

* : Rivised figures.
** : Preliminary figures.
/a. In 1996, the Government released national accounts series using a 1993 base, based on an up-date of the 1990 Input-Output Table and refined estimates of some sub-sectors.
/b. Residuals.

Source: Central Bureau of Statistics.

Table 2.4

INDONESIA

COUNTRY ECONOMIC REPORT

Balance of Payments, 1983/84 - 1996/97
(US$ million)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97 /c
1. Net oil exports /a	6,016	5,845	4,004	1,426	2,334	1,535	2,311	2,882	2,158	1,327	319	1,372	1,175	1,479
2. Net LNG exports /a	1,355	1,971	2,119	1,158	1,426	1,525	1,600	3,128	2,404	2,188	2,215	2,415	2,298	3,215
3. Non-oil exports (net)	-11,522	-9,784	-7,955	-6,635	-5,466	-4,919	-5,510	-9,751	-8,914	-6,076	-5,474	-7,275	-10,460	-12,809
Exports, fob	5,367	5,907	6,175	6,731	9,502	12,184	14,493	15,380	19,008	24,823	27,170	31,716	37,138	39,591
Imports, cif	-14,346	-12,921	-11,186	-10,385	-11,763	-13,586	-16,478	-21,609	-24,066	-26,390	-25,410	-30,815	-37,597	-41,502
Services (nonfreight)	-2,543	-2,770	-2,944	-2,981	-3,205	-3,517	-3,525	-3,522	-3,856	-4,509	-7,234	-8,176	-10,001	-10,898
4. Current account (1+2+3)	-4,151	-1,968	-1,832	-4,051	-1,706	-1,859	-1,599	-3,741	-4,352	-2,561	-2,940	-3,488	-6,987	-8,115
5. Official capital disbursements	5,793	3,519	3,432	5,472	4,575	6,588	5,516	5,006	5,600	5,755	6,195	5,651	5,730	5,425
IGGI	4,255	3,189	2,751	3,978	4,368	5,603	4,698	4,929	5,292	5,567	5,795	5,651	5,380	5,025
Special assistance	0	0	0	0	0	2,169	1,807	1,542	1,069	886	556	314	205	290
Program aid	84	52	38	48	30	23	6	0	0	0	0	0	0	0
Project aid	4,171	3,137	2,713	3,930	4,338	3,411	2,885	3,387	4,223	4,681	5,239	5,337	5,175	4,735
ODA	1,902	1,442	1,332	1,932	2,807	2,406	2,300	2,766	3,165	3,078	3,697	3,662	3,540	3,223
Non-ODA	2,269	1,695	1,381	1,998	1,531	1,005	585	621	1,058	1,603	1,542	1,675	1,635	1,512
Others	1,538	330	681	1,494	207	985	818	77	308	188	400	0	350	400
6. Amortization	-1,010	-1,292	-1,644	-2,129	-3,049	-3,763	-3,686	-4,082	-4,182	-4,840	-5,132	-5,546	-5,939	-6,163
7. Other capital (net)	1,191	499	572	1,232	1,709	-211	575	5,856	4,133	4,284	4,648	4,645	11,672	11,787
Direct investment	193	245	299	252	544	585	722	1,424	1,531	1,705	1,971	2,566	5,357	6,546
Others	998	254	273	980	1,165	-796	-147	4,432	2,602	2,579	2,677	2,079	6,315	5,241
8. Total (4 through 7)	1,823	758	528	524	1,529	755	806	3,039	1,199	2,638	2,771	1,262	4,476	2,934
9. Errors and omissions	247	-91	-498	-1,262	57	-1,432	-558	263	-218	-1,199	-2,044	-646	-1,825	966
10. Monetary movements /b	-2,070	-667	-30	738	-1,586	677	-248	-3,302	-981	-1,439	-727	-616	-2,651	-3,900

/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.

Table 3.1

Table 3.2

INDONESIA

COUNTRY ECONOMIC REPORT

Selected Non - oil Exports, 1986 - 1996
(US$ million)

	Value (US $ million)										
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
1. Rubber	720	966	1,296	1,013	885	924	1,039	959	1,268	1,986	1,875
2. Coffee	830	550	560	488	372	355	236	333	750	622	593
3. Palm oil & Cernel	103	169	325	296	253	335	465	535	878	973	1,004
4. Rattan	96	147	119	153	275	275	307	333	354	374	318
5. Foodstuff	95	94	180	248	308	382	467	455	603	670	729
6. Shrimps, Lobster, Tuna	284	352	588	558	705	811	802	902	1,056	1,093	1,045
7. Other Animal Products	83	115	169	231	293	354	445	465	557	585	605
8. Tin	139	147	355	291	176	146	148	92	121	240	300
9. Copper	158	154	233	316	400	146	687	646	879	1,551	1,387
10. Nickel	120	131	367	466	319	512	269	304	334	410	361
11. Aluminum	202	219	288	318	216	304	214	165	204	354	319
12. Iron Steel	83	219	372	424	367	172	381	464	454	522	602
13. Plywood	1,004	1,707	2,092	2,325	2,690	356	3,219	4,128	3,650	3,452	3,504
14. Textiles	279	415	597	779	1,084	2,772	2,470	2,311	2,517	2,908	2,626
15. Handicrafts	31	48	156	241	346	1,539	541	663	978	655	502
16. Electrical app.	65	48	81	162	237	379	1,017	1,301	1,774	2,724	3,563
17. Garments	527	614	822	1,248	1,570	2,203	3,212	3,395	3,096	3,324	3,086
18. Pulp and Paper	33	101	147	199	250	312	401	483	782	1,504	1,353
Others	2,261	2,991	3,844	5,612	5,832	8,292	10,916	12,025	13,493	17,093	16,958
Total Non-oil Exports	6,552	8,472	11,621	13,919	14,758	18,054	23,624	26,080	29,870	36,210	36,292

Source: Bank Indonesia

INDONESIA

COUNTRY ECONOMIC REPORT

Value of Exports by Principal Country of Destination, 1985-1996
(US$ million)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996 /a
Asean	1,983	1,514	1,704	2,079	2,429	2,516	3,197	4,361	4,746	5,704	6,070	5,962
Malaysia	77	82	94	184	220	253	342	488	586	738	987	920
Thailand	81	83	87	151	234	189	267	353	468	401	703	675
Philippines	199	108	71	87	149	161	168	181	285	365	590	560
Singapore	1,626	1,239	1,449	1,653	1,818	1,902	2,410	3,314	3,372	4,150	3,767	3,786
Brunei	0	2	3	4	8	11	10	25	35	50	24	20
Hongkong	348	345	420	554	549	618	703	881	901	1,321	1,657	1,342
Japan	8,594	6,644	7,393	8,018	9,321	10,923	10,767	10,761	11,172	10,929	12,288	10,564
Other Asia	1,475	1,171	1,869	2,415	2,934	4,035	5,540	6,567	6,980	7,645	9,069	7,914
Africa	160	179	150	272	217	199	394	419	463	638	621	526
USA	4,040	2,902	3,349	3,074	3,497	3,365	3,509	4,419	5,230	5,829	6,322	5,573
Canada	46	60	94	101	108	139	172	289	304	322	359	302
Other America	326	182	48	47	50	102	184	328	469	562	759	640
Australia	149	159	310	293	387	403	628	746	774	705	915	974
Other Oceania	81	83	43	31	59	84	39	53	78	67	156	67
EEC	1,114	1,341	1,540	2,152	2,340	3,029	3,743	4,844	5,296	5,824	6,615	6,137
United Kingdom	191	197	212	349	384	517	654	844	1,005	1,038	1,129	985
Netherlands	392	453	493	646	681	723	838	1,100	1,086	1,324	1,452	1,373
West Germany	255	334	361	456	493	750	907	978	1,178	1,263	1,382	1,248
Belgium & Luxemburg	45	91	109	177	173	210	258	401	366	409	539	543
France	71	93	102	164	209	286	386	495	500	426	520	457
Denmark	3	6	13	20	36	54	74	97	98	110	111	98
Ireland	2	2	7	17	22	35	43	46	40	37	37	29
Italy	152	152	175	221	234	276	382	583	615	661	784	619
Greece	3	6	3	2	4	9	18	29	46	63	79	71
Portugal	0	7	10	22	24	17	14	16	29	39	49	39
Spain	0	0	55	78	80	152	169	255	333	454	535	676
Soviet Union	78	52	82	38	100	81	40	70	125	91	134	117
Others in Europe	194	174	133	144	171	183	229	231	288	417	452	559
Total	18,588	14,806	17,135	19,218	22,162	25,677	29,145	33,969	36,826	40,054	45,418	40,676

/a As of October 1996

Source: Central Bureau of Statistics

Table 3.3

INDONESIA

COUNTRY ECONOMIC REPORT

Value of Imports by Principal Country of Origin, 1985-1996
(US$ million)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996 /a
Asean	962	1,120	1,243	1,305	1,766	2,430	2,465	2,593	2,603	2,928	3,953	3,956
Malaysia	52	50	139	276	369	326	407	525	517	579	767	667
Thailand	48	72	75	96	210	183	278	345	235	407	737	982
Philippines	23	28	82	36	63	649	81	52	57	65	81	80
Singapore	839	969	947	896	1,122	1,272	1,699	1,670	1,793	1,877	2,368	2,227
Brunei	0.0	1.0	0.0	1.0	2.0	0.0	0.0	1.0	1.0	0.0	0.5	0.5
Hongkong	53	94	104	133	179	273	232	229	247	241	275	220
Japan	2,644	3,128	3,596	3,386	3,767	5,300	6,327	6,014	6,248	7,734	9,217	7,016
Other Asia	1,727	1,681	1,924	2,266	3,203	4,633	5,156	5,496	5,972	6,870	8,376	7,273
Africa	160	103	153	201	202	170	195	213	140	332	608	496
USA	1,721	1,483	1,415	1,736	2,218	2,520	3,397	3,822	3,255	3,594	4,756	4,210
Canada	198	214	303	274	311	407	354	459	410	497	811	659
Other America	191	174	211	224	455	519	597	488	625	755	1,088	916
Australia	461	413	463	578	925	1,186	1,378	1,413	1,399	1,542	2,016	2,085
Other Oceania	69	71	80	96	98	115	118	136	161	186	206	205
EEC	1,705	1,796	2,354	2,511	2,572	4,060	4,705	5,400	5,651	5,827	7,253	6,475
United Kingdom	300	342	325	340	360	440	603	719	782	710	902	953
Netherlands	215	189	316	258	248	550	505	507	626	564	842	413
West Germany	677	719	836	887	920	1,502	2,061	2,141	2,072	2,473	2,819	2,405
Belgium & Luxemburg	101	89	142	159	167	232	254	324	340	292	401	332
France	284	281	392	465	406	643	544	816	853	786	1,064	820.7
Denmark	18	26	26	22	31	61	49	124	158	106	105	150.7
Ireland	9	4	6	6	8	74	13	23	21	22	41	34.8
Italy	101	144	237	248	348	410	536	558	523	670	791	998.9
Greece	0	0	2	3		6	5	8	12	26	61	59.6
Portugal	0	2	6	3	2	6	4	2	2	4	8	4.4
Spain	0	0	66	120	82	136	131	178	262	174	219	303
Soviet Union	3	5	16	45	51	53	48	47	97	220	438	314
Others in Europe	365	435	510	494	611	764	899	969	1,517	1,264	1,631	1,627
Total	10,259	10,717	12,372	13,249	16,358	22,430	25,871	27,279	28,325	31,990	40,628	35,450

/a As of October 1996

Source: Central Bureau of Statistics

Table 3.4

INDONESIA

COUNTRY ECONOMIC REPORT

Summary of Public and Publicly Guaranteed External Debt, 1983-1995
(US$ million)

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Disbursed and outstanding debt (DOD) /b	21,493	22,269	26,778	32,626	40,853	41,200	44,255	48,066	52,122	53,958	57,461	63,848	65,347
Bilateral/multilateral	11,750	12,142	14,979	18,473	24,655	26,385	28,133	33,031	37,602	39,994	44,203	49,735	51,231
Other /c	9,743	10,127	11,799	14,153	16,198	14,816	16,121	15,035	14,520	13,965	13,258	14,113	14,116
Commitments	5,687	4,816	4,584	4,104	5,995	6,220	7,632	6,652	8,855	8,035	8,200	7,234	11,147
Bilateral/multilateral	2,294	2,745	2,433	1,923	4,793	4,752	5,655	5,261	6,328	5,159	4,777	5,203	7,417
Other /c	3,393	2,072	2,151	2,182	1,202	1,468	1,977	1,391	2,527	2,876	3,423	2,031	3,730
Gross disbursements	4,980	3,890	3,573	4,239	5,440	6,502	7,044	5,069	7,101	7,966	7,072	7,493	6,765
Bilateral/multilateral	1,734	1,932	1,625	1,900	3,655	4,196	4,276	3,972	5,105	5,013	4,484	4,759	4,239
Other /c	3,246	1,958	1,948	2,338	1,785	2,307	2,768	1,097	1,997	2,954	2,588	2,733	..
Net disbursements	3,688	2,290	1,229	1,617	2,033	2,080	2,228	519	2,452	2,734	1,225	1,580	1,048
Bilateral/multilateral	1,183	1,366	1,003	1,017	2,523	2,892	2,936	2,387	3,328	3,022	2,339	1,467	1,101
Other /c	2,506	924	225	601	-490	-812	-708	-1,868	-876	-288	-1,114	112	..
Net resource transfers	2,455	661	-416	-455	-239	-445	-549	-2,302	-468	-332	-2,030	-1,826	-2,725
Bilateral/multilateral	735	804	310	96	1,449	1,592	1,550	799	1,545	1,007	89	-1,006	-1,567
Other /c	1,721	-143	-727	-550	-1,688	-2,037	-2,099	-3,101	-2,013	-1,339	-2,119	-821	..
Public debt service	2,524	3,229	3,989	4,693	5,679	6,947	7,592	7,371	7,569	8,298	9,102	9,319	9,491
Amortization	1,291	1,600	2,344	2,621	3,408	4,422	4,816	4,550	4,649	5,232	5,847	5,913	5,717
Interest	1,233	1,629	1,645	2,072	2,272	2,525	2,776	2,820	2,920	3,066	3,255	3,406	..
Public debt service	2,524	3,229	3,989	4,693	5,679	6,947	7,592	7,371	7,569	8,298	9,102	9,319	9,491
Bilateral/multilateral	999	1,127	1,314	1,804	2,206	2,603	2,726	3,173	3,560	4,006	4,395	5,765	5,806
Other /c	1,525	2,102	2,675	2,889	3,473	4,344	4,867	4,198	4,009	4,293	4,707	3,554	..

/a Data in this sector refer to public 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.

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

Table 4.1

Table 4.2
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INDONESIA

COUNTRY ECONOMIC REPORT

External Public Debt Outstanding as of December 31, 1995
(US$ '000)

Type of creditor/ creditor country	Debt outstanding Disbursed	Undisbursed	Total	Major reported new commitments Jan 1-Dec 31 1995
Bilateral Loans				
Australia	675,804	262,650	938,454	174,512
Austria	6,384	-	6,384	0
Belgium	103,132	38,410	141,542	2,904
Brunei	96,040	-	96,040	0
Bulgaria	456	-	456	0
Canada	419,522	163,287	582,809	31,162
China	40,183	9,489	49,672	7,122
Czechoslovakia	15,204	-	15,204	0
Denmark	61,315	581	61,896	0
Egypt, Arab Republic of	637	-	637	0
Finland	-	3,618	3,618	3,618
France	1,087,292	163,390	1,250,682	0
German Dem. Rep.	12,504	-	12,504	0
Germany, Fed.Rep.of	3,474,913	1,742,526	5,217,439	1,057,162
Hungary	3,793	-	3,793	0
India	201	-	201	0
Italy	189,808	1,612	191,420	143
Japan	20,762,791	6,660,209	27,423,000	2,801,749
Korea, Republic of	57,467	62,428	119,895	27,219
Kuwait	46,375	8,219	54,594	0
Netherlands	1,067,333	13,561	1,080,894	0
New Zealand	461	-	461	0
Norway	1,355	25,999	27,354	0
Other	19,444	10,000	29,444	10,000
Pakistan	1,548	-	1,548	0
Poland	21,356	-	21,356	0
Romania	3,059	-	3,059	0
Saudi Arabia	57,917	23,222	81,139	0
Singapore	-	500,000	500,000	
Spain	214,157	82,058	296,215	17,600
Switzerland	36,353	-	36,353	0
United Arab Emirates	-	-	0	0
United Kingdom	46,106	14,840	60,946	0
United States	2,449,244	355,784	2,805,028	227,671
USSR	222,831	-	222,831	0
Yugoslavia	25,597	-	25,597	0
Total bilateral loans	31,220,582	10,141,883	41,362,465	4,360,862
Export Credits				
Austria	861,863	406,076	1,267,939	201,526
Belgium	207,830	103,605	311,435	1,955
Denmark	87,228	531	87,759	0
Finland	28,068	348	28,416	0
France	1,375,010	382,589	1,757,599	60,523
Germany, Fed.Rep.of	73,962	-	73,962	1,797
Japan	56,834	23,908	80,742	26,855
Netherlands	242,631	274,194	516,825	221,779
Norway	-	57,946	57,946	57,850
Singapore	-	2,000	2,000	2,000
Spain	40,000	70,600	110,600	10,600
Sweden	81,247	-	81,247	0
Switzerland	388,505	310,695	699,200	0
United Kingdom	1,004,838	648,705	1,653,543	233,355
United States	469,142	73,838	542,980	0
Total export credits	4,917,158	2,355,035	7,272,193	818,240
Total external public debt	65,347,095	24,868,750	90,231,672	10,646,611

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

INDONESIA

COUNTRY ECONOMIC REPORT

Service Payments, Commitments, Disbursements and Outstanding Amounts of External Public Debt, 1980 - 2009
(US$ '000)

	Debt outstanding at end of period		Transactions during period					Other Changes	
	Disbursed only	Including Undisbursed	Commit-ments	Disburse-ments	Service Payments: Principal	Service Payments: Interest	Service Payments: Total	Cancel-lations	Adjust-ment /a
Actual									
1980	20,937,697	30,420,359	4,277,373	3,245,505	1,632,494	1,451,811	3,084,305	128,422	1,343,066
1981	22,761,139	33,805,826	4,957,117	3,845,429	1,784,995	1,707,127	3,492,122	118,261	376,631
1982	25,133,280	38,847,056	7,067,267	4,410,336	1,942,084	1,914,070	3,856,154	163,286	-78,480
1983	30,229,384	44,069,191	5,686,879	6,392,696	1,798,027	1,943,231	3,741,258	5,472	1,530,951
1984	32,025,604	46,152,969	4,816,038	4,840,324	2,270,173	2,575,904	4,846,077	197,669	-435,379
1985	36,715,241	52,664,318	4,583,947	4,170,204	3,421,579	2,401,135	5,822,714	26,707	5,863,797
1986	42,916,411	60,291,399	4,104,406	4,829,475	3,285,238	2,698,512	5,983,750	514,815	6,992,912
1987	52,494,917	71,957,065	5,994,820	7,489,770	4,057,399	2,945,073	7,002,472	18,499	10,363,663
1988	54,078,473	72,944,387	6,087,327	8,179,570	5,296,940	3,345,242	8,642,182	635,419	708,145
1989	59,401,728	77,914,712	7,512,623	9,008,916	5,993,871	3,839,209	9,833,080	307,264	3,758,836
1990	69,871,544	90,040,670	6,691,047	10,024,228	5,968,648	3,977,615	9,946,263	891,611	12,295,169
1991	79,517,725	99,921,005	8,811,206	11,757,797	6,857,802	4,617,488	11,475,290	2,102,942	10,029,874
1992	88,003,749	107,048,794	7,878,659	13,557,635	7,943,980	4,512,766	12,456,746	1,253,333	8,446,465
1993	84,147,604	109,534,010	8,135,208	8,064,247	9,143,545	4,951,472	14,095,017	408,651	3,902,204
1994	96,543,371	117,681,649	7,807,537	12,537,515	8,955,376	5,316,329	14,271,705	402,882	9,698,360
1995	107,831,414	132,715,990	11,146,612	13,728,365	10,199,312	6,219,486	16,418,798	571,506	14,654,262
Projected									
1996	102,801,343	118,534,437	-	8,084,915	13,114,986	5,123,397	18,238,383	1,066,566	-
1997	98,604,720	108,139,421	-	6,198,394	10,395,017	4,848,157	15,243,174	-	-
1998	92,258,825	97,854,850	-	3,938,678	10,284,573	4,495,739	14,780,312	-	3
1999	85,875,882	89,003,355	-	2,468,555	8,851,497	3,913,139	12,764,636	-	2
2000	79,190,974	80,861,357	-	1,457,110	8,142,018	3,486,292	11,628,310	-	19
2001	73,266,229	74,125,553	-	811,139	6,735,884	2,849,232	9,585,116	-	80
2002	68,119,732	68,501,247	-	477,975	5,624,472	2,339,866	7,964,338	-	167
2003	63,290,873	63,497,539	-	174,850	5,003,709	2,030,347	7,034,056	-	-
2004	58,804,214	58,931,857	-	5,422	4,565,688	1,765,724	6,331,412	-	-6
2005	54,049,682	54,171,901	-	-	4,759,955	1,529,856	6,289,811	-	0
2006	50,189,487	50,311,698	-	-	3,860,195	1,247,038	5,107,233	-	-7
2007	46,822,702	46,944,891	-	-	3,366,786	1,062,487	4,429,273	-	-21
2008	43,806,072	43,928,243	-	-	3,016,625	903,967	3,920,592	-	-22
2009	41,047,621	41,169,790	-	-	2,758,451	765,692	3,524,143	-	-1

/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 imbalance 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.

Table 5.1

INDONESIA

COUNTRY ECONOMIC REPORT

Central Government Budget Summary, 1984/85-1997/98
(Rp. billion)

	Actual												Budget	
	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
1. Domestic revenues	15,931	20,939	17,385	21,731	23.414	31,504	42,193	42,582	48,863	56,113	61,370	66,265	78,203	78,203
2. Routine expenditures /a	9,406	12,006	13,717	17,341	20,935	24,335	29,121	29,050	33.605	40,290	43,180	47,241	56,114	56,114
3. Government saving (1-2)	6,525	8,933	3,669	4,390	2,479	7,169	13,072	13,532	15,257	15,823	18,190	19,025	22,089	22,089
4. Development expenditures	8,375	11,740	9,091	9.770	12,317	15.394	18,251	23,075	26.906	28,428	29.163	30,784	34,503	34,504
5. Balance (3-4)	-1,849	-2,807	-5,423	-5,380	-9,838	-8,225	-5,179	-9,542	-11,649	-12,605	-10,973	-11,759	-12,414	-12,415
Financed by:														
6. Program aid	69	69	1,791	685	2,666	966	1,347	1,386	517	0	0	0	0	0
7. Project aid	1,711	2,760	3,722	4,871	7,458	7,365	7,035	8,590	10,581	10,753	10.983	11,759	12,414	12,414
8. Change in balances (- = increase)	69	-22	-90	-176	-286	-105	-3,203	-433	551	1,852	-10	0	0	1

/a Includes debt service payments.

Source: Ministry of Finance.

INDONESIA

COUNTRY ECONOMIC REPORT

Central Government Receipts, 1984/85 - 1997/98
(Rp. billion)

	Actual												Budget	
	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Taxes on income	12,850	15,461	9,832	13,460	14,586	19,932	26,992	26,040	29,206	29,030	33,684	34,757	40,675	47,126
Income tax	2,042	2,071	2,603	2,876	4,432	5,755	8,250	9,727	12,516	14,759	18,350	19,239	23,708	29,118
Corporate tax on oil /a	10,430	12,925	6,687	10,083	9,536	13,381	17,740	15,070	15,331	12,503	13,399	13,276	14,120	14,871
IPEDA/property tax /b	213	165	239	212	362	604	786	944	1,107	1,485	1,632	1,923	2,277	2,505
Others /c	165	301	303	289	256	191	217	299	252	283	303	319	570	633
Taxes on domestic consumption	1,746	3,071	3,988	4,932	5,778	7,468	9,919	11,061	12,984	16,569	17,088	19,954	25,821	29,038
Sales/value added tax	874	2,191	2,986	3,826	4,367	5,986	8,119	9,146	10,742	13,944	14,087	16,655	21,788	24,601
Excises	873	880	1,003	1,105	1,410	1,482	1,800	1,915	2,242	2,626	3,001	3,299	4,033	4,436
Taxes on international trade	627	723	1,350	1,622	1,517	2,066	2,840	2,888	3,232	3,569	3,338	3,588	3,611	3,422
Import duties	541	674	1,269	1,442	1,376	1,892	2,800	2,871	3,223	3,555	3,218	3,543	3,451	3,322
Export tax	86	48	80	180	141	173	40	17	9	14	120	44	160	100
Nontax receipts	708	1,685	2,216	1,717	1,533	2,039	2,442	2,593	3,440	6,945	7,260	7,966	7,268	8,226
Domestic revenue	15,930	20,939	17,385	21,731	23,414	31,504	42,193	42,582	48,863	56,113	61,370	66,265	77,375	87,812
Development funds	1,781	2,830	5,513	5,556	10,124	8,330	8,382	9,975	11,098	11,193	10,983	11,759	12,414	13,026
Program aid	69	69	1,791	685	2,666	966	1,347	1,386	517	441	0	0	0	0
Project aid /d	1,711	2,760	3,722	4,871	7,458	7,365	7,035	8,590	10,581	10,753	10,983	11,759	12,414	13,026
Total revenues	17,711	23,769	22,898	27,286	33,538	39,835	50,575	52,557	59,961	67,306	72,353	78,024	89,789	100,838

/a Since 1984/85, witholding tax eliminated as separate category and combined with income tax.
/b Since January 1986, Ipeda replaced by land and building tax.
/c Classification changed to other tax (included in miscellaneous levies which consist of other taxes and stamp duty).
/d Includes commercial bank and suppliers' credits for development projects.

Source: Ministry of Finance.

Table 5.2

INDONESIA

COUNTRY ECONOMIC REPORT

Central Government Expenditures, 1984/85 - 1997/98
(Rp. billion)

	Actual												Budget	
	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
Personnel expenditures	3,141	3,930	4,438	4,545	5,489	6,206	7,088	8,166	9,554	11,145	13,069	15,347	18,281	18,281
Wages and salaries	2,259	3,005	3,459	3,499	4,209	4,829	5,598	6,352	7,595	9,145	10,490	12,416	14,763	14,763
Rice allowance	416	393	415	447	569	589	643	930	891	834	1,038	1,140	1,194	1,194
Food allowance	287	294	288	296	359	373	384	393	479	493	801	835	1,122	1,122
Other	100	158	177	177	203	243	265	281	315	418	396	511	710	710
External	79	80	100	127	149	172	199	211	274	255	344	445	492	492
Material expenditures	1,165	1,351	1,311	1,296	1,227	1,704	1,842	2,328	2,929	3,032	4,297	4,745	6,589	6,589
Transfers to regions	1,787	2,496	2,769	2,811	3,011	3,577	3,888	4,376	5,384	6,909	7,188	8,409	10,012	10,012
Debt service payments	2,776	3,323	5,058	8,157	11,040	11,924	12,816	12,838	14,524	17,163	18,422	18,215	20,227	20,227
Internal	30	20	0	0	78	149	239	240	275	121	204	319	291	291
External	2,746	3,303	5,058	8,157	10,962	11,776	12,577	12,598	14,249	17,042	18,218	17,896	19,936	19,936
Oil subsidy	508	450	0	402	82	707	3,306	930	692	1,280	0	0	0	0
Others	30	457	140	129	86	217	182	411	524	761	204	524	1,005	1,005
Routine expenditures	9,406	12,006	13,717	17,341	20,935	24,335	29,121	29,050	33,605	40,290	43,180	47,241	55,109	55,109
Development expenditures /a	8,375	11,740	9,091	9,770	12,317	15,394	18,251	23,075	26,906	28,428	29,163	30,784	56,114	56,114
Total expenditures	17,781	23,747	22,808	27,111	33,252	39,729	47,372	52,124	60,512	68,718	72,343	78,024	111,222	111,222

/a For details see Tables 5.4.

Source: Ministry of Finance.

Table 5.3

Table 5.4

INDONESIA

COUNTRY ECONOMIC REPORT

Development Expenditures, 1984/85 - 1997/98 /a
(Rp. billion)

	Actual												Budget	
	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98
1. Departments /a	2,680	4,861	2,660	3,151	2,365	3,154	5,134	7,484	10,033	10,916	9,478	10,910	12,722	14,915
2. General INPRES programs	540	563	567	656	801	721	1,062	1,414	1,829	2,049	4,304	4,228	5,268	6,095
Subsidies to provinces	253	280	293	281	325	319	482	582	700	741	1,318	1,277 /b	1,424	1,662
Subsidies to Regencies	195	185	188	262	361	270	400	583	802	916	2,554	2,525 /c	2,905	3,484
Subsidies to villages	93	99	86	113	116	132	181	249	326	392	432	426	939	949
3. Sectoral INPRES programs	824	746	760	812	526	530	981	1,840	2,224	2,134	949	868	1,121	1,536
Primary schools	565	572	536	498	241	130	100	515	645	595	538	499 /d	595	928
Health	71	94	109	93	90	101	174	267	316	340	412	370	526	608
Markets /e	26	5	11	3	4	8	13	5	2	3	0	0	0	0
Replanting/reforestration /f	61	4	30	34	16	16	33	74	96	111	0	0	0	0
Roads /g	101	71	74	184	175	274	661	979	1,165	1,084	0	0	0	0
4 PBB	166	117	215	169	327	543	688	859	983	1,334	1,485	1,750	2,072	2,280
5. Irian Jaya and East Timor	3	24	7	5	6	0	0	0	0	0	0	0	0	0
Total (2-5) : Transfer to local governments	1,534	1,449	1,550	1,642	1,660	1,794	2,730	4,113	5,036	5,516	6,738	6,847	8,461	9,910
6. Fertilizer subsidy	732	917	467	763	200	1,150	265	300	175	175	457	143	137	137
7. Government capital participation (PMP)	208	762	232	25	177	888	644	988	138	381	205	50	55	177
8. Others	1,502	1,027	498	293	572	1,075	2,173	1,600	943	689	905	601	714	763
Total (1 - 8)	6,655	9,016	5,407	5,874	4,974	8,060	10,946	14,485	16,325	17,676	17,783	18,551	22,089	25,902
9. Project aid	1,781	2,830	5,513	5,556	10,124	8,330	8,382	9,975	11,098	10,753	10,983	11,759	12,414	13,026
Total (1 - 9)	8,436	11,845	10,920	11,429	15,098	16,390	19,328	24,460	27,423	28,428	28,766	30,310	34,503	38,928
10. Residual ballance /h (- = increases)	-61	-105	-1,829	-1,659	-2,781	-996	-1,077	-1,386	-517	0	397	474	0	-4,424

/a Included Defence Agency
/b Included subsidies for operational fund and irrigation maintanance (provinces).
/c Included subsidies for Planning, Development Control and Rehabilitation of Community Health Centre
/d Excluded subsidies for preliminary school reconstruction (accomodated to subsidies to regencies).
/e Since 1994/1995 subsidies for market is accomodated to subsidies to Regencies
/f Since 1994/1995 subsidies for replanting is accomodated to subsidies to regencies. and for Reboisation accomodated to subsidies to Villages
/g Since 1994/1995 Road subsidies are accomodated to Province and Regency subsidies
/h Difference between total development expenditure in this table and total indicated in Central table 5.1

Source: Ministry of Finance

Table 6.1

INDONESIA

COUNTRY ECONOMIC REPORT

Money Supply (M1), 1983 - 1996
(Rp. billion)

End of Period	Total	Currency		Demand deposits		Change over period	
		Amount	(%)	Amount	(%)	Amount	(%)
1983	7,569	3,333	44	4,236	56	448	6.3
1984	8,581	3,712	43	4,869	57	1,012	13.4
1985	10,104	4,440	44	5,664	56	1,523	17.7
1986	11,677	5,338	46	6,339	54	1,573	15.6
1987	12,685	5,782	46	6,903	54	1,008	8.6
1988	14,392	6,246	43	8,146	57	1,707	13.5
1989	20,114	7,426	37	12,688	63	5,722	39.8
1990	23,819	9,094	38	14,725	62	3,705	18.4
1991	26,342	9,346	35	16,996	65	2,523	10.6
1992	28,779	11,478	40	17,301	60	2,437	9.3
1993	36,805	14,431	39	22,374	61	8,026	27.9
1994	45,374	18,634	41	26,740	59	8,569	23.3
1995	52,677	20,807	39	31,870	61	7,303	16.1
1996	64,089	22,487	35	41,602	65	11,412	21.7

Source: Bank Indonesia.

Table 6.2

INDONESIA

COUNTRY ECONOMIC REPORT

Changes in Factors Affecting Money Supply, 1983-1996
(Rp. billion)

End of period	Net foreign assets	Public Sector: Net claims on Central Government	Public Sector: Claims on official entities & public enterprises	Claims on business & individuals	Net other items	Total change in Broad Money Supply (M2): Amount	Total change in Broad Money Supply (M2): Percentage (%)
1983 /a	1,180	-1,286	-42	2,183	1,553	3,588	32.4
1984	3,531	-3,359	190	3,646	-734	3,274	22.3
1985	1,750	-214	511	3,333	-165	5,216	29.1
1986 /b	1,870	469	252	4,547	-2,630	4,508	19.5
1987	2,444	1,538	728	6,245	-4,732	6,224	22.5
1988	-549	247	659	11,069	-3,313	8,113	23.9
1989	409	-1,175	1,444	22,131	-6,104	16,707	39.8
1990	-2,171	-3,877	-921	35,809	-2,914	25,925	44.2
1991	7,430	-1,356	105	20,263	-12,013	14,429	17.0
1992	7,013	-1,292	492	15,257	-1,475	19,995	20.2
1993	-934	731	1,505	30,230	-5,383	26,149	22.0
1994	-4,428	-4,686	-485	37,845	1,064	29,310	20.1
1995	7,354	-7,472	1,305	47,504	-565	48,126	27.6
1996	18,015	-2,757	4,626	51,768	-5,658	65,994	29.6

/a 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.

/b Includes revaluation adjustment due to devaluation on September 12, 1986.

Source: Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Consolidated Balance Sheet of the Monetary System, 1983-1996
(Rp. billion)

End of period	1983 /a	1984	1985	1986 /b	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Net foreign assets	8,837	12,368	14,119	15,989	18,433	17,884	18,293	16,122	23,621	30,634	29,700	25,272	32,627	50,641
Domestic credit	9,744	10,345	14,325	19,323	26,729	39,802	62,131	93,118	110,285	126,612	158,934	191,629	233,088	286,725
Claims on public sector														
Central government	-5,739	-9,098	-9,319	-8,798	-8,366	-7,036	-8,309	-12,202	-13,581	-14,873	-14,142	-18,828	-26,300	-29,057
Claims on official entities and public enterprises	5,040	5,230	6,034	5,993	6,725	7,381	8,825	7,904	8,008	8,501	8,277	8,025	10,955	15,581
Government-blocked account	-240.0	-116.0	-52.0	-81.0	-84.0	-66.0	-40.0	-24.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on private enterprises and individuals	10,683	14,329	17,662	22,209	28,454	39,523	61,655	97,440	115,858	132,984	164,799	202,432	248,433	300,201
Assets = liabilities	18,581	22,713	28,444	35,312	45,162	57,686	80,424	109,240	133,906	157,246	188,634	216,901	265,715	337,366
Import deposits	242	218	268	402	424	684	632	1,048	966	890	1,699	1,540	1,779	2,099
Net other items	3,676	4,558	5,291	7,651	11,277	15,688	21,087	23,562	33,881	37,303	41,733	40,849	41,298	46,635
Money and quasi money	14,663	17,937	23,153	27,661	33,885	41,998	58,705	84,630	99,059	119,053	145,202	174,512	222,638	288,632
Money	7,569	8,581	10,104	11,677	12,685	14,392	20,114	23,819	26,341	28,779	36,805	45,374	52,677	64,089
Currency	3,333	3,712	4,440	5,338	5,782	6,246	7,426	9,094	9,346	11,478	14,431	18,634	20,807	22,487
Demand deposits	4,236	4,869	5,664	6,339	6,903	8,146	12,688	14,725	16,995	17,301	22,374	26,740	31,870	41,602
Quasi money	7,094	9,356	13,049	15,984	21,200	27,606	38,591	60,811	72,718	90,274	108,397	129,138	169,961	224,543

/a Includes changes resulting from the exchange rate adjustment of March 30, 1983 from Rp. 702.50 to Rp. 970 per US$.
/b Includes changes resulting from the exchange rate adjustment on September 12, 1986 from Rp 1,134 to Rp 1,644 per US$.

Source: Bank Indonesia.

Table 6.3

INDONESIA

COUNTRY ECONOMIC REPORT

Banking System Credits by Economic Sector, 1983-1996 /a
(Rp. billion)

Sectors	1983 /f	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993 /h	1994	1995	1996
Agriculture	1,226	1,318	1,656	2,097	2,657	3,648	5,350	5,350	8,465	10,281	12,057	13,860	15,525	17,630
In rupiah	1,226	1,318	1,656	2,097	2,631	3,610	5,281	5,281	7,979	9,173	10,368	12,026	13,661	15,158
In foreign exchange	0	0	0	0	26	38	69	69	486	1,108	1,689	1,834	1,864	2,472
Mining /b	806	384	258	394	381	144	591	591	743	762	777	799	913	1,693
In rupiah	806	384	258	394	371	124	456	456	614	605	416	359	434	716
In foreign exchange	0	0	0	0	10	20	135	135	129	157	361	440	479	977
Manufacturing industry /c	5,207	6,667	7,592	9,005	10,912	14,956	20,333	20,333	33,131	37,458	51,432	60,211	72,088	78,850
In rupiah	4,595	6,205	7,069	8,839	10,503	13,994	17,654	17,654	24,828	26,197	36,334	42,236	48,476	51,984
In foreign exchange	612	462	523	166	409	962	2,679	2,679	8,303	11,261	15,098	17,975	23,612	26,866
Trade /d	5,132	6,344	7,255	8,399	10,247	13,888	20,109	20,109	33,049	32,944	37,794	44,372	54,224	70,586
In rupiah	4,781	6,299	7,214	8,329	10,065	13,682	19,342	19,342	28,842	28,100	31,470	36,840	43,608	55,763
In foreign exchange	351	45	41	70	182	206	767	767	4,207	4,844	6,324	7,532	10,616	14,823
Service rendering industry /e	2,277	3,169	4,183	4,345	5,460	7,382	10,424	10,424	20,066	25,899	35,824	50,806	66,584	91,655
In rupiah	2,253	3,088	4,047	4,130	5,151	6,917	9,600	9,600	16,683	21,979	30,167	42,453	57,432	78,392
In foreign exchange	24	81	136	215	309	465	824	824	3,383	3,920	5,657	8,353	9,152	13,263
Others	651	931	1,213	2,162	3,187	3,721	1,866	1,866	17,371	15,574	12,387	18,832	25,277	32,507
In rupiah	651	929	1,210	2,156	3,143	3,667	1,709	1,709	16,326	14,653	12,374	18,824	25,265	32,478
In foreign exchange	0	2	3	6	44	54	157	157	1,045	921	13	8	12	29
Total	15,299	18,813	22,157	26,402	32,844	43,739	58,673	58,673	112,825	122,918	150,271	188,880	234,611	292,921
In rupiah	14,312	18,223	21,454	25,945	31,864	41,994	54,042	54,042	95,272	100,707	121,129	152,738	188,876	234,491
In foreign exchange	987	590	703	457	980	1,745	4,631	4,631	17,553	22,211	29,142	36,142	45,735	58,430

/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 credits to PERTAMINA for repayment of foreign borrowing. Since March 1979, credit in foreign exchange to PERTAMINA has been converted to rupiah credits.
/c 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.
/d Includes credits for food procurement and hotel projects.
/e Credits for electricity, gas and water supply are included in service-rendering industry sector.
/f Includes foreign exchange revaluation amounting to Rp. 251 billion.
/g Includes revaluation adjustment due to the devaluation of September 12, 1986.

Source: Bank Indonesia.

Table 6.4

INDONESIA

COUNTRY ECONOMIC REPORT

Banking Credits Outstanding in Rupiah and Foreign Exchange by Group of Banks, 1984 - 1996 /a
(Rp. billion)

	1984	1985	1986 /b	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Bank Indonesia direct credits /c	870	964	1,144	1,347	1,547	696	718	783	771	158	130	71	26
In rupiah	870	964	1,144	1,347	1,547	696	718	783	771	158	130	71	26
In foreign exchange	0	0	0	0	0	0	0	0	0	0	0	0	0
State commercial banks /d	13,345	15,374	17,782	21,676	28,631	39,579	55,826	59,861	68,236	71,760	80,010	93,480	108,925
In rupiah	12,959	14,925	17,711	21,225	27,614	37,151	50,648	52,628	58,133	59,738	68,085	79,394	93,051
In foreign exchange	386	449	71	451	1,017	2,428	5,178	7,233	10,103	11,805	11,925	14,086	15,874
National Private Banks /e	3,552	4,746	6,272	8,423	11,910	20,216	34,975	44,452	45,352	63,995	90,504	116,886	156,412
In rupiah	3,480	4,631	6,061	8,175	11,536	18,955	31,458	39,467	39,685	55,076	76,506	99,466	130,194
In foreign exchange	72	115	211	248	374	1,261	3,517	4,985	5,667	8,919	13,998	17,420	26,218
Foreign Banks	1,046	1,073	1,204	1,406	1,913	3,115	6,177	8,512	9,330	14,733	18,366	24,245	27,584
In rupiah	914	934	1,029	1,122	1,559	2,173	3,039	3,177	2,889	6,315	8,147	10,016	11,245
In foreign exchange	132	139	175	284	354	942	3,138	5,335	6,441	8,418	10,219	14,229	16,339
Total	18,813	22,157	26,402	32,852	44,001	63,606	97,696	113,608	123,689	150,429	189,010	234,682	292,921
In rupiah	18,223	21,454	25,945	31,869	42,256	58,975	85,863	96,055	101,478	121,287	152,868	188,947	234,490
In foreign exchange	590	703	457	983	1,745	4,631	11,833	17,553	22,211	29,142	36,142	45,735	58,431

/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 revaluation adjustment due to devaluation on September 12, 1986.
/c Excludes liquidity credits, includes credits to Pertamina for repayment for foreign borrowing.
/d Includes state development bank and liquidity credits.
/e Includes liquidity credits. National private banks refer to national private commercial banks and regional development banks.

Source : Bank Indonesia.

Table 6.5

INDONESIA

COUNTRY ECONOMIC REPORT

Investment Credits by Economic Sector, 1984-1996 /a
(Rp. billion)

End of period	1984	1985	1986	1987	1988	1989	1990	1991 /c	1992	1993 /d	1994	1995	1996
Credits outstanding /b	3,802	5,471	6,486	7,635	10,422	14,292	19,961	25,748	35,994	42,713	47,136	59,274	71,419
Agriculture	555	948	1,292	1,690	2,284	3,357	4,361	5,450	7,050	8,730	9,865	10,564	11,737
Mining	178	224	367	342	372	358	372	459	459	310	196	256	405
Manufacturing industry	2,102	2,781	3,098	3,567	4,817	6,424	8,866	10,484	15,416	17,371	19,516	23,159	24,248
Trade	168	396	443	435	632	1,022	1,859	3,372	4,099	7,192	6,154	8,468	11,891
Service rendering industry	770	1,098	1,215	1,560	2,249	3,010	4,060	5,032	7,896	9,110	11,405	16,827	22,162
Others	29	24	71	41	68	121	443	951	1,074	0	0	0	976

/a Excludes investment credits from Bank Indonesia; includes State Development Bank and Local Development 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.
/c As of 1991 includes Small-scale Investment Credits.
/d As of 1993 includes Commercial Banks exs. Non-Bank Financial Institutions.

Source: Bank Indonesia.

Table 6.6

INDONESIA

COUNTRY ECONOMIC REPORT

Outstanding Bank Funds in Rupiah and Foreign Exchange by Group of Banks, 1984-1996 /a
(Rp. billion)

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Deposits													
State Banks	10,035	12,916	15,193	18,111	22,527	29,731	40,638	41,812	52,600	61,684	64,283	75,920	90,434
Private Banks	3,020	4,550	5,435	8,040	11,167	19,655	33,951	43,143	51,079	67,542	88,926	117,451	164,979
Regional Development Banks	700	825	797	954	1,300	1,674	2,550	3,228	3,697	4,773	6,183	7,812	8,522
Foreign Banks	1,743	1,883	2,086	2,226	2,516	3,315	6,016	6,935	7,474	8,681	11,015	13,581	17,783
Total	15,498	20,174	23,511	29,331	37,510	54,375	83,155	95,118	114,850	142,680	170,407	214,764	281,718
Share in Total Deposits													
State Banks	64.8	64.0	64.6	61.7	60.1	54.7	48.9	44.0	45.8	43.2	37.7	35.4	32.1
Private Banks	19.5	22.6	23.1	27.4	29.8	36.1	40.8	45.4	44.5	47.3	52.2	54.7	58.6
Regional Development Banks	4.5	4.1	3.4	3.3	3.5	3.1	3.1	3.4	3.2	3.3	3.6	3.6	3.0
Foreign Banks	11.2	9.3	8.9	7.6	6.7	6.1	7.2	7.3	6.5	6.1	6.5	6.3	6.3
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	100.0
Annual Growth Rate in Deposits													
State Banks	19.7	28.7	17.6	19.2	24.4	32.0	36.7	2.9	25.8	17.3	4.2	18.1	19.1
Private Banks	42.5	50.7	19.5	47.9	38.9	76.0	72.7	27.1	18.4	32.2	31.7	32.1	40.5
Regional Development Banks	40.6	17.9	-3.4	19.7	36.3	28.8	52.3	26.6	14.5	29.1	29.5	26.3	9.1
Foreign Banks	24.7	8.0	10.8	6.7	13.0	31.8	81.5	15.3	7.8	16.1	26.9	23.3	30.9
Total	25.0	30.2	16.5	24.8	27.9	45.0	52.9	14.4	20.7	24.2	19.4	26.0	31.2

/a Total funds are the sum of demand, time and savings deposits. Figures differ from the monetary survey because these include Central Government accounts. Rural credit banks are excluded.

Source : Bank Indonesia.

Table 6.7

INDONESIA

COUNTRY ECONOMIC REPORT

Interest Rates 1985-1996 /a
(% p.a)

Year	Interbank Call Money /b	SBI's Discount Rate /c	SBPU's Discount Rate /c	Time Deposits									
				State Bank					Private National Bank /a				
				Less than 3 mos /d	3 mos	6 mos	12 mos	24 mos	Less than 3 mos /f	3 mos	6 mos	12 mos	24 mos
1985	n.a	n.a	n.a	13.4	14.6	16.0	17.8	18.3	15.6	17.2	18.9	20.8	21.8
1986	n.a	n.a	n.a	13.3	14.2	14.7	15.2	16.0	15.4	16.1	17.0	18.3	21.6
1987	n.a	n.a	n.a	15.5	17.0	17.3	17.0	17.4	17.8	19.2	20.1	19.8	20.5
1988	14.22	n.a	n.a	15.8	16.2	18.2	17.8	16.8	20.8	20.5	21.0	20.9	21.2
1989	12.02	12.10-14.90	n.a	15.1	16.2	17.2	18.1	18.8	17.5	18.3	19.3	20.2	20.8
1990	21.20	17.45	20.54	21.2	20.6	19.4	18.1	18.5	22.6	21.4	20.5	19.8	21.0
1991	14.91	17.37-20.17	18.75-25.74	20.0	21.3	22.3	22.5	21.0	21.8	22.6	23.3	23.4	18.6
1992	11.95	13.00-17.00	13.50-18.50	17.4	18.6	19.8	20.9	21.0	19.2	20.4	21.2	21.7	18.7
1993	8.74	7.99-12.00	10.09-13.39	11.2	10.8	14.3	15.7	18.5	14.8	15.8	16.6	17.1	17.4
1994	9.74	7.65-11.48	11.00-15.50	9.7	9.9	11.6	12.1	14.1	13.6	13.8	13.8	14.0	17.8
1995	13.56	11.81-13.53	14.89-15.75	14.4	13.9	14.8	13.9	14.0	17.4	17.4	17.2	16.0	16.2
1996	14.06	11.76-13.00	15.30-15.75	15.3	15.0	16.3	16.0	15.2	17.5	17.8	17.7	17.3	16.6

/a Weighted average rate of interest at selected banks.
/b Overnight interest rate on Interbank Call Money transactions recorded at the Jakarta Clearing House.
/c Seven days Money market securities (SBPUs) and Bank Indonesia Certificate transactions
/d One month time deposit rate used as representative rate.

Source: Bank Indonesia.

Table 6.8

INDONESIA

COUNTRY ECONOMIC REPORT

Principal Agricultural Products by Subsectors, 1983-1995
('000 tons)

Product	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995 /a
Food crops													
Rice /b	35,302	38,134	39,033	39,726	40,078	41,676	44,726	45,179	44,689	48,240	48,181	46,642	49,744
Corn	5,087	5,288	4,330	5,920	5,155	6,652	6,193	6,734	6,256	7,995	6,460	6,869	8,246
Cassava	12,103	14,167	14,037	13,312	14,356	15,471	17,117	15,830	15,954	16,516	17,285	15,729	15,441
Sweet potato	2,213	2,156	2,161	2,091	2,013	2,159	2,224	1,971	2,039	2,171	2,088	1,845	2,171
Soya beans (shelled)	536	769	870	1,227	1,161	1,270	1,315	1,487	1,555	1,870	1,709	1,565	1,680
Groundnuts (shelled)	460	535	528	642	533	589	620	651	652	739	639	632	760
Fisheries													
Saltwater fish	1,682	1,713	1,822	1,923	2,017	2,170	2,272	2,370	2,505	2,692	2,886	3,080	3,275
Freshwater fish	533	548	573	607	653	711	765	793	807	851	909	900	921
Meat and dairy													
Meat	650	742	808	860	895	937	971	1,028	1,099	1,239	1,378	1,493	1,564
Eggs	319	355	370	432	452	443	456	484	510	572	573	689	729
Milk /c	143	179	192	220	235	265	338	346	360	367	388	427	433
Cash crops													
Rubber	1,007	1,033	1,055	1,109	1,130	1,176	1,209	1,275	1,284	1,399	1,476	1,499	1,535
Palm oil	979	1,147	1,243	1,350	1,506	1,800	1,965	2,413	2,658	3,266	3,421	4,008	4,350
Coconut/copra	1,604	1,750	1,920	2,114	2,075	2,139	2,208	2,332	2,337	2,455	2,606	2,649	2,690
Coffee	305	315	311	339	380	386	401	413	419	437	439	450	455
Tea	110	126	127	136	126	137	141	155	159	154	165	139	155
Cloves	41	49	42	55	58	61	55	66	84	73	67	78	77
Pepper	46	46	41	40	49	56	68	70	69	65	66	54	54
Tobacco	109	108	161	164	113	116	81	156	161	112	121	130	133
Cane sugar	1,628	1,810	1,899	1,894	2,176	1,918	2,108	2,119	2,253	2,307	2,330	2,454	2,354
Cotton /d	14	12	45	53	48	39,731	38,374	32,857	13,443	12,670	13,772	14	19
Forestry /e													
Teakwood	718	758	777	798	689	725	725	780	778	780	745	805	902
Other timber	24,180	27,716	24,277	27,403	28,255	28,485	24,409	25,312	23,892	28,267	26,848	24,027	24,796

/a Preliminary figures.
/b Paddy production starting 1983.
/c In million of liters.
/d In tons. Starting 1994, in thousand tons.
/e In '000 cubic meters.

Source: Supplement to the President's Report to Parliament, August 16, 1996.

Table 7.1

Table 7.2

INDONESIA

COUNTRY ECONOMIC REPORT

Production of Major Crops by Type of Estate, 1984-1995
('000 tons)

Product	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995 /a
Smallholders												
Rubber	704	720	763	795	839	853	913	919	1,030	1,102	1,139	1,156
Coconut/copra	1,737	1,905	2,098	2,055	2,117	2,193	2,313	2,317	2,426	2,558	2,601	2,639
Coffee	291	288	316	359	362	377	384	390	409	410	422	426
Cloves	48	41	53	57	59	53	64	82	70	66	76	75
Tea	24	30	31	25	26	25	31	32	32	37	30	34
Sugar	1,397	1,450	1,417	1,744	1,499	1,621	1,609	1,610	1,653	1,685	1,673	1,620
Tobacco	104	156	159	110	113	77	152	157	110	119	128	130
Pepper	46	41	40	49	56	68	70	69	65	66	54	54
Cotton	12	45	53	48	40	38	33	13	13	14	14	19
Palm oil	0	0	0	0	0	0	0	0	0	0	0	0
Palm kernel	0	0	0	0	0	0	0	0	0	0	0	0
Private estates												
Rubber	121	124	150	135	143	141	145	146	163	166	172	178
Coconut/copra	13	15	16	20	22	15	19	20	29	30	27	30
Coffee	9	10	10	8	10	11	13	13	11	12	11	11
Cloves	1	1	2	1	2	2	2	2	2	2	2	2
Tea	18	17	18	21	23	26	29	30	28	33	31	35
Sugar	83	106	106	109	103	181	204	257	178	251	272	277
Tobacco	0	0	0	0	0	0	0	0	-	-	-	-
Pepper	0	0	0	0	0	0	0	0	-	-	-	-
Cotton	0	0	0	0	0	0	0	0	-	-	-	-
Palm oil	329	339	385	352	435	597	789	884	1,077	1,370	1,597	1,773
Palm kernel	69	71	73	76	87	119	179	181	172	209	296	318
Government estates												
Rubber	208	211	196	200	194	215	217	219	205	208	188	201
Coconut/copra	0	0	0	0	0	0	0	0	0	0	0	0
Coffee	15	13	13	13	14	13	16	16	17	17	18	18
Cloves	0	0	0	0	0	0	0	0	0	0	0	0
Tea	84	80	87	80	88	90	95	97	94	95	78	86
Sugar	330	343	371	323	316	306	306	386	476	394	509	458
Tobacco	4	5	5	3	3	4	4	4	2	2	2	2
Pepper	0	0	0	0	0	0	0	0	0	0	0	0
Cotton	0	0	0	0	0	0	0	0	0	0	0	0
Palm oil	818	904	965	1,154	1,365	1,368	1,624	1,774	2,189	2,051	1,572	1,573
Palm kernel	178	187	193	243	273	274	325	370	388	393	339	341
Total												
Rubber	1,033	1,055	1,109	1,130	1,176	1,209	1,275	1,284	1,399	1,476	1,499	1,535
Coconut/copra	1,750	1,920	2,114	2,075	2,139	2,208	2,332	2,337	2,455	2,588	2,628	2,669
Coffee	315	311	339	380	386	401	413	419	437	439	450	455
Cloves	49	42	55	58	61	55	66	84	73	67	78	77
Tea	126	127	136	126	137	141	155	159	154	165	139	155
Sugar	1,810	1,899	1,894	2,176	1,918	2,108	2,119	2,253	2,307	2,329	2,454	2,354
Tobacco	108	161	164	113	116	81	156	161	112	121	130	133
Pepper	46	41	40	49	56	68	70	69	65	66	54	54
Cotton	12	45	53	48	40	39	33	14	13	14	14	19
Palm oil	1,147	1,243	1,350	1,506	1,800	1,965	2,413	2,658	3,266	3,421	3,169	3,346
Palm kernel	247	258	266	319	360	393	504	551	559	602	634	659

/a Preliminary figures.

Source: Supplement to President's Report to Parliament, August 16, 1996.

Table 7.3

INDONESIA

COUNTRY ECONOMIC REPORT

Rice - Area Harvested, Production and Yield, 1982-1996

Year	Area harvested ('000 ha)	Average yield (tons/ha)	Paddy output ('000 tons)	Rice output /a ('000 tons)	Growth (%)
1974	8,509	2.64	22,464	15,276	
1975	8,495	2.63	22,331	15,185	-0.6
1976	8,368	2.78	23,301	15,845	4.3
1977	8,360	2.79	23,347	15,876	0.2
1978	8,929	2.89	25,772	17,525	10.4
1979	8,850	2.97	26,283	17,872	2.0
1980	9,005	3.29	29,652	20,163	12.8
1981	9,382	3.49	32,774	22,286	10.5
1982	8,988	3.74	33,584	22,837	2.5
1983	9,162	3.85	35,302	24,006	5.1
1984	9,764	3.91	38,134	25,933	8.0
1985	9,902	3.97	39,033	26,542	2.3
1986	9,988	4.00	39,726	27,014	1.8
1987	9,923	4.04	40,078	27,253	0.9
1988	10,138	4.11	41,676	28,340	4.0
1989	10,531	4.25	44,726	29,072	2.6
1990	10,502	4.30	45,179	29,366	1.0
1991	10,282	4.35	44,689	29,048	-1.1
1992	11,103	4.34	48,240	31,356	7.9
1993	11,013	4.38	48,181	31,318	-0.1
1994	10,734	4.35	46,641	30,317	-3.2
1995	11,439	4.35	49,744	32,334	6.7
1996 /b	11,520	4.39	50,575	32,874	1.7

/a Estimated on the basis of a conversion factor of 0.68 from paddy into rice for the years prior to 1989, and a factor of 0.65 for the years 1989 and following.
/b preliminary figures

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Index of Manufacturing Production by Selected Industry Group, 1986-1996 /a
(1983 = 100)

Code of Industry Group	Description /b	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996 /d
31121	Condensed and dried milk, creamery and processed butter, fresh and preserved cream (6)	87.5	94.0	123.3	122.5	142.2	154.1	160.6	215.6	132.3	156.5	153.4
31330	Malt liquor and malt (5)	94.4	113.2	116.4	117.2	146.8	160.1	142.0	173.5	115.5	137.8	143.2
31420	Clove cigarettes (80)	147.4	166.5	177.7	196.2	226.4	165.5	165.3	176.2	117.2	120.6	196.9
31430	Other cigarettes (13)	78.8	81.9	79.2	78.2	80.7	95.4	111.3	87.1	118.0	111.3	108.8
32111	Yarn and thread (53)	129.9	130.5	169.0	196.2	253.5	273.7	313.1	312.0	100.9	114.6	128.1
32114	Weaving mills (except jute weaving products (409)	130.7	144.3	172.9	187.6	216.9	215.0	238.2	236.3	104.1	108.2	106.8
32117	Batik (65)	95.8	81.8	83.9	111.1	144.0	218.5	190.0	176.5	141.8	140.5	163.4
32130	Knitting mills (73)	219.2	233.3	239.8	312.8	347.2	449.2	332.0	324.4	155.1	135.2	127.9
32411	Footwear (32)	113.1	91.5	111.2	184.9	208.2	230.4	324.5	355.2	95.6	88.4	101.9
33113	Plywood (40)	139.3	192.7	242.1	266.2	256.7	273.7	295.7	268.0	104.5	102.7	87.0
34111	Paper manufacture (all kinds) (23)	159.2	159.7	242.0	251.5	298.1	292.2	429.8	459.2	100.7	115.6	98.2
35110	Basic chemicals (except fertilizer) (50)	119.0	156.4	139.0	152.9	174.0	189.5	151.8	178.1	86.7	76.4	64.4
35120	Fertilizer (10)	166.0	121.8	129.7	143.7	158.1	158.1	152.1	153.6	108.6	98.2	91.6
35210	Paint, varnish, and lacquers (25)	135.6	126.5	91.2	129.9	136.6	127.2	182.6	283.7	101.6	95.7	108.3
35232	Matches (8)	108.7	142.3	175.5	154.4	167.3	178.5	216.0	113.6	99.7	104.3	95.1
35510	Tyres and tubes (22)	109.5	79.2	109.7	141.2	157.4	205.6	223.8	220.2	89.8	91.2	85.5
36210	Glass and glass products (21)	178.0	149.3	124.6	145.2	163.3	254.6	236.8	265.8	118.6	146.3	143.9
36310	Cement (7)	144.4	150.9	149.8	198.1	206.4	217.9	244.9	300.7	134.4	167.2	179.5
37100	Basic iron and steel industries (16)	154.9	147.1	167.4	199.0	259.1	476.5	427.1	552.6	110.5	86.5	75.7
38130	Structural metal products (59)	110.2	118.7	125.7	180.6	224.4	190.9	210.4	202.3	168.0	322.6	683.2
38312	Drycell batteries (7)	123.9	115.5	158.6	179.1	192.6	158.7	174.1	190.8	104.5	116.4	120.4
38320	Radio, TVs, cassettes, other communication equipment and apparatus (23)	90.6	86.9	118.1	153.9	180.6	114.7	111.2	113.1	109.5	109.8	106.2
38430	Motor vehicles assembly and manufacture (23)	114.7	126.8	115.8	132.5	200.0	212.9	116.0	98.0	153.8	1,239.6	59.8
38440	Motor cycles and three wheel motor vehicles, assembly and manufacture (11)	98.0	81.3	76.8	106.0	104.9	187.5	252.1	322.7	157.5	152.1	128.1
	General index	128.4	143.5	164.2	184.1	209.4	232.3	257.9	286.8	117.6	130.8	130.4

/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 Starting in 1994, the base year is 1993=100.
/d First quarter 1996.

Source: Central Bureau of statistics.

Table 8.1

Table 8.2

INDONESIA

COUNTRY ECONOMIC REPORT

Production of Minerals, 1984 - 1996

Year	Petroleum (mln bbls)	Tin concentrate	Copper ore concentrate	Nickel ore	Bauxite	Coal	Iron sand concentrate	Gold /a (kg)	Silver /a (kg)	Natural gas (mcf)
		('000 tons)								
1984	516.5	23.2	190.3	1,066.8	1,003.2	1,468.2	83.0	2,247	38,585	1,521.5
1985	483.8	21.8	223.4	961.9	830.5	1,942.1	130.9	2,604	38,075	1,580.0
1986	507.2	24.0	251.2	1,533.1	648.8	2,572.3	153.3	2,948	44,075	1,628.9
1987	479.0	26.1	259.8	1,825.7	635.3	2,813.5	194.0	3,117	49,046	1,732.1
1988	484.7	30.6	294.7	1,733.2	505.8	4,094.6	202.7	3,877	57,603	1,846.9
1989	514.2	31.3	331.5	2,020.9	862.3	9,246.7	142.7	4,625	63,597	1,968.3
1990	533.6	30.4	398.6	2,217.4	1,205.7	10,461.5	145.4	9,355	62,158	2,828.2
1991	581.2	30.4	656.5	2,300.3	1,406.1	14,143.0	173.2	13,889	77,897	2,461.8
1992	550.7	28.2	906.7	2,511.6	803.5	23,120.5	287.8	37,987	99,954	2,582.6
1993	547.4	30.4	928.2	1,975.8	1,320.4	27,605.3	341.3	42,097	90,301	2,661.9
1994	551.1	31.1	1,065.5	2,311.5	1,342.4	31,238.5	334.9	42,605	107,026	2,941.6
1995	547.0	38.6	1,516.6	2,513.4	899.0	41,516.7	348.4	62,818	265,222	2,999.3
1996 /b	366.0	33.0	1,116.9	1,760.5	470.4	30,505.1	263.1	51,164	159,406	n.a

/a Since 1983, production of gold and silver including private enterprises.
/b Until August 1996

Source: Central Bureau of Statistics.

Table 8.3

INDONESIA

COUNTRY ECONOMIC REPORT

Crude Oil Production by Company, 1974-1995
('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	25,567	/b	-	2,044	13,233	15,277	473,341	514,185	1,409
1990	24,483	/b	-	1,972	10,587	12,559	496,664	533,706	1,462
1991	24,989	/b	-	1,462	8,845	10,307	545,937	581,233	1,592
1992	24,722	/b		1,401	8,136	9,537	516,409	550,668	1,505
1993	26,427	/b		1,327	5,304	6,631	517,567	550,625	1,509
1994	24,139	/b		-	-	-	527,008	551,147	1,510
1995	21,129	/b		-	-	-	525,848	546,977	1,499
1996 /c	16,765	/b		-	-	-	349,263	366,028	1,500

/a Since May 1983, contract of work data have been consolidated.
/b Since 1988, Lemigas data have been included in Pertamina.
/c Until August 1996

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

INDONESIA

COUNTRY ECONOMIC REPORT

Domestic Sales of Petroleum Products, 1983-1996 /a
('000 bbls)

	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996 /c
Aviation gas	83	73	66	63	56	60	60	59	58	54.0	51.0	50	51	51
Aviation turbo	3,686	4,374	4,442	3,806	4,199	4,445	4,286	4,607	4,889	5,315	6,039	10,188	10,969	7,206
Premium gasoline	247	523	738	1,024	1,431	1,838	2,451	1,047	/b	/b	/b	/b	/b	/b
Regular gasoline	24,380	24,909	25,206	27,083	29,048	30,855	33,199	39,005	43,023	45,308	46,733	52,463	57,798	63,747
Kerosene	48,224	45,213	43,954	43,618	43,352	44,664	46,601	49,472	50,573	53,850	54,242	56,110	58,188	61,656
Motor diesel	49,790	48,567	47,682	47,421	54,075	59,143	64,508	72,950	80,837	92,061	104,460	100,730	106,755	119,138
Industrial diesel	9,978	10,285	10,329	8,855	8,319	8,809	9,515	10,720	10,806	11,318	11,445	11,174	10,069	8,679
Fuel oil	21,149	23,625	22,863	18,004	19,054	18,097	18,329	24,847	28,899	29,313	30,154	25,456	25,543	24,524
Total	157,537	157,569	155,280	149,874	159,534	167,911	178,949	202,707	219,085	237,219	253,124	256,171	269,373	285,000

/a Excluding lubricating oil and similar products.
/b Discontinued.
/c Estimated

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

Table 8.4

Table 9.1

INDONESIA

COUNTRY ECONOMIC REPORT

Consumer Price Index, 1979 - 1996 /a /b
(April 1977 - March 1978 = 100)

End of period	Foodstuff	Housing	Clothing	Others	Total	Change (%) /c
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	9.2
1988	320.1	335.4	280.0	307.4	317.6	5.6
1989	104.1	109.6	108.1	105.7	106.4	6.1
1990	111.5	123.9	113.4	118.6	117.0	9.9
1991	122.6	133.7	119.5	135.0	128.6	9.9
1992	130.2	140.0	128.3	139.7	135.1	5.0
1993	136.8	163.2	138.9	154.0	148.8	10.2
1994	157.0	178.6	147.5	161.7	163.2	9.7
1995	179.1	188.9	157.4	173.3	177.8	9.0
1996	190.0	198.0	166.8	190.7	189.6	6.6

/a The consumer price index for Indonesia has been used commencing March 1979 to replace the Jakarta cost of living index.
/b Starting 1989, using new base period (April 1988-March 1989 = 100).
/c End-year basis.

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Indonesia Wholesale Price Index, 1983-1996 /a
(1983 = 100)

Sectors /b	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Agriculture (44)	100	113	118	128	145	163	177	191	206	225	251	298	355	365
Mining & quarrying (6)	100	109	117	125	132	143	156	169	188	201	218	237	266	296
Manufacturing (140)	100	103	115	123	143	156	166	176	194	206	218	231	256	265
Imports (53)	100	113	119	129	158	164	178	191	201	208	211	215	230	243
Exports (38)	100	111	112	85	118	118	131	159	153	159	157	157	178	203
Excluding petroleum (34)	100	114	115	130	170	183	195	195	203	212	226	255	298	306
Petroleum (4)	100	112	113	73	103	99	112	148	139	143	137	128	142	173
General index (281)	100	111	116	116	142	149	162	178	187	197	204	215	240	259
General index excluding exports (243)	100	111	117	127	149	160	173	185	199	210	221	235	261	292
General index excluding exports of petroleum (224)	100	110	116	125	146	161	172	182	198	211	227	250	285	295

/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.

Table 9.2

Table 9.3

INDONESIA

COUNTRY ECONOMIC REPORT

Domestic Prices of Petroleum Products,1984 - 1996
(Rp./liter)

	1984 /a	1985 /b	1986	1987	1988	1989	1990 /c	1991 /d	1992	1993 /e	1994	1995	1996
Aviation gas	300	330	250	250	250	250	330	400	400	420	420	420	420
Aviation turbo	300	330	250	250	250	250	330	400	400	420	420	420	420
Premium gasoline	400	440	440	440	440	440	/f	/f	/f	/f	/f	/f	/f
Regular gasoline	350	385	385	385	385	385	450	550	550	700	700	700	700
Kerosene	150	165	165	165	165	165	190	220	220	280	280	280	280
Motor diesel	220	242	200	200	200	200	245	300	300	380	380	380	380
Industrial diesel	200	220	200	200	200	200	235	285	285	360	360	360	360
Fuel oil	200	220	200	200	200	200	220	220	220	240	240	240	240

/a Price increased on January 12.
/b Price increased on April 1, due to the application of 10% VAT.
/c Price increased on May 25.
/d Price increased on July 11.
/e Price increased on January 8.
/f Discontinued.

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

INDONESIA

COUNTRY ECONOMIC REPORT

Approved Foreign Investment by Sector, 1983-1996 /a
(US$ million)

Sector	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Agriculture	10	0	9	126	117	8	122	117	14	66	138	690	1,153	1,306
Forestry	7	0	0	0	5	26	4	20	1	138	22	0	0	136
Fishery	21	0	11	4	12	46	47	20	11	28	0	40	231	80
Mining & quarrying	0	0	0	0	0	0	0	116	0	2,312	0	0	0	1,697
Manufacturing	2,615	1,002	687	537	852	3,828	4,246	5,822	3,970	5,669	3,423	18,739	30,441	19,884
Food	83	77	6	34	54	231	223	99	382	213	141	1,235	1,332	691
Textiles & leather	12	1	7	9	118	213	581	1,094	532	591	419	396	471	515
Wood & wood products	13	0	0	32	45	104	106	218	62	34	50	68	263	101
Paper & paper products	722	0	25	47	109	1,506	211	730	822	686	202	5,120	2,540	2,907
Chemicals & rubber	183	96	338	294	209	1,544	2,512	1,991	923	2,342	1,171	7,743	19,368	7,362
Nonmetallic minerals	50	0	3	0	251	30	184	125	133	841	98	632	289	793
Basic metals	836	609	65	39	7	61	106	825	197	47	186	2,082	292	651
Metal products	716	210	244	82	57	129	292	460	856	863	1,114	1,423	2,258	2,939
Others	1	9	0	0	3	10	30	281	62	52	42	40	3,628	3,925
Construction	44	17	122	65	42	2	16	77	26	41	97	77	206	297
Trade & hotels	78	84	0	0	196	405	98	874	4,019	919	1,088	430	1,029	1,762
Wholesale trade	0	0	0	0	0	0	0	0	0	0	693	87	31	45
Hotels	78	84	0	0	196	405	98	874	4,019	919	394	344	999	1,717
Transport & communications	0	4	0	70	213	3	5	803	167	14	85	145	5,539	695
Real estate and business services	108	0	29	25	20	117	181	902	570	1,136	3,292	3,604	1,314	4,076
Total	2,882	1,107	859	826	1,457	4,435	4,719	8,750	8,778	10,323	8,144	23,724	39,915	29,931

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

Source: Investment Coordinating Board (BKPM).

Table 10.1

Table 10.2

INDONESIA

COUNTRY ECONOMIC REPORT

Approved Domestic Investment by Sector, 1984-1996 /a
(Rp billion)

Sector	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Agriculture, fisheries and livestock	277	899	1,879	2,885	2,698	3,418	6,442	3,468	1,952	2,835	2,835	8,621	16,026
Forestry	19	37	21	640	487	252	593	310	534	258	258	1,476	46
Mining	8	38	89	290	111	94	155	182	236	69	69	205	460
Manufacturing	1,332	1,632	1,842	5,518	9,747	12,931	39,850	27,624	19,079	24,037	24,037	43,962	62,703
Textiles	127	97	263	1,289	2,309	3,563	12,561	3,646	2,546	3,539	3,539	7,177	3,366
Chemicals	272	928	773	2,047	3,039	4,062	7,894	8,425	3,299	7,689	7,689	8,740	13,335
Electrical goods	0	0	0	0	0	0	0	0	0	5	5	620	3,486
Other manufacturing	933	607	806	2,183	4,399	5,307	19,395	15,553	13,235	12,804	12,804	27,425	42,517
Construction	67	270	74	50	31	146	87	275	215	187	187	848	1,550
Hotels	214	312	17	139	537	1,265	4,703	3,895	3,115	3,051	3,051	3,792	5,019
Real estate	31	267	169	174	846	936	1,783	2,633	536	3,049	3,049	4,659	8,688
Others	1	296	325	569	460	551	2,898	1,785	3,675	5,965	5,965	6,290	6,224
Total	1,949	3,750	4,417	10,265	14,916	19,594	56,511	41,078	29,342	39,450	39,450	69,853	100,715

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

Source: Investment Coordinating Board.

IMAGING

Report No.: 16433 IND
Type: ER