Report No. 14006-IND

Indonesia
Improving Efficiency and Equity Changes in the Public Sector's Role

July 24, 1995

Country Operations Division
Country Department III
East Asia and Pacific Region

CURRENCY EQUIVALENTS

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

Annual Average 1979-1992

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

June 2, 1995 US$1.00 = Rp.2,237

FISCAL YEAR

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

ABBREVIATIONS, ACRONYMS AND DEFINITIONS

AFTA	ASEAN Free Trade Area
AIDS	Acquired Immune Deficiency Syndrome
AMDAL	Environmental Impact Assessment
APEC	Asia Pacific Economic Cooperation
ARI	Acute Respiratory Infection
ASKES	Public Employee Health Insurance
BANI	National Arbitration Board
BAPEPAM	Capital Market Supervisory Agency
BAPINDO	Indonesia Development Bank
BIS	Bank for International Settlements
BKKBN	National Family Planning Coordination Board
BKPM	Investment Coordinating Board
BOO	Build-Own-Operate
BOT	Build-Own-Transfer
BPD	Regional Development Bank
BPN	National Land Agency
BPS	Central Bureau of Statistics
BTN	National Savings Bank
CAMEL	Capital Asset Quality Earnings and Liquidity
CDC	Control of Communicable Diseases
CEPT	Common Effective Preferential Tariff
CGI	Consultative Group for Indonesia
COLT	The Commercial Offshore Loan Team
CPI	Consumer Price Index
CPO	Crude Palm Oil
CSIs	Contractual Savings Institutions
DGWRD	Directorate General of Water Resource Development
DIPS	Local Infrastructure Investment
DKI	Special Administrative Region
DPT3	Diptheria, Polio, Tetanus (three doses)
ECO	Expanded Cofinancing
GATT	General Agreement on Trade and Tariffs
GBHN	State Policy Guidelines
GDP	Gross Domestic Product
GNP	Gross National Product
GOI	Government of Indonesia
IDHS	Indonesia Demographic and Health Survey
IDT	Left-behind Village
IFC	International Finance Corporation
IHH	Forestry Concession Fee
INPRES	President's Instruction
IPO	Initial Public Offering
JAMSOSTEK	Labour Social Security

JICA	Japan International Cooperation Agency
JSE	Jakarta Stock Exchange
Kandep	Central Departmental District Office
KUDs	Local Cooperatives
LNG	Liquified Natural Gas
LPG	Liquified Petroleum Gas
MCH	Maternal and Child Health
MIGA	Multilateral Investment Guarantee Agency
MLT	Medium and Long Term
MOF	Ministry of Finance
MOH	Ministry of Health
NGO	Non-Governmental Organization
NIC	Newly Industrialized Countries
NTBs	Nontariff Barriers
OECF	Overseas Economic Cooperation Fund
OPIC	Overseas Private Investment Corporation
Pakto93	The October 1993 Deregulation Package
PDAM	Regional Public Drinking Water Company
PERTAMINA	State Oil Company
PERUMKA	State Railways Company
PEs	Public Enterprises
PJP2	The Second Long-term (25 year) Development Plan
PLN	State Electricity Company
PNG	Publicly Non Guaranteed
PP20	Government Regulation No. 20
PP51	Government Regulation No. 51
PPA	Power Purchase Agreement
PT	Limited Company
PTP	Agricultural Estate Companies
PUSKESMAS	Health Center
R&D	Research and Development
RENSALITA	Five Year State Company's Strategic Plan
REPELITA	Five Year Development Plan
RUKN	National Electrification Plan
RWA	Risk Weighted Assets
SBI	Bank Indonesia Certificate
SBPU	Central Bank Monetary Instrument
SIUP	Ordinary Business License
STD	Sexually Transmitted Disease
SUSENAS	National Social Economic Survey
UNICEF	United Nations Children's Fund
VAT	Value Added Tax
WDR	World Development Report
WDT	World Debt Table
WSSSLIC	Water Supply and Sanitation Services for Low Income
WTO	World Trade Organization

INDONESIA: IMPROVING EFFICIENCY AND EQUITY—CHANGES IN THE PUBLIC SECTOR'S ROLE

CONTENTS

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RINGKASAN EKSEKUTIF
INDONESIA: PERBAIKAN EFFISIENSI DAN PEMERATAAN -PEROBAHAN DALAM PERANAN SEKTOR PEMERINTAH

Tinjauan Umum

Indonesia telah berhasil dengan baik dalam mempertahankan pertumbuhan ekonomi yang tinggi dan mengurangi kemiskinan serta menempati posisi pada kelompok negara berpenghasilan menengah. Untuk mempertahankan kemajuan yang telah dicapai ini, Indonesia harus dapat mengatasi sejumlah tantangan. Pertama, pertumbuhan ekonomi yang cepat pada waktu akhir ini, menunjukkan pula tanda-tanda pemanasan ekonomi (overheating). Kenaikkan yang diperkirakan dalam pembelanjaan pembangunan prasarana dan investasi dalam negeri dapat memperburuk peristiwa pemanasan ekonomi ini. Kedua, pemberi pinjaman luar negeri mengamati kebijaksanaan pemerintah lebih seksama sejak terjadinya krisis (keuangan) Meksiko. Pemberi pinjaman menaruh perhatian pada kebijaksanaan dasar ekonomi makro yang kokoh dan pengelolaan hutang luar negeri yang berhati-hati, tetapi juga dalam memperhatikan kerangka kerja yang menjamin bahwa pinjaman digunakan secara efisien dan membantu pelunasan pinjaman luar negeri. Ketiga, persaingan di pasar ekspor dunia semakin ketat. Indonesia harus bersaing di pasar seperti ini untuk mempertahankan pertumbuhan yang tinggi dalam ekpor non-migas, yang diperlukan untuk pertumbuhan ekonomi dengan basis yang lebih luas dan untuk pengurangan beban hutang luar negeri yang besar.

Untuk mengatasi tantangan-tantangan ini, Pemerintah seyogyanya mendorong efisiensi dan pemerataan yang lebih besar. Hal ini mengharuskan penekanan yang lebih besar pada peranan pengaturan dari Pemerintah, dengan pengurangan tekanan (tetapi lebih efisien dan merata) dalam peranan keuangan dan produksinya, dan sejalan dengan itu lebih mengandalkan sektor swasta. Banyak pemerintah (di dunia) sedang melakukan pergeseran kebijaksanaan kearah ini. Khususnya, kemajuan yang berkelanjutan akan tergantung pada stabilitas ekonomi makro yang berkelanjutan, perbaikan dalam pasar dan perangkat peraturan-perundangan, pengandalan yang lebih besar pada dunia usaha serta peningkatan efisiensi investasi pemerintah dan pelayanan umum.

*1) **Mempertahankan dasar ekonomi makro yang kokoh.** Untuk mempertahankan stabilitas, mengelola hutang dan meningkatkan keyakinan investor, maka langkah-langkah yang utama adalah:*

- *Membatasi pembelanjaan pada tingkat anggaran yang tersedia dan mengurangi belanja non-budgetair;*
- *Mengketatkan kebijaksanaan fiskal untuk menutupi kenaikkan biaya suku bunga luar negeri yang terjadi sebagai akibat perobahan nilai tukar mata uang; menggunakan penerimaan yang berasal dari penjualan equity perusahaan milik negara kepada swasta untuk pra-pembayaran hutang luar negeri;*
- *Meningkatkan penerimaan dalam negeri dengan penyelenggaraan administrasi perpajakan yang lebih baik dan penerimaan IHH (Iyuran Hasil Hutan) yang lebih besar serta menaikkan pajak kekayaan perkotaan;*
- *Menyempurnakan penetapan harga oleh pemerintah untuk tanah, air, energi dan transportasi, yang akan turut meningkatkan efisiensi dan*

kualitas lingkungan;

- *Mengikuti suku bunga internasional secara cermat dan mentargetkan suatu jumlah yang tepat dari cadangan devisa;*
- *Memperkuat sistem perbankan; menyediakan dukungan yang memadai bagi penanggulangan pinjaman yang macet, meningkatkan keterbukaan, dan melaksanakan peningkatan permodalan yang terencana;*
- *Meningkatkan penerapan peraturan-perundangan dan keterbukaan di sektor keuangan bukan bank, guna mendorong pengembangan instrumen baru dan untuk menjamin pembangunan sektor yang berhati-hati, terutama investasi dana pensiun;*
- *Memperkuat Tim Koordinasi Penglolaan Pinjaman Komersial Luar Negeri (Tim PKLN) dan meneruskan penegakkan pagu pinjaman luar negeri serta pengelolaan yang berhati-hati atas pinjaman pemerintah dan semi pemerintah.*

*2) **Memperbaiki pasar**. Paket deregulasi Mei 1955 merupakan langkah utama untuk memperbaiki pasar, yaitu menurunkan tarif secara berarti pada tahap awal dan menetapkan sejumlah peraturan untuk pencapaian tarif yang menyeluruh dan seragam pada tahun 2003. Dengan paket ini, Indonesia meneruskan keterbukaannya dalam pasar bagi perdagangan dan investasi, yang merupakan tindak lanjut PP-20 Tahun 1994 maupun hasil pertemuan APEC di Bogor. Untuk menunjang kemajuan selanjutnya, Indonesia perlu untuk:*

- *Mengurangi hambatan non-tarif, terutama pada komoditi pertanian yang akan menaikkan upah riil*
- *Menghapuskan pembatasan ekspor dan pembatasan perdagangan dalam negeri, karena jarang sekali dapat mendukung pencapaian maksud dari pembatasan tersebut, dan akan merugikan eksportir dan produsen yang miskin;*
- *Mempercepat reformasi peraturan-perundangan, peraturan dan kelembagaan untuk memperkuat pasar dalam negeri yang kompetitip, termasuk sektor keuangan (lihat di atas);*
- *Melakukan deregulasi perusahaan milik negara yang beroperasi di pasar kompetitif;*
- *Menjamin pembangunan yang lebih berkelanjutan dengan beralih kepada penetapan harga berdasarkan sistem pasar untuk tanah, hutan, dan air;mengembangkan penerapan kegiatan pemukiman kembali yang lebih baik; menyempurnakan pemberian ijin penggunaan tanah dan kebijaksanaan tataguna tanah untuk proyek swasta; memperkuat pengendalian pencemaran industri; dan melakukan investasi terutama pada pelayanan kebutuhan dasar perkotaan.*

*3) **Pembangunan perangkat peraturan-perundangan yang jelas untuk partisipasi dunia usaha di sektor infrastruktur**, sebagai pengganti pendekatan "perjanjian sepotong-sepotong" untuk mendorong aliran investasi secara berkelanjutan dan biaya infrastruktur yang lebih rendah seperti yang dilakukan di Indonesia sendiri dan di Philipina. Untuk mendukung pertumbuhan yang tinggi, hambatan infrastruktur yang sangat menentukan, meminta pemecahannya sementara itu tetap mempertahankan stabilitas ekonomi makro. Ini berarti efisiensi yang lebih tinggi, terutama pengandalan yang lebih besar pada peranan sektor swasta seperti yang dicantumkan dalam REPELITA VI:*

- *Melakukan investasi yang rasional di sektor listrik/energi, dengan tekanan yang lebih besar pada transmisi dan distribusi; hasil yang diperoleh dapat meningkatkan 15 persen penjualan*

dari kapasitas tersedia saat ini;

- *Menyiapkan perangkat peraturan-perundangan yang transparan dan kompetitip, serta tender/lelang untuk hak pengusahaan yang diberikan kepada swasta dalam sektor listrik, gas alam, telkom, jalan bebas hambatan dan air minum;*
- *Mengelola secara berhati-hati jaminan pemerintah yang sifatnya implisit dan eksplisit serta jaminan kerugian yang belum dapat diperkirakan;*
- *Menetapkan harga atas jasa pelayanan umum yang lebih baik untuk efisiensi yang lebih besar dan untuk pemerataan;*
- *Mengelola fasilitas umum yang lebih baik, melalui perbaikan penetapan harga dan pelayanan umum yang lebih berdasarkan sistem pasar di sektor seperti air minum, limbah cair, dan limbah padat serta angkutan perkotaan;*
- *Menitik-beratkan investasi pemerintah pada bidang dimana minat sektor swasta kecil dan dampak pemerataannya besar.*

4) ***Pengembangan sumber daya manusia merupakan kunci bagi perbaikan jangka panjang dalam kemampuan bersaing dan pemerataan yang lebih baik.*** *Laporan ini membahas sektor kesehatan, sebagai suatu contoh dari tantangan yang berobah dalam memperbaiki sumber daya manusia.*

- *Meningkatkan anggaran belanja sektor kesehatan pemerintah, yang menitik beratkan pada pelayanan kesehatan dan penduduk miskin;*
- *Meningkatkan pelayanan umum untuk penduduk miskin, dengan meningkatkan pembiayaan puskesmas dan puskesmas pembantu, menyediakan insentif untuk staf kesehatan untuk mengobati penduduk miskin, dan lebih menjadi lebih tanggap terhadap kebutuhan setempat;*
- *Meningkatkan kualitas dan efisiensi dalam pelayanan Pemerintah dengan memperbaiki pengelolaan, sumber daya, insentif, dan jaminan kualitas pada fasilitas kesehatan di garis depan dan mendorong kegiatan jangkauan kesehatan;*
- *Mendorong upaya sektor swasta dengan mendukung pemberian pelayanan oleh badan tidak mengejar laba; mengurangi biaya obat-obatan; dan men-deregulasi asuransi dan pelayanan kesehatan swasta.*
- *Meningkatkan pelatihan dan penetapan baku mutu.*

A. Pembangunan Ekonomi Sekarang

i. Indonesia menempati posisi kelompok negara berpenghasilan menengah bagian bawah (menurut klasifikasi Bank Dunia) pada 1993, yang mengikuti pertumbuhan PDB rata-rata per tahun sebesar 6 persen, selama satu dekade. Dalam 1994 pendapatan per kapita mencapai suatu perkiraan US$884 (menurut perhitungan pendapatan nasional yang baru dari BPS). Sektor manufaktur merupakan sektor yang terbesar sumbangannya dalam PDB. Ekspor non-migas dan pajak merupakan penyumbang ekspor dan penerimaan pemerintah yang terbesar (memperagakan keberhasilan diversifikasi ekonomi dari penerimaan minyak). Perluasan kesempatan kerja bertambah dengan cepat, dan pekerja wanita telah mengambil bagian penting dalam angkatan kerja. Hasilnya, prosentase penduduk miskin turun dari 30 persen pada 1987 menjadi 14 persen pada 1993, yaitu berdasarkan perhitungan resmi.

ii. Sebagai lanjutan dari periode pendinginan ekonomi pada 1992 dan permulaan 1993, semua sektor utama perekonomian tumbuh dengan cepat pada 1994, kecuali sektor pertanian. PDB tumbuh sebesar 7,3 persen menurut cara perhitungan baru (perobahan tahun dasar) dari pendapatan nasional. Pertumbuhan dituntun oleh sektor konstruksi dan manufaktur yang berorientasi pasar dalam negeri. Pertanian mengalami kemunduran dalam dua tahun berturut-turut, yang mencerminkan musim kemarau panjang.

iii. Deregulasi berlangsung terus sejak tahun lalu. Dengan paket pertengahan tahun 1994 (PP-20 Tahun 1994), Indonesia mengurangi hambatan terhadap investasi asing langsung ke tingkat yang salah satu terendah di kawasan ini. Sebagai tuan rumah pertemuan APEC bulan Nopember (1994) di Bogor, Indonesia memberikan dukungan kuat bagi pasar terbuka untuk perdagangan dan investasi. Paket deregulasi pemerintah Mei 1995 menurunkan tarif impor rata-rata pada tahap awal sekitar 15 persen, suatu pemotongan hampir 25 persen yang tingkat rata-rata mendekati Malaysia. Paket tersebut juga menetapkan program yang berdasarkan peraturan untuk pemotongan tarif yang akan datang, yang akan mengurangi rata-rata tarif menjadi 7 persen dan akan mengurangi dispersi tarif pada tahun 2003. Hal ini menunjukkan perluasan dan pendalaman tekad Indonesia bagi pengurangan tarif yang multilateral, yaitu melebihi janji yang telah diberikan kepada GATT.

iv. Namun demikian, keberhasilan tahun lalu diikuti oleh tanda-tanda adanya pemanasan ekonomi. Inflasi hampir mencapai 10 persen untuk dua tahun berturut-turut, dan 4,8 persen pada empat bulan pertama tahun 1995, yang terutama didorong ke atas oleh harga makanan dan perumahan serta pertambahan aggregate demand. Tekanan tingkat upah bertambah (terhadap aggregate demand), hal mana bersumber pada kenaikkan yang besar dalam upah minimum resmi yang besar pada 1993 dan 1994. Transaksi berjalan mengalami kemunduran hampir $1,5 milyard, meskipun defisit neraca pembayaran tetap rendah ($3,5 milyard atau 1,9 persen PDB) karena perkiraan penerimaan migas yang tinggi. Impor non-migas tumbuh dengan cepat (21 persen), yang mencerminkan impor makanan dan barang-barang konsumsi lainnya, sedangkan ekspor non-migas mencapai 16,5 persen, yang menunjukkan suatu kemajuan dibandingkan pada triwulan pertama dari 1994. Pergerakan nilai mata uang dalam jumlah besar pada akhir ini, ditambah dengan hutang baru, telah mendorong hutang luar negeri mencapai sekitar US$100 milyar.

v. Pada 1994, persetujuan penanaman modal asing naik hampir 200 persen (mencapai US$24 milyar), sebagian mencerminkan deregulasi tahun lalu dari investasi asing berdasarkan PP 20 tahun 1994. Tambahan lagi, jumlah tersebut tidak termasuk proyek gas alam Natuna sebesar US$34 milyar

yang ditanda-tangani pada awal 1995. Persetujuan penanaman modal dalam negeri naik sebesar 50 persen. Pemerintah sedang mempersiapkan pula sekitar US$15 milyar proyek investasi prasarana swasta. Pengelolaan yang seksama atas proyek ini diperlukan untuk menjamin bahwa aggregate demand dan neraca pembayaran luar negeri berada pada tingkat yang aman.

vi. Kebijaksanaan fiskal dalam 1994/95 menerapkan anggaran belanja secara hati-hati, dan Indonesia diperkirakan pada akhir tahun anggaran dengan surplus yang menyeluruh yang kecil; yang berarti setengah persen dari PDB lebih ketat dari pada anggaran 1993/94. Namun, anggaran 1995/96 tampaknya kurang bersifat kontraktif. Anggaran tersebut meningkatkan biaya pegawai sebesar 19 persen termasuk kenaikkan 10 persen gaji pegawai negeri. Sebagai perbandingan, anggaran tersebut meningkatkan belanja barang modal hanya sebesar 12 persen. Pertumbuhan penerimaan dirancang untuk diperlambat (yang mencerminkan pemotongan tingkat pajak pendapatan sekitar sepertiga dari yang direncanakan untuk menjadikan administrasi pajak yang lebih kompetitip). Permintaan pembiayaan yang lebih tinggi dan tabungan pemerintah yang lebih rendah yang diproyeksikan, akan menambah, dan bukannya mengurangi, tekanan permintaan yang meningkat dari sektor swasta.

vii. Bank Indonesia menaikkan tingkat suku bunga secara aktif selama paruh kedua 1994 dan permulaan 1995, yaitu menanggapi secara efektif atas kenaikkan tingkat suku bunga internasional dan krisis Meksiko. Pada awalnya, pada paruh pertama 1994, sejumlah faktor, seperti kenaikkan tingkat suku bunga Amerika Serikat, perpindahan secara internasional investasi terhadap munculnya pasar baru dan faktor-faktor yang bersifat lokal, menyebabkan pengaliran modal ke luar. Faktor-faktor ini dan tanggapan Bank Indonesia yang terlambat terhadap kenaikkan suku bunga menyebabkan kerugian yang berarti dari devisa. Di sektor perbankan, Pemerintah mulai menangani masalah kredit macet dengan memperkuat peraturan dan pengawasan bank. Demikian pula, tuntutan yang keras terhadap pelanggaran yang terjadi di BAPPINDO merupakan suatu kasus dan contoh yang baik. Tetapi, pengelolaan yang seksama dari sektor (perbankan) ini masih diperlukan, terutama bagi pinjaman untuk real estate yang berkembang pesat.

viii. Pemerintah mengelola dengan baik tingkat nilai tukar dan menyesuaikannya selama 1994 dan 1995 untuk mempertahankan kompetisi eksternal. Hal ini telah melindungi rupiah dari dampak penularan krisis Meksiko dengan menaikkan tingkat suku bunga domestik dan hanya menjual cadangan valuta asing dalam jumlah kecil.

ix. Dalam perkembangan lainnya, program deregulasi Indonesia mulai dengan penuh kesungguhan. Suatu saham minoritas pada PT INDOSAT, suatu perusahaan telekomunikasi internasional, dijual di pasar modal. Sekitar US$750 juta dari uang hasil penjualan saham digunakan untuk pembayaran pinjaman berbunga tetap dari bank multilateral. Pemerintah telah mengumumkan pula niatnya untuk mengdakan listing PT Telkom (perusahaan telepon), PLN (perusahaan listrik negara), PT Jasa Marga (jalan toll), Bank Negara Indonesia (bank), PT Aneka Tambang dan PT Timah. Tambahan lagi, Pemerintah telah menanda-tangani "power purchase agreement" (PPA) yang mendorong sebagian besar investasi pembangkit tenaga listrik, dan mendorong partisipasi swasta dalam pembangunan prasarana lainnya (seperti telekomunikasi dan jalan bebas hambatan).

B. Kebijaksanaan Ekonomi Makro

x. Indonesia dapat mempertahankan pertumbuhan ekonomi sebesar 7 persen setahun jika dapat mempertahankan stabilitas ekonomi makro dan memecahkan masalah

efisiensi jangka panjang. Pertumbuhan pada tingkat tersebut akan menaikkan pendapatan per kapita melebihi US$1.000 sebelum akhir abad ini. Pertumbuhan kesempatan kerja dan pendapatan akan mengurangi kemiskinan dan menaikkan tingkat hidup secara subtansial. Sementara peningkatan investasi swasta yang diperkirakan menyebabkan tekanan demand tetap tinggi, indikator kunci ekonomi makro akan menjadi baik dalam perjalanan waktu. Inflasi akan turun, dan defisit transaksi berjalan akan berkurang di bawah 2,5 persen dari PDB (dibandingkan dengan perkiraan 2,7 persen dalam kurun 1995/96 - 1996/97). Pembiayaan akan datang sebagian besar dari masuknya investasi (equity) asing langsung dan dari pinjaman swasta. Untuk mencapai tingkat pertumbuhan yang berlanjut ini, Pemerintah perlu mempertahankan stabilitas dengan mengetatkan kebijaksanaan fiskal dan moneter, mengelola hutang luar negeri secara berhati-hati, dan menjaga kepercayaan para investor.

B1. Stabilitas Ekonomi Makro

xi. Kebijaksanaan fiskal adalah instrumen yang efektif untuk mengelola agregate demand dalam konteks neraca modal (capital account) Indonesia yang bersifat terbuka. Dengan arahan menyeluruh yang diletakkan dalam anggaran 1995/96, dan demand sektor swasta yang bertambah dengan cepat, Pemerintah perlu membatasi tingkat penganggaran, menghindari belanja non-budgetair, dan menyempurnakan administrasi perpajakan. Penerimaan akan dapat ditingkat lebih lanjut dengan menaikkan iuran di subsektor kehutanan (Iuran Hasil Hutan, IHH), menaikkan penilaian dan pajak kekayaan perkotaan dan penetapan harga pelayanan prasarana yang lebih baik. Pembelanjaan untuk prasarana perlu pula dirasionalisasikan (lihat alinea xxxiv dan xxxv). Dana hasil partisipasi atau kelebihan penerimaan dari yang dianggarkan harus digunakan untuk membayar kembali, seperti kasusnya PT INDOSAT. Akhirnya, anggaran waktu yang akan datang perlu diketatkan untuk menutupi kenaikkan beban pelunasan hutang luar negeri pemerintah yang berpangkal dari perobahan nilai mata uang secara silang akhir-akhir ini.

xii. Untuk memelihara cadangan devisa yang aman dan dukungan atas kebijaksanaan ekonomi makro yang berhati-hati, yang berarti diperlukan kebijaksanaan moneter yang lebih ketat. Bank Indonesia perlu terus mengikuti perobahan suku bunga internasional secara seksama, dan menaikkan suku bunga lebih tinggi lagi jika keadaan menghendakinya. Untuk mencegah spekulasi jangka pendek dan pengalihan resiko nilai tukar dari bank sentral kepada pasar, Bank Indonesia dapat melebarkan "spreads" dalam pasar valuta asing apabila pasar valuta asing internasional telah menjadi lebih tenang.

xiii. Dengan pengendalian demand yang lebih ketat dan pulihnya kondisi sektor pertanian, inflasi dapat dikurangi menjadi 6 sampai 7 persen per tahun. Tetapi kecermatan diperlukan dalam menaikkan upah minimum yang resmi. Pasar tenaga kerja yang lebih lentur akan membantu tenaga kerja, kesempatan kerja, dan daya saing yang lebih baik. Untuk menjaga pertumbuhan kesempatan kerja yang cepat dan berlanjut, Pemerintah seyogyanya tidak menetapkan upah minimum pada tingkat yang mendekati upah rata-rata di berbagai sektor ekonomi, atau tingkat upah yang menghendaki kenaikan produktivitas yang besar untuk mempertahankan daya saing secara internasional.

xiv. Deregulasi selanjutnya akan memberikan pula sumbangan untuk menurunkan inflasi dan memperbaiki pemerataan, disamping merangsang pertumbuhan yang lebih efisien (lihat bagian C). Paket deregulasi Mei 1995 telah menyebabkan penurunan harga beberapa barang (misalnya kendaraan bermotor). Menurunkan hambatan non-tarif dan tarif atas

komoditi kunci, terutama di sektor pertanian, akan mengurangi tekanan pada harga konsumen, dan menaikkan upah riil dari konsumen berpenghasilan rendah tanpa mengurangi daya saing.

B2. Kebijaksanaan Hutang Luar Negeri

xv. Investor asing semakin mengamati pinjaman luar negeri, tidak saja dalam jumlah, sesudah krisis Meksiko, tetapi juga dalam penggunaannya yang efektif. Perhatian ini adalah relevan untuk Indonesia, dimana hutang luar negeri cukup besar. Perkiraan Bank Dunia adalah bahwa hutang jangka pendek melebihi US$20 milyar dan debt service ratio (DSR) melebihi 30 persen. Tambahan pula, investasi prasarana yang besar dan pembiayaan proyek-proyek besar akan meningkatkan hutang luar negeri swasta.

xvi. Pemerintah perlu mengelola hutang (luar negeri) secara teliti dalam suatu kerangka yang terkoordinasi dan menyeluruh. Tim PKLN (Tim Koordinasi Pengelolaan Pinjaman Komersial Luar Negeri) perlu diperkuat, dan pagu pinjaman harus membatasi pinjaman pemerintah dan semi-pemerintah ke tingkat yang aman untuk beberapa tahun yang akan datang ini. Pemerintah juga seyogyanya menghindarkan jaminan yang diberikan kepada proyek swasta dan pemberi pinjaman mereka. Kredit komersial di Bank Indonesia seyogyanya disiapkan untuk melindungi terhadap kejadian eksternal yang tidak diperkirakan sebelumnya, dan tidak digunakan untuk belanja non-budgetair. Terdapat kemungkinan untuk pembiayaan kembali dan pembayaran hutang eksternal yang mahal.

xvii. Untuk me-maksimal-kan penggunaan yang efisien dari pinjaman luar negeri Pemerintah memerlukan pasar yang terbuka dan pangaturan yang dapat diterapkan. Paket deregulasi Mei 1955 akan meningkatkan efisiensi pinjaman luar negeri. Paket tersebut akan membantu untuk menjaga bahwa investasi swasta melakukan kegiatan yang kompetitif secara internasional. Pemerintah dapat melanjutkan peningkatan efisiensi dengan men-deregulasi hambatan non-tarif dan tarif di sektor pertanian, mengurangi berbagai hambatan yang masih ada terhadap ekspor dan peningkatan kompetisi pasar domestik. Bersama-sama dengan paket Mei 1995 dan PP No. 20 Tahun 1994 tentang deregulasi investasi asing langsung, hal ini akan mendorong pertumbuhan ekspor non-migas yang diperlukan untuk mengurangi beban pembayaran hutang luar negeri. Suatu perangkat peraturan yang dapat diterapkan untuk investasi prasarana swasta, termasuk pemberian hak pengusahaan yang jelas dan bersaing dalam perolehan hak melalui tender/lelang dan fungsi BUMN yang tidak majemuk untuk memungkinkan persaingan berdasarkan mekanisme pasar (untuk menurunkan biaya investasi yang langsung atau tidak langsung), akan memberikan saham untuk meningkatkan kapasitas pembayaran hutang luar negeri (Bagian C).

B3. Keyakinan Investor

xviii. Dasar-dasar ekonomi makro yang sehat adalah landasan dari keyakinan investor. "Credit rating" Indonesia yang naik baru-baru ini ke tingkat BBB mencerminkan keberhasilan masa lalu di dalam hal keyakinan ini. Tetapi kebijaksanaan ini saja belum cukup untuk melepaskan Indonesia dari berbaliknya secara mendadak yang antara lain terjadi dalam pilihan portfolio investasi setelah krisis mata uang peso Meksiko. Untuk mengurangi keadaan yang kurang menguntungkan ini, hutang jangka pendek perlu dipantau secara cermat, cadangan devisa dipertahankan pada tingkat yang memadai untuk menjaga goncangan masuknya kapital, dan suku bunga yang disesuaikan dengan perkembangan internasional. Jika perlu, kebijaksanaan moneter yang ketat dan kebijaksanaan fiskal yang konservatif akan mengurangi bahaya pengaliran kapital ke luar negeri.

xix. Kemajuan selanjutnya dalam sektor keuangan juga menentukan. Terlepas dari keberhasilan di tahun yang lampau, banyak bank masih dibebani dengan "non-performing assets". Adalah sangat penting bagi Pemerintah dan Bank Indonesia untuk bertahan dengan kebijaksanaan untuk memperbaiki sistem perbankan (dibicarakan pada bagian C di bawah ini). Masalah penting tambahan lainnya adalah memperkuat peraturan dari sektor non-bank, terutama keamanan investasi dan batas penggunaan dana pensiun dan asuransi. Peraturan yang hati-hati sifatnya, terutama yang menyangkut kepada pensiun dan perusahaan asuransi serta perusahaan pembiayaan non-bank, adalah penting untuk menjaga stabilitas sistem keuangan, dimana terjadi investasi produktif dan dimana Pemerintah tidak dihadapkan kepada kewajiban yang tidak dapat dibiayai bagi para pensiunan.

C. Mendorong Efisiensi dan Pemerataan

xx. Pertumbuhan jangka panjang di Indonesia akan tergantung pada stabilitas makro ekonomi, tetapi juga pada meningkatnya produktivitas dan efisiensi di perekonomian yang swasta yang berlandaskan pasar, menyediakan prasarana yang lebih baik, dan memperkuat sumber daya manusia. Perobahan dalam peranan Pemerintah, terutama perbaikan dalam pasar dan perangkat peraturan, lebih mengandalkan pada sektor swasta, investasi dan pelayanan pemerintah yang lebih efisien, merupakan faktor-faktor penentu dalam upaya ini. Perobahan tersebut menghendaki pula pencapaian tujuan pemerataan lebih lanjut. Laporan ini tidak menyediakan perlakuan yang rinci dari semua aspek dari perobahan peranan sektor pemerintah. Misalnya, laporan ini membahas pembangunan daerah dan desentralisasi dari pelayanan pemerintah hanya secara ringkas. Juga, masalah kebijaksanaan sektor pendidikan, tidak dibahas, karena pengkajian yang sedang berlangsung. Laporan ini menitik-beratkan pada perobahan yang diperlukan dalam peran pengaturan dari Pemerintah dalam pasar dan prasarana, dan cara-cara untuk meningkatkan pelayanan umum dalam prasarana, pendidikan dan kesehatan, temasuk pengandalan yang lebih besar pada sektor swasta. laporan ini membahas masalah pada sektor kesehatan, sebagai suatu contoh dari tantangan yang berobah dalam perbaikan sumber daya manusia dan peranan dari sektor pemerintah.

C1. Meningkatkan Hasil Pasar Kompetitip

xxi. Dengan hampir semua pertumbuhan masa depan berasal dari sektor swasta, Indonesia memerlukan lebih dari hanya suatu tingkat investasi swasta yang tinggi. Dikehendaki pula penggunaan investasi tersebut secara produktif. Pemerintah perlu untuk menyediakan perangkat insentif yang mendorong perusahaan swasta yang efisien dengan melembagakan kebijaksanaan dan penegakkan peraturan yang menjamin keterbukaan yang lebih besar kepada perdagangan, kompetisi pasar dan kelembagaan. Efisiensi yang ditingkatkan akan terjadi melalui penjualan saham BUMN, terutama pada sektor yang bersaing. Efisiensi yang lebih baik sangat menentukan untuk membangkitkan pertumbuhan ekspor non-migas yang diperlukan untuk pencapaian pertumbuhan yang luas dan mengurangi beban hutang. Deregulasi dengan basis luas akan membantu untuk memajukan perusahaan berskala kecil dan menengah, mendorong petani kecil, dan menghasilkan manfaat yang substansial bagi konsumen, termasuk konsumen yang berpenghasilan rendah.

xxii. **Men-deregulasi Perdagangan Luar Negeri.** Keterbukaan terhadap pasar luar negeri membantu perekonomian untuk mencapai produktivitas yang lebih tinggi dan pertumbuhan yang lebih cepat, pertumbuhan ekspor yang lebih tinggi. Dengan paket deregulasi Mei 1995, Indonesia telah mengambil langkah penting menuju suatu program yang berlandaskan peraturan dari pemangkasan tarif, yang sangat menonjol

sesudah 1991. Hal ini akan mendorong suatu pemindahan sumber daya ke sektor yang paling produktif, dan menciptakan kompetisi yang lebih besar dalam perekonomian.

xxiii. Paket reformasi perdagangan Mei 1995 mengurangi tarif rata-rata sampai dengan 15 persen dengan pemotongan tarif dari 4,500 jenis sebesar 5 persen, 1.050 jenis dengan 10 persen, dan 500 jenis dengan antara 15 sampai dengan 35 persen. Tambahan lagi, paket tersebut mengurangi tarif dan mengeluarkan suatu rencana untuk menurunkan tarif rata-rata sebesar 7 persen selambat-lambatnya tahun 2003.

xxiv. Tetapi, paket deregulasi Mei 1995 belum menyentuh ekspor dan perdagangan hasil-hasil pertanian belum tersentuh. Menghilangkan hambatan non-tarif pada produk seperti gula, gandum dan tepung terigu, serta bungkil kedele, akan menurunkan harga bahan makanan dan menguntungkan konsumen, terutama konsumen yang berpenghasilan rendah, dan menaikkan upah riil tanpa menaikkan biaya industri. Hal ini akan menurunkan pula biaya tinggi pengolahan hasil pertanian yang menggunakannya sebagai input. Akhirnya, tindakan itu juga akan mengurangi distorsi. Misalnya, pembatasan pada gula menjurus kepada alokasi yang keliru sekitar 2 persen lahan pertanian untuk tebu, dengan biaya dipikul oleh program swasembada pangan dan efisiensi nasional (Harga beras Indonesia lebih dekat ke tingkat harga pasar dunia dibandingkan dengan gula).

xxv. Ekspor Indonesia juga diatur dan dikendalikan, terutama ekspor produk pertanian. Terdapat larangan ekspor bagi 72 produk khusus, dan 1.827 produk yang sebelumnya terkena peraturan khusus dapat diekspor oleh eksportir yang diakui. Ekspor sebanyak 105 produk dilakukan dibawah pengawasan/bimbingan yang memerlukan ijin, dan 80 produk dikenakan pajak ekspor khusus. Berdasarkan nilai, pengawasan mempengaruhi setengah dari ekspor non-migas dan hampir dua pertiga dari ekpor pertanian. Pembatasan seperti itu membatasi produsen dan sukar sekali mencapai sasaran yang mereka nyatakan untuk meningkatkan kualitas, memajukan industri hilir yang efisien, atau menstabilkan pangsa pasar domestik. Pembatasan tersebut, memang (secara peragaan) menahan pertumbuhan ekspor. Menghilangkan pembatasan eskpor ini akan merangsang ekspor hasil-hasil pertanian dan menaikkan pendapatan petani kecil, terutama di luar Jawa.

xxvi. Oleh sebab itu penghapusan secara menyeluruh pembatasan ekspor adalah dapat dipertanggung-jawabkan untuk semua komoditi kecuali tekstil yang sekarang terbentur dalam kuota Multi-Fiber Arrangement, dan untuk jenis tanaman/satwa langka. Pada subsektor kehutanan, peningkatan bea penebangan kayu akan mendorong produksi yang berkelanjutan, meningkatkan anggaran pendapatan dan menggugah industri yang berbasis kayu yang lebih efisien. (Pada tingkat eksploitasi sekarang dan dengan penebangan dan praktek industri yang tidak efisien dewasa ini, pasok kayu bulat berukuran komersial akan menjadi berkurang pada 2010 atau lebih awal).

xxvii. **Meningkatkan Kompetisi Domestik**. Deregulasi yang berarti dari pembatasan investasi dan prosedur perijinan perusahaan asing dan dalam negeri, dan deregulasi hambatan perdagangan luar negeri telah menambah kompetisi atau persaingan. Namun, banyak pembatasan pada perdagangan domestik masih menghambat efisiensi dan menyebabkan ekonomi biaya tinggi, seperti adanya kartel, pengendalian harga, pengendalian entry dan exit, perijinan yang ekslusif, dominasi sektor publik, proses tender dan pengadaan barang pemerintah yang belum transparan dalam memilih perusahaan atau industri tertentu. Beberapa pembatasan dilakukan oleh Pemerintah Pusat, dan lainnya oleh Pemerintah Daerah, serta selebihnya oleh assosiasi perdagangan industri yang mendapatkan pengakuan pemerintah.

xxviii. Terdapat beberapa arahan kebijaksanaan dapat diikuti oleh Pemerintah untuk mendorong kompetisi dalam pasar domestik yang lebih besar. Suatu pendekatan yang berdasarkan peraturan deregulasi perdagangan dalam negeri diperlukan (seperti halnya dalam deregulasi perdagangan luar negeri). Pemerintah seyogyanya menghapuskan monopoli yang disetujui atau disponsori Pemerintah yang mengendalikan pemasaran dan distribusi komoditi "strategis" dan lainnya, serta membuka distribusi perdagangan besar dan eceran untuk investasi asing. Kebijaksanaan perdagangan domestik ini harus dapat memperagakan bahwa pembatasan dalam perdagangan domestik adalah minimal. Suatu ijin usaha biasa, misalnya, bukan keanggotaannya dalam assosiasi perdagangan atau komoditi, seharusnya merupakan ijin yang diperlukan. Deregulasi perdagangan domestik harus mengikuti penurunan tarif dan penghapusan hambatan non-tarif untuk impor dan ekspor. Pajak barang khusus, retribusi pemerintah daerah dan hambatan perdagangan lainnya seyogyanya dihapus. Tujuan utama dari peraturan perundangan yang mendorong dan mempertahankan kompetisi, adalah memberikan manfaat kepada konsumen. Kontrak pemerintah, termasuk kontrak BUMN, seharusnya mengikuti peraturan dan ketentuan yang disyaratkan oleh tender yang kompetitif dan prosedur yang transparan. Pembatasan terhadap keterbukaan bank yang berkaitan dengan kelompok bisnis sebaiknya ditegakan, seperti yang direncanakan.

xxix. Deregulasi dan Reformasi BUMN. BUMN tertinggal dari pesaing swastanya dalam hal keuntungan usaha dan kualitas pelayanan. Kinerja (performance) yang kurang baik dari PTP (PT Perkebunan) adalah salah satu contoh. Tambahan lagi, kinerja BUMN merosot pada kurun waktu 1990 dan 1994.

xxx. Untuk meningkatkan kinerja BUMN, Indonesia perlu mengembangkan suatu program reformasi perusahaan yang komprehensif, menitik-beratkan pada penjualan saham perusahan yang beroperasi di pasar kompetitif. Dalam kompetisi antar sektor, terutama jika ditingkatkan melalui langkah-langkah yang disarankan di atas, akan menjamin pelayanan yang lebih baik pada biaya yang lebih rendah. Sering sekali, BUMN menyediakan perlindungan bagi yang kurang efisien. Deregulasi melalui penjualan saham di pasar saham saja tidak cukup. Mitra kerja swasta yang berkemampuan diperlukan untuk mengelola perusahaan, dan prosedur yang transparan dan kompetitif disyaratkan untuk menarik kehadiran mitra swasta tersebut. Akhirnya, pengaturan yang terkendali membutuhkan perbaikan bagi perusahaan yang tetap berada di dalam lingkup pemerintah. Langkah yang penting adalah penunjukkan pengelola dan badan komisaris yang profesional, memberikan otonomi yang lebih luas kepada pengelola (terutama pengendalian dan campur tangan departemen teknis), dan melembagakan suatu sistem pemantauan kinerja yang bertanggung jawab kepada suatu badan yang tunggal dan independen (seperti badan komisaris perusahaan).

xxxi. **Mengembangkan Aturan Permainan Yang Efisien**. Perbaikan dalam aturan permainan akan mendorong kelangsungan, dan pertumbuhan yang digerakkan oleh sektor swasta yang efisien. Pemerintah mempunyai peranan penting dalam berbagai hal sektor pembiayaan, karena mekanisme pasar saja tidak dapat memberikan perlindungan yang memadai bagi keselamatan dan ketepatan sistem, lingkungan karena ekternalitas yang besar, dan perangkat peraturan/perundang-undangan, dimana sistem penegakkan hukum yang modern dibutuhkan untuk bekerjanya pasar yang kompetitif.

- **Mengatur Sektor Keuangan**. Meskipun perangkat peraturan/perundang-undangan untuk sektor perbankan telah mengalami perbaikan, kemajuan yang lebih besar

lagi adalah suatu keharusan. kebijaksanaan harus diperkuat untuk membayar tunggakan pinjaman yang melebihi waktu, memperkuat pengawasan bank, meningkatkan keterbukaan informasi dengan mensyaratkan publikasi yang lebih sering dari neraca yang telah di-audit, mengurangi hubungan bank yang terbatas kepada beberapa kelompok nasabah tunggal, melebur bank yang kuat dengan yang lemah, dan meningkatkan kapasitas untuk menangani likuiditas bank. Ketika kondisi keuangan meningkat, Pemerintah seyogyanya menyiapkan bank komersial pemerintah yang kuat untuk menjual sahamnya. Lembaga keuangan bukan bank (misalnya sewa beli, pembiayaan konsumen, dan lainnya), yang kegiatannya tumbuh dengan cepat, membutuhkan peraturan yang lebih berhati-hati, terutama keterbukaan informasi keuangan yang akurat kepada para investor. Rencana pensiun dan asuransi membutuhkan perhatian untuk menjaga bahwa investasi yang produktif dilaksanakan dan bahwa Pemerintah tidak ditinggalkan dengan hutang besar yang tidak tersedia dana pembayarnya.

- **Merumuskan Peraturan Untuk Kegiatan Pasar Swasta**. Indonesia yang belum mempunyai peraturan yang transparan, yang dapat diperkirakan, dan yang dapat ditegakkan untuk pembangunan dunia usaha, telah menempatkannya pada persaingan yang tidak menguntungkan dan (kurang mendukung entry dan kompetisi), mengurangi efisiensi. karena itu, meningkatkan lingkungan hukum merupakan suatu unsur kunci pada program pemerintah. Pengesahan Undang Undang Perusahaan baru-baru ini adalah langkah penting. Tetapi undang-undang kredit dan pengamanan (seperti jaminan kredit) juga perlu untuk diperbaharui, termasuk pengakuan dari suatu keragaman yang lebih luas dari keamanan yang berlandaskan hukum, peraturan yang lebih sistamatik mengenai hak, pemindahan hak, hipotek tanah, dan sistem untuk pendaftaran dan penegakkan jaminan hutang. Arbitrase komersial dan memfungsikan sistem pengadilan membutuhkan pula perhatian yang seksama. Sementara inisiatif sedang dipersiapkan, dunia usaha akan mendapat manfaat dari sejumlah reformasi yang cepat, seperti mendirikan pengadilan ekonomi khusus, penerbitan keputusan pengadilan, dan memperbaiki undang-undang dan prosedur arbitrase. Peraturan yang mencegah penyalah-gunaan kekuatan pasar akan mendukung lembaga pasar. Untuk meningkatkan berfungsinya pasar uang, perlindungan pemegang saham minoritas dan peraturan pengambil-alihan (menurut Undang Undang Perusahaan yang baru) perlu ditegakkan. Akhirnya, rancangan undang undang pasar akan memberikan suatu dasar kelembagaan untuk pengembangan pasar modal.

- **Mengelola Lingkungan**. Terdapat faktor saling menunjang antara kebijaksanaan ekonomi yang baik dan suatu strategi yang efektif untuk pertumbuhan berkelanjutan. Tambahan pula, Pemerintah perlu untuk menyusun suatu perangkat peraturan/insentif yang memadai untuk perilaku yang bertanggung jawab terhadap lingkungan. Hal ini karena pasar yang tidak dikendalikan sering gagal mencerminkan biaya lingkungan dari kegiatan perusahaan. Dalam kebijaksanaan pertanahan, menciptakan pasar tanah yang transparan dan hak milik yang memadai adalah penting, yaitu mereformasi proses pemberian ijin pertanahan untuk developer, menuju kepada mekanisme harga berdasarkan pasar bagi tanah milik pemerintah (termasuk pelelangan yang terbuka), kebijaksanaan pemukiman kembali yang memadai untuk pengadaan tanah pemerintah, dan kegiatan perencanaan tata guna tanah yang terarah dan sederhana. Dalam subsektor kehutanan, iuran hasil

hutan (IHH) yang tinggi terhadap pemegang hak dan perlindungan masyarakat setempat sangat menentukan untuk menjaga terjadinya keberlanjutan. Pengelolaan air akan memperoleh manfaat pula dari penetapan harga yang lebih baik, dan pengelolaan daerah aliran sungai yang lebih ditingkatkan. Pengembangan perkotaan menghendaki peranan yang lebih besar untuk kekuatan pasar dan pembentukan kelembagaan yang lebih baik (dibahas lebih lanjut pada bagian prasarana di bawah ini). Di sektor industri, upaya pengendalian pencemaran membutuhkan sasaran yang ditetapkan, kapasitas kelembagaan pemantauan dan penegakkan peraturan yang diperkuat, dan pencemaran yang akan datang yang berkurang, adalah penting dengan menitik-beratkan pada penilaian lingkungan dan pengurangan pencemaran bagi pabrik baru. Sebagai tambahan kepada masalah pengaturan/insentif ini, investasi pemeritah (dan swasta) yang lebih besar diperlukan dalam upaya perbaikan lingkungan.

C2. Mengelola Pelayanan Prasarana

xxxii. Pertumbuhan industri yang cepat dan urbanisasi yang berkaitan dengan itu mulai membebani prasarana. Walaupun kapasitas telah meningkat secara substansial, perbaikan lanjutan dibutuhkan untuk menunjang tingkat hidup yang menaik, persaingan internasional, dan perbaikan pemerataan.

xxxiii. Dengan kehati-hatian kebijaksanaan ekonomi makro yang membatasi volume investasi prasarana, peningkatan efisiensi dalam investasi prasarana adalah penting untuk mencapai tujuan ini. Partisipasi sektor swasta yang meningkat, dengan perangkat peraturan-perundangan yang dapat diterima, akan menaikkan efisiensi dan hal ini tercantum dalam program REPELITA VI. Pemerintah akan tetap mempunyai peranan penting dalam prasarana, tetapi titik beratnya lebih pada pengelolaan yang meningkat dari program investasi yang menyeluruh, yang terdiri dari investasi pemerintah dan investasi swasta, pengaturan, dan prasarana umum. Hal ini menuntut rasionalisasi program investasi dan menyeimbangkan interaksi pemerintah-swasta, mengembangkanperangkat peraturan-perundangan yang jelas dan kompetitif untuk memaksimumkan pemanfaatan pembiayaan sektor swasta dan kegiatan pemerintah yang tidak terpilah-pilah sehingga pemanfaatan yang lebih baik dari partisipasi dan investasi sektor swasta. Unsur penting lainnya adalah penetapan harga jasa pelayanan umum yang meningkat, pendapatan yang dapat menutup pengeluaran, membiayai perluasan kapasitas, mengelola demand, dan mendorong peningkatan efisiensi. Untuk meningkatkan kualitas pelayanan umum, Pemerintah memerlukan mengoperasikan BUMN seperti suatu perusahaan swasta, tanggap terhadap konsumen, memperjelas tanggung jawab secara kelembagaan di dalam pemerintahan, dan melakukan desentralisasi dan peningkatan partisipasi setempat.

xxxiv. **Rasionalisasi Investasi dan Perbaikan Penggunaan Kapasitas.** Usul investasi prasarana swasta dan pemerintah adalah 50 persen lebih besar (sebagai prosentase terhadap PDB) dari REPELITA V. Jika investasi tidak dirasionalisasikan, maka terdapat kecenderungan bahwa defisit transaksi berjalan akan melebar. Tentu saja rencana belum tentu menjadi realisasi investasi seluruhnya, terutama dalam keadaan pasar modal dunia yang ketat. Jadi, Pemerintah seyogyanya mengemudikan ekonomi secara berhati-hati antara pemanasan ekonomi dan tepian kapasitas (prasarana) yang rendah. Untuk melakukan ini, Pemerintah me-rasionalisasi-kan investasi sektoral atas dasar efisiensi. Investasi Pemerintah perlu dititik-beratkan pada daerah yang menentukan dimana investasi swasta yang cenderung rendah, dan dampak pemerataannya tinggi.

xxxv. Misalnya, tekanan lebih diberikan pada transmisi dan distribusi tenaga listrik (yang merupakan penyebab dari rendahnya pelayanan tenaga listrik) daripada pembangunan pembangkit listrik (dimana kapasitas yang berlebih secara substansial terdapat di Jawa-Bali). Penggunaan yang lebih baik dari kapasitas yang tersedia serta pengelolaan kapasitas yang lebih efisien, akan meningkatkan penjualan 15 persen lebih dari kapasitas pembangkit yang tersedia sekarang ini. Pembangkit tenaga listrik dan telekomunikasi dapat lebih mengandalkan pada investasi swasta, bahkan dapat melampaui sasaran REPELITA VI jika perangkat peraturan meningkat. Akhirnya, Pemerintah perlu untuk melanjutkan investasi yang direncanakan di sektor yang rendah pelayanannya untuk memperbaiki pelayanan yang vital seperti itu, misalnya pasokan air perkotaan, sanitasi dan angkutan serta akses kepada pelayanan tersebut bagi daerah pedesaan.

xxxvi. **Mengembangkan suatu perangkat peraturan yang jelas dan kompetitif untuk me-maksimum-kan manfaat pembiayaan sektor swasta dan meningkatkan efisiensi.** Arus investasi swasta yang mantap dari investasi swasta (pada tingkat biaya yang dapat diterima), akan tergantung pada suatu perobahan dari pendekatan perundingan yang bersifat sepotong-sepotong menjadi suatu perangkat peraturan yang kompetitif dan jelas. Langkah pertama adalah memperjelas hak pengusahaan di tahap awal, dan menetapkannya melalui transparansi serta penawaran yang kompetitif (dengan persyaratan khusus yang tergantung pada sektor masing-masing). Pendekatan ini telah mengurangi biaya di Filipina dan di Indonesia sendiri. Perangkat tersebut perlu untuk mengelola resiko secara berhati-hati dengan meng-alokasi-kannya kepada pihak-pihak yang mempunyai kemampuan untuk mengelolanya, dengan mengelola secara cermat dan menetapkan harga yang memadai terhadap jaminan kredit sektor pemerintah yang langka dan hutang yang belum diperhitungkan sebelumnya.

xxxvii. **Pemilahan fungsi sektor pemerintah yang tidak meluas, dalam suatu perangkat peraturan yang lebih kompetitif dan memadai**, dapat mendorong partisipasi swasta yang efisien dan memberikan hasil untuk konsumen. Langkah pertama yang mudah yang mengurangi biaya adalah mendorong perusahaan BUMN, meng-kontrak-kan pemeliharaan, penagihan, pengelolaan, konstruksi, dan pelayanan yang bukan inti secara kompetitif. Suatu yang lebih rumit (tetapi akhirnya tugas yang merupakan suatu keharusan untuk meningkatkan efisiensi berbentuk pemilahan produksi, transmisi, dan distribusi pada tenaga listrik, gas, dan air. Hal ini akan membuka kemungkinan untuk perolehan efisiensi melalui kompetisi langsung (sebagai tambahan kepada yang bersifat tidak langsung), dan kompetisi penawaran untuk mendapatkan hak pengusahaan. Pemilahan akan mengijinkan perusahaan untuk menjual tenaga listrik, gas atau air melalui sistem grid langsung kepada pemakai. Akhirnya, perangkat peraturan sektoral dibutuhkan. Dalam hal ini, adalah penting untuk memisahkan fungsi pengaturan pemerintah dari perusahaan BUMN untuk mencegah konflik kepentingan.

- *Tenaga Listrik.* Dewasa ini, perusahaan swasta diharapkan untuk membangkit dan menjual listrik kepada PLN atas kontrak "take-or-pay contracts". Kontrak ini umumnya telah di-negosiasi dengan penawar yang terseleksi dan bukan melalui penawaran yang kompetitif. Dalam hubungannya dengan posisi keuangan PLN dan kebutuhan untuk memusatkan sumber daya pada transmisi dan distribusi, sektor swasta seyogyanya didorong untuk menawarkan secara kompetitif untuk semua pembangkit baru, yang juga tergantung pada akses yang ditingkatkan terhadap pasokan gas. Perusahaan swasta seyogyanya pula

didorong untuk menjual langsung kepada pemakai melalui grid. Hal ini akan mengurangi resiko kapasitas berlebih yang melekat pada "take-or-pay contracts", dan memulangkan sebagian resiko komersial dari perkiraan demand kepada sektor swasta.

- *Telekomunikasi*. PT Telkom sedang mengalami reorganisasi menjadi 7 perusahaan, yang 5 diantaranya memasuki usaha patungan dengan perusahaan yang dioperasikan oleh swasta, yang akan mengelola sistem telepon regional dan membangun instalasi 2 juta sambungan telepon. PT Telkom akan mengelola sistem telepon Jakarta dan Surabaya, yang membangun instalasi 3 juta sambungan. PT Indosat telah menjual sebagian sahamnya di pasar modal dan listing PT Telkom direncanakan. Pada pelayanan internasional, dan telepon genggam, PT Satelindo diberikan hak untuk itu dan Deutsche Telekom membeli seperempat hak perusahaan sebesar US$586 juta. Masalah yang penting adalah untuk memperkenalkan kompetisi lebih lanjut di semua segmen dari sektor tersebut dan menganut pendekatan yang terstruktur terhadap persoalan tarif dan peraturan yang bersifat sektoral untuk menjamin suatu penerusan efisiensi yang diperoleh kepada konsumen.

- *Gas*. Konsesi perlu dibuka untuk mengembangkan lapangan gas skala kecil. Suatu penetapan harga yang baik dan perangkat peraturan dibutuhkan untuk mendorong pengembangan dan perluasan jaringan transmisi dan distribusi dengan partisipasi swasta, untuk memanfaatkan bahan bakar yang biayanya murah dan bersih lingkungan. Industri ini harus dipilah-pilah untuk membentuk suatu struktur produsen ganda yang menjualnya melalui suatu grid transmisi, untuk pembeli yang ganda pula. Partisipasi swasta yang lebih besar melalui kompetisi, dan transparansi prosedur seleksi, akan menurunkan biaya.

- *Air*. Untuk mencapai sasaran REPELITA VI, perusahaan (air minum) perlu dioperasikan secara perusahaan swasta, dengan titik perhatian pada pelayanan air. Hal ini menuntut pemeliharan dan pengurangan yang lebih baik dari tunggakan pembayaran, tarif yang tinggi pada kebanyakan daerah, penetapan biaya per satuan yang lebih baik, dan pengelolaan operasi dan keuangan yang ditingkatkan. Tindakan ini akan menghasilkan penghasilan untuk memperbaiki akses, terutama melalui investasi dalam distribusi dan kualitas air. Struktur kelembagaan menghendaki perbaikan dengan penugasan yang jelas tentang tanggung jawab dan pertanggung jawaban yang lebih besar bagi menejer dan menghapuskan transfer penghasilan kepada Pemerintah (Daerah). Perusahaan air minum yang kecil perlu dikelompokkan untuk meningkatkan viabilitas secara ekonomi dan meningkatkan pengelolaan sumber air. Akhirnya, pemberian hak bagi partisipasi swasta seyogyanya dipertimbangkan, seperti yang dipraktekkan di banyak negara di dunia.

xxxviii. **Menetapkan harga untuk efisiensi dan pemerataan**. Penetapan harga yang memadai adalah penting untuk mengelola pelayanan prasarana yang lebih baik, apakah milik pemerintah maupun swasta, dan untuk meningkatkan ketersediaannya. Unsur-unsur kunci adalah lebih kecil dan subsidi dengan sasaran yang mengena dalam tenaga listrik, air, kereta api dan angkutan umum; tarif harga air yang lebih tinggi; pungutan iuran untuk penggunaan jalan yang padat; dan persaingan untuk menurunkan harga pembangkit listrik dan telekomunikasi dalam perjalanan waktu. Cost recovery yang buruk men-subsidi yang berpenghasilan tinggi karena penduduk miskin

tidak mempunyai akses terhadap pelayanan. Sumber daya yang dikerahkan oleh penetapan harga yang memadai dapat digunakan untuk memperluas akses kepada pelayanan, yang akan memberikan manfaat kepada penduduk miskin. Masyarakat umum, termasuk penduduk miskin, bersedia untuk membayar akses yang lebih baik terhadap pelayan yang berkualitas. Tetapi, pengandalan yang mekanistis pada penetapan harga berdasarkan biaya akan mengurangi efisiensi dan persaingan internasional. Tujuan utama adalah untuk meningkatkan cara penetapan harga di suatu pasar yang kompetitif.

xxxix. **Me-rasionalisasi-kan pengelolaan sektor, mengurangi kerumitan kelembagaan, dan pemberian tanggung jawab yang lebih baik** dengan klarifikasi peran, fungsi, dan kewenangan, terutama pada pelayanan perkotaan. Fragmentasi dan tumpang tindih tanggung jawab pada keadaan sekarang ini akan menjurus kepada perumusan kebijaksanaan yang kurang tepat, investasi yang kurang efisien, kurang rasa tanggung jawab, dan kesulitan dalam partisipasi swasta. Sebagai tambahan untuk memisahkan peran pengaturan dari fungsi lainnya, Pemerintah Pusat seyogyanya menyerahkan pelaksanaan kepada tingkat pemerintah bawahan, BUMN dan sektor swasta, kecuali sebagai jaminan dengan pengelolaan yang berhati-hati dari pinjaman pemerintah. Sebagai penggantinya, Pemerintah menitik-beratkan pada perumusan kebijaksanaan dan perangkat sektor, pengembangan standar keuangan dan teknis serta prosedur, dan memberikan bimbingan dan bantuan teknis kepada Pemerintah bawahan.

xl. **Memberikan pelayanan umum sebagai usaha, yang tanggap kepada konsumen.** Lembaga pemerintah membutuhkan tujuan umum yang lebih kecil, yang menitik beratkan pada kualitas pelayanan, dan otonomi pengelolaan dan tanggung jawab yang lebih besar, serta pengandalan yang lebih pada sektor swasta (lihat di atas) untuk meningkatkan kinerjanya. Desentralisasi akan meningkatkan efisiensi dalam banyak hal, karena kebanyakan prasarana (seperti jalan lokal, air, saluran limbah cair, pembuangan limbah padat, dan pencegahan banjir) menghasilkan manfaat di tingkat lokal. Misalnya, menghubungkan pelayanan perkotaan lebih dekat ke pada penerimaan pendapatan melalui retribusi dan pajak kekayaan yang lebih tinggi atau penilaian (asset) yang lebih baik (yang, selain Jakarta, adalah terendah di negara berkembang) akan meningkatkan tanggung jawab dan kualitas pelayanan, serta akan meningkatkan ketersediaan sumber daya yang diperlukan untuk perluasan pelayanan. Dimana pasar tidak sesuai dengan permintaan pelayanan dan cost effective, Pemerintah perlu melibatkan si pemakai dan mereka yang berkepentingan di dalam proses pengambilan keputusan untuk meningkatkan efisiensi investasi.

D. Meningkatkan Kapital Manusia-Tantangan Yang Berubah di Sektor Kesehatan

xli. Indonesia telah membuat kemajuan yang substansial dalam pengembangan sumber daya manusianya dalam beberapa dekade yang lalu. Diperlukan peningkatan labih lanjut dalam sumber daya manusia, seperti dicanangkan dalam REPELITA VI, untuk meningkatkan kesejahteraan penduduknya dan untuk bersaing secara efektif di pasar internasional. Laporan ini membahas sektor kesehatan, sebagai suatu tantangan yang berubah dalam meningkatkan sumber daya manusia dan peranan sektor pemerintah. Untuk peningkatan pelayanan kesehatan, Pemerintah seyogyanya perlu untuk: (a) mempelajari kembali anggaran belanja dan proritas; (b) meningkatkan efisiensi dan kualitas pelayanan, terutama untuk penduduk miskin; dan (c) meningkatkan peranan pengaturan dan pemberian dukungan terhadap pemberian pelayanan umum oleh sektor swasta.

xlii. Salah satu peranan penting Pemerintah adalah dalam membiayai pelayanan kesehatan dasar. Penyediaan secara tersebar dari sistem pelayanan kesehatan pemerintah dalam bentuk puskesmas, klinik dan rumah sakit, telah menyediakan akses kepada pelayanan kesehatan yang sifatnya esensial. Indonesia telah berhasil pula dalam menyediakan pelayanan penting seperti imunisasi anak secara masal, pemberian gizi unsur mikro, dan pelaksanaan keluarga berencana. Namun, belanja secara keseluruhan dari kesehatan masyarakat umum masih rendah (jika dibandingkan dengan negara yang sedang berkembang lainnya). Dibutuhkan untuk pembiayaan kesehatan masyarakat yang lebih besar pada pelayanan kesehatan dasar dan unsur penunjangnya seperti investasi yang memadai dalam air minum dan sanitasi, untuk menyediakan suatu tingkat yang diinginkan minimum dan kualitas dari pelayanan (kesehatan) yang esensial, dengan titik berat pada penduduk miskin.

xliii. Walaupun Pemerintah telah meningkatkan pelayanan kesehatan dan jumlah petugas kesehatan secara substansial, penggunaan pelayanan kesehatan masyarakat (misalnya rata-rata kunjungan ke puskesmas) masih rendah. Penggunaan pelayanan kesehatan oleh penduduk miskin juga tampaknya turun antara 1987 dan 1992, yaitu menurut data SUSENAS. Salah satu faktor dalam rendahnya penggunaan tampaknya berkaitan dengan rendahnya kualitas pelayanan kesehatan. Terdapat laporan mengenai perawat kesehatan dengan pelatihan yang belum memadai, kecerobohan pemeriksaan fisik, tidak konsistennya antara diagnosa dan resep, dan praktek pasien yang belum baik. Dengan demikian, perhatian yang lebih besar diperlukan terhadap perbaikan kualitas pelayanan kesehatan masyarakat, yang dibedakan menurut kondisi kesehatan yang khusus daerah tertentu, dan menitik-beratkan pada rumah tangga dan daerah miskin.

xliv. Daerah ketiga yang penting untuk perbaikan adalah peranan pengaturan dan penunjangan Pemerintah dalam pelayanan kesehatan swasta. Pembelian obat-obatan adalah bagian yang terbesar dari belanja rumah tangga, dan penyakit yang mudah disembuhkan dengan obat-obatan sering tidak dapat ditangani karena biayanya yang tinggi dan pasokannya dan penyebaran yang tidak merata. Produsen farmasi swasta tampaknya menikmati tingkat proteksi yang tinggi dan tidak adanya persaingan. Pelayanan kesehatan swasta yang tumbuh pesat juga tampaknya memberikan pelayanan dengan kualitas yang belum memadai. Pemerintah mempunyai peranan penting dalam meningkatkan kualitas tenaga kesehatan dengan menyediakan pelatihan, akreditasi dan baku mutu yang lebih baik.

xlv. Dengan perbaikan di daerah-daerah tersebut di atas, dimungkinkan bagi Indonesia untuk mencapai kemajuan yang substansial lebih lanjut dalam hasil-hasil di sektor kesehatan. Laporan ini menyarankan bahwa Pemerintah:

- **Meningkatkan anggaran pelayanan kesehatan masyarakat, mentitik-beratkan pada pelayanan kesehatan penduduk miskin.** Anggaran belanja pemerintah untuk kesehatan rendah (sekitar 0,7 persen PDB, dibandingkan dengan 2,0 persen dari PDB pada semua negara berkembang). Pemerintah perlu menyediakan anggaran belanja lebih besar untuk kesehatan untuk menjamin suatu tingkat perbaikan kualitas pelayanan dan sarana pendudkung (misalnya air minum dan sanitasi). Pemerintah menyadari kebutuhan ini, dan bermaksud untuk menaikkan anggaran belanja secara progresif.

- **Meningkatkan pelayanan kesehatan untuk penduduk miskin,** dengan lebih

tanggap terhadap kebutuhan lokal dan anggaran belanja puskesmas dan klinik yang meningkat yang sangat efektif menjangkau penduduk miskin. Penyediaan kartu pemeliharaan kesehatan yang gratis untuk penduduk miskin tidak cukup; insentif yang lebih baik untuk petugas kesehatan untuk melayani penduduk miskin diperlukan pula.

- **Meningkatkan kualitas dan efisiensi pelayanan masyarakat,** dengan meningkatkan pengelolaan fasilitas kesehatan garis depan, menyediakan dengan dana, memperbaharui insentif petugas kesehatan, membentuk program jaminan kualitas dan mendorong jangkauan masyarakat yang lebih luas. Dalam hal petugas kesehatan, kebijaksanaan seharusnya ditujukan untuk memenuhi kebutuhan dan permintaan lokal, dengan kewenangan yang lebih besar diberikan kepada pemerintah setempat dan pengelola fasilitas umum bertanggung jawab atas pelayanan di daerah. Penempatan petugas pada fasilitas kesehatan pedesaan yang terpencil memerlukan perhatian yang seksama, demikian pula persyaratan penerimaan, seleksi dan pelatihan tenaga bidan.

- **Meningkatkan pasokan obat-obatan** untuk fasilitas kesehatan masyarakat dan melembagakan cara distribusiannya; meneruskan untuk melakukan deregulasi perdagangan farmasi untuk mengurangi biaya obat-obatan.

- **Mendorong Praktek Dokter Swasta** dengan mengijinkan dan mendorong organisasi lembaga swadaya masyarakat dan swasta lainnya, lembaga tidak mengejar laba untuk memberikan pelayanan kesehatan; mendorong asuransi swasta dan bukan asuransi kesehatan yang disediakan Pemerintah; meningkatkan mekanisme yang ada dalam penilaian fakultas kedokteran, mempelajari kurikulum, dan ujian mahasiswa untuk meningkatkan kualitas petugas kesehatan; menyiapkan secukupnya untuk deregulasi pelayanan kesehatan swasta untuk memungkinkan entry praktek dokter internasional dan tenaga profesional pengelola kesehatan ke dalam praktek dokter swasta.

E. Pembiayaan Eksternal dan Bantuan Luar Negeri

xlvi. Kebutuhan pembiayaan eksternal jangka menengah Indonesia akan dapat dipenuhi jika langkah kebijaksanaan kunci seperti yang digariskan di dalam bagian-bagian terdahulu dilakukan Pemerintah secara tepat waktu. Keperluan pembiayaan secara garis besar akan bertambah secara nyata pada 1995/96, dengan menggantungkan pada investasi yang lebih besar oleh sektor swasta (yang impornya memperlebar defisit transaksi berjalan), yang menaikkan pembayaran bunga dan pinjaman pokok, (berkaitan dengan perobahan nilai tukar lintas mata uang). Tambahan lagi, kepekaan dalam pasar uang internasional menunjukkan bahwa diinginkan untuk meningkatkan cadangan devisa pada tahun anggaran 1995/96. Pembiayaan yang meningkat berasal terutama dari sektor swasta, yaitu investasi langsung asing yang lebih tinggi dan pinjaman swasta yang berkaitan dengannya.

xlvii. Selama kurun waktu jangka menengah, transaksi berjalan cenderung untuk menyempit sebagai suatu prosentase dari PDB, yang mencerminkan langkah-langkah untuk menghindari pemanasan ekonomi, tetapi pembayaran kembali hutang luar negeri akan meningkat dan cadangan devisa akan terakumulasi dalam tahapan yang berhati-hati. Sebagai akibatnya, kebutuhan pembiayaan total akan terus naik, sebesar kira-kira US$2 milyar per tahun. Kenaikkan jangka menengah dalam kebutuhan pembiayaan ini akan dipenuhi seluruhnya oleh sektor swasta (yaitu oleh investasi langsung asing, pinjaman jangka menengah dan panjang dan pemasukan yang

berkaitan dengan perdagangan jangka pendek). Pencairan dana bantuan resmi tetap tidak berobah, sementara pinjaman pemerintah dari sumber swasta akan menaik sedikit.

xlviii. Terlepas dari peningkatan pentingnya sektor swasta dalam pembiayaan eksternal Indonesia, bantuan resmi akan terus memainkan peranan yang strategis. Pertama, bantuan resmi adalah cara atau jalan yang konkrit bagi Pemerintah asing dan badan internasional memberikan tanda dukungan mereka untuk kebijaksanaan pembangunan Indonesia. Kedua, ketersediaan jumlah yang memadai bantuan luar negeri menjamin suatu transisi yang berjalan secara teratur menuju sumber pembiayaan yang beragam. Ketiga, bantuan resmi tersebut menjamin penyediaan yang mencukupi untuk bidang pembangunan yang bukan merupakan minat sektor swasta, misalnya, pengembangan sumberdaya manusia dan beberapa bidang prasarana atau fasilitas umum. Akhirnya, persyaratan dan resiko diversifikasi yang berkaitan dengan bantuan resmi meningkatkan struktur pembiayaan eksternal; hal tersebut juga membantu untuk mempertahankan akses Indonesia kepada pasar uang internasional dan meningkatkan daya tarik negeri ini sebagai tujuan bagi investasi langsung asing.

xlix. Atas dasar perkiraan disajikan pada Bab 1, dan tersedianya proyek yang kemungkinannya dapat disetujui, komitmen bantuan pembiayaan (termasuk hibah) dari Consultative Group for Indonesia (CGI) yang sama dengan angka tahun lalu diharapkan sebesar US$5,2 milyar. Setelah memperhitungkan dana yang belum cair (pipeline of assistance), akan hal ini menghasilkan pencairan dana berjumlah lebih dari US$4 milyar, termasuk dana hibah. Sisa kenaikkan dalam kebutuhan pembiayaan dalam tahun anggaran 1995/96 akan dipenuhi dari pencairan dana yang berasal dari sumber lain.

l. Seperti diketahui oleh kedua pihak Pemerintah Indonesia dan donor pada pertemuan CGI dalam bulan Juli 1994, kebutuhan prioritas Indonesia menghendaki komposisi bantuan ini yang menekankan pada pengembangan sumber daya manusia, pengurangan kemiskinan, dan penyediaan prasarana fisik yang merupakan hambatan bagi sektor swasta. Perkembangan sejak pertemuan CGI tahun lalu, mencatat minat sektor swasta dalam meningkatkan secara nyata dalam bentuk pembelajaannya pada investasi prasarana. Dengan demikian, daerah prioritas untuk bantuan yang baru adalah pengembangan sumber daya manusia, pengurangan kemiskinan, perlindungan lingkungan, dan penyediaan prasarana fisik yang menunjang kegiatan sektor swasta.

EXECUTIVE SUMMARY
INDONESIA: IMPROVING EFFICIENCY AND EQUITY – CHANGES IN THE PUBLIC SECTOR'S ROLE

Overview

Indonesia has done well in sustaining rapid economic growth and reducing poverty, and moved into the lower middle-income group of countries. To maintain progress, Indonesia must deal with a number of challenges. First, recent rapid economic growth is generating signs of overheating. Projected rises in infrastructure spending and foreign and domestic investment could worsen these pressures. Second, international lenders are scrutinizing countries' policies more carefully since the Mexico crisis. Lenders are interested in strong macroeconomic fundamentals and prudent external debt management, but also in frameworks that ensure that borrowings are put to efficient use and will help service external debt. Third, international markets are becoming more competitive. Indonesia must be competitive in these markets in order to maintain the rapid increases in non-oil exports that are needed for continued broad-based growth and reduction of the large external debt burden.

To meet these challenges, the Government must improve efficiency and equity. This will entail greater emphasis on the Government's regulatory role, less emphasis—but more efficiency and equity— in its financing and production roles, and correspondingly greater reliance on the private sector. Governments are making this shift the world over. Specifically, sustaining progress will depend on continuing macroeconomic stability, improving markets and regulatory frameworks, relying more on the private sector, and increasing the efficiency of public investments and services.

1) ***Maintain strong macroeconomic fundamentals.*** *To maintain stability, manage debt and improve investor confidence, the key steps would be:*

- *Limit spending to budgeted levels and curtail off-budget spending;*
- *Tighten fiscal policy to cover the increase in external debt service arising from cross-currency movements; use privatization receipts to prepay external debt;*
- *Raise more domestic revenues from better tax administration and higher forestry (IHH) and urban property taxes;*
- *Improve public pricing policies (land, water, energy, transport), which would also benefit efficiency and the environment;*
- *Track international interest rates closely and target a prudent increase in international reserves;*
- *Strengthen the banking system. Provide highest-level support for recovery of bad debts, improve disclosure, strengthen regulation, and carry out the programmed increases of capital in all banks, to cover higher provisions against classified assets;*
- *Improve regulation and disclosure in the non-bank financial sector, to encourage development of new instruments and to ensure prudent development of the sector, particularly investments of pension funds;*
- *Strengthen the Commercial Offshore Loan Team and continue strict enforcement of external borrowing ceilings and prudent management of public and quasi-public debt.*

2) ***Improve markets.*** *The May 1995 trade deregulation package represents a major step to improve markets: it reduces tariffs substantially up-front, and sets a rules-*

based program for reaching a low, fairly uniform multilateral tariff by 2003. With this package, Indonesia continues progress towards open market in trade and investment, following up on last year's PP-20, which significantly reduced barriers to foreign investment, and its hosting of the APEC meeting in Bogor. To sustain further progress, Indonesia needs to:

- *Reduce non-tariff barriers, particularly on agriculture, which will improve real wages;*
- *Eliminate export restrictions and domestic trade restrictions, since they rarely serve stated objectives, and hurt exporters and small-scale producers;*
- *Expedite legal, regulatory and institutional reforms to strengthen domestic competition, including the financial sector (see above);*
- *Privatize public enterprises operating in competitive markets;*
- *Ensure more sustainable development by shifting to market-based pricing for land, forests, and water; develop better resettlement practices; reform land permits and land-use policies for private projects; strengthen industrial pollution control; and invest more in basic urban services.*

3) ***Establishment of clear, competitive regulatory framework for private participation in infrastructure sectors,*** *instead of a "deal-by-deal" approach, would lead to sustained investment flows and lower infrastructure costs (as in the Philippines). Critical infrastructure bottlenecks will need to be relieved while maintaining macroeconomic stability in order to maintain rapid growth and improve access to services. This means greater efficiency, in particular greater reliance on the private sector as proposed in* REPELITA VI, *through:*

- *Rationalizing investment in the power sector, with greater emphasis on transmission & distribution; the resulting gains could lead to 15 percent more sales from existing generation capacity;*
- *Establishing transparent and competitive regulatory frameworks and tenders/bidding for private concessions—in power, natural gas, telecoms, toll-roads and water;*
- *Prudently managing explicit and implicit public guarantees and contingent liabilities;*
- *Pricing public services better, for greater efficiency and equity;*
- *Managing public services better—through improved pricing, and more customer-oriented public services, in sectors such as water, sewerage and waste disposal, and urban transport;*
- *Focusing public investment on areas where private investment interest is low and equity impacts are high.*

4) ***Human resource development will be a key to longer-term improvements in competitiveness, and better equity.*** *The Report discusses the health sector, as one example of the transition challenges in improving human resources.*

- *Increase public health spending, focused on essential health services and the poor;*
- *Improve health services for the poor, by increasing spending on health centers and sub-centers, providing incentives for health personnel to treat the poor, and by being more responsive to local needs;*
- *Improve the quality and efficiency of basic public services, by improving the management, resources, staff incentives, and quality assurance in front-line health facilities, and encouraging community outreach activities;*
- *Encourage private services, by supporting non-profit agencies' delivery of services; reducing medicine costs; and deregulating private health insurance and medical services;*
- *improve training and standard-setting.*

A. Recent Economic Developments

i. Indonesia moved into the lower middle-income group of countries (as classified by the World Bank) in 1993, following a decade of about 6 percent per annum average growth in GDP; in 1994, its per capita GNP reached an estimated US$884 (according to the new national accounts from the Central Bureau of Statistics). Manufacturing is now the largest sector in GDP. Non-oil exports and taxes account for the bulk of total exports and Government revenues—demonstrating the economy's successful diversification away from oil. Employment has grown rapidly, and women have entered the labor force in large numbers. As a result, the percentage of the population in poverty fell from about 30 percent in 1987, to about 14 percent in 1993, according to official estimates.

ii. Following a cooling-off period in 1992 and early 1993, all major sectors of the economy have expanded rapidly, except agriculture. In 1994, GDP growth was 7.3 percent according to the new, rebased national accounts. Growth was led by construction and domestically-oriented manufacturing; agri-culture suffered a second consecutive year of weakness, reflecting the severe dry season.

iii. Deregulation proceeded strongly over the past year. With the mid-1994 deregulation package (PP-20), Indonesia reduced barriers to direct foreign investment to among the lowest in the region. As host of the November APEC meeting in Bogor, Indonesia provided strong support for open markets for trade and investment. The Government's May 1995 deregulation package lowered average import tariffs up-front to about 15 percent, a cut of nearly 25 percent that puts the average rate close to Malaysia's. The package also sets a rules-based program for future tariff-cuts, which will reduce the average tariff to 7 percent and greatly reduce tariff dispersion by 2003. This represents a significant broadening and deepening of Indonesia's commitment to multilateral tariff reduction, going well beyond GATT commitments.

iv. Last year's successes were, however, accompanied by some signs of overheating. Inflation was nearly 10 percent for the second consecutive year, and totaled 4.8 percent in the first four months of 1995, pushed up by higher food and housing prices, and rising aggregate demand. Wage pressures have increased, to which the large increases in official minimum wages in 1993 and 1994 contributed. The non-oil trade balance for 1994/95 deteriorated by nearly US$1.5 billion, although the current account deficit remained low (US$3.5 billion or 1.9 percent of GDP) because of strong oil revenues. Non-oil import growth was rapid (21 percent), reflecting food and other consumption goods imports, while non-oil exports growth exceeded 16.5 percent, an appreciable improvement after the slowdown in the first quarter of 1994. The recent large cross-currency movements, plus some new borrowings, have pushed external debt up to about US$100 billion.

v. In 1994, foreign investment approvals rose nearly 200 percent (to nearly US$24 billion), in part reflecting last year's deregulation of foreign investment under PP-20. Moreover, the total excludes the US$34 billion Natuna natural gas project signed early in 1995. Domestic investment approvals rose by 50 percent. The Government also has underway some US$15 billion of private infrastructure projects. Careful management of these projects will be needed to ensure that aggregate demand and the balance of payments remain at prudent levels.

vi. Fiscal policies in 1994/95 were budgeted to be appropriately cautious, and Indonesia is estimated to have ended the year with a small overall surplus; this fiscal outturn was about one-half percent of GDP tighter than in 1993/94. However, the 1995/96 budget appears to be somewhat less contractionary. The budget boosts personnel spending by 19 percent including a 10 percent rise in civil service salaries. By comparison, it increases capital spending by only 12 percent. Revenue growth is budgeted to slow, reflecting cuts to income taxes of about one-third that were designed to make the tax regime more competitive. The projected higher financing requirements and lower Government savings will add to, rather than offset, rising demand pressures from the private sector.

vii. Bank Indonesia raised interest rates agilely during the latter half of 1994 and early 1995, responding effectively to rising international interest rates and the Mexico crisis. Earlier, in the first half of 1994, a number of factors—the increase in US interest rates, the worldwide shift of portfolio capital against emerging markets and local factors—led to some capital outflow. These factors and Bank Indonesia's slower response in raising interest rates contributed to a substantial loss of net foreign assets. In the banking sector, the Government is moving to address the problem of bad debts by strengthening prudential regulations and banking supervision. Also, the strong prosecution of the BAPINDO fraud case set a good example. However, cautious management of the financial sector is needed, particularly as real estate lending has grown rapidly.

viii. The Government managed the exchange rate well during 1994 and 1995 to maintain external competitiveness. It protected the rupiah from the contagion effect of the Mexico crisis by raising domestic interest rates and sold only a small amount of reserves.

ix. In other developments, Indonesia's privatization program began. A minority share in PT INDOSAT, an international telecommunication firm, was sold off in the stock markets. About US$750 million of the proceeds were used to pre-pay older, high fixed-interest loans from multilateral banks. The Government has also announced its intention to list PT Telkom (domestic telephones), PLN (the state electricity company), PT Jasa Marga (tollroads), PT Garuda Indonesia (the national airline), Bank Negara Indonesia (banking), and PT Aneka Tambang (tin) and PT Timah (tin). In addition, the Government signed power purchase agreements (PPAs) that will account for a substantial portion of power generation investments, and is advancing private participation in other infrastructure sectors (e.g., telecommunications, toll-roads).

B. Macroeconomic Policy Agenda

x. Indonesia can sustain economic growth of about 7 percent a year if it maintains macroeconomic stability and addresses longer-term efficiency issues. Growth at that rate would raise per capita income to over US$1,000 before the turn of the century. Employment and earnings growth would reduce poverty and raise average living standards substantially. While the projected private foreign investment boom will temporarily keep demand pressures high, key macroeconomic indicators would improve over time. Inflation would fall, and the current account deficit would decline to under 2.5 percent of GNP (compared to an expected 2.7 percent in 1995/96-1996/97). Finance will increasingly come from much larger direct foreign investment (equity) inflows and from private borrowing. To achieve this

sustained rate of growth, Government will need to maintain macroeconomic stability by tightening fiscal and monetary policy, managing external debt prudently, and improving investor confidence.

B1. Macroeconomic Stability

xi. Fiscal policy is the most effective instrument for managing aggregate demand in the context of Indonesia's open capital account. With the overall direction already set in the 1995/96 budget, and private demand rising rapidly, the Government will need to limit spending to budgeted levels, avoid off-budget spending and improve tax administration. Revenue could be increased further by raising forestry fees (*Iuran Hasil Hutan, (IHH)*), raising urban property taxes and assessments, and pricing infrastructure services better. Spending on infrastructure also needs to be rationalized. (See paras. xxxiv and xxxv). Privatization proceeds or higher-than-budgeted revenues should be used to retire high-cost external debt, following the INDOSAT example. Finally, future budgets will need to be tightened to cover the increase in public external debt servicing costs resulting from recent cross-currency movements.

xii. To maintain prudent international reserves and support a cautious macro-economic stance, tighter monetary policies also will be required. Bank Indonesia will need to continue to follow international interest rate movements closely, and raise interest rates beyond that if circumstances warrant. To deter short-run speculation and transfer more exchange-rate risk from the central bank to the market, Bank Indonesia also could widen spreads in the foreign exchange rate market when international exchange markets become calmer.

xiii. With tighter demand management and the return of better agricultural conditions, inflation can be reduced to 6 to 7 percent a year. But caution is needed in increasing official minimum wages. More flexible labor markets and attention to other cost elements would serve labor, employment, and export competitiveness better. To ensure continued rapid employment growth, the Government should not set minimum wages at levels that approach average wages in many sectors of the economy, or that would require overly large productivity increases to remain inter-nationally competitive.

xiv. Further deregulation would also contribute to lower inflation and improve equity, besides spurring more efficient growth (Section C). The May 1995 deregulation package has already resulted in some price declines (e.g., automobiles). Lowering non-tariff and tariff barriers on key commodities, especially agricultural products, would reduce pressure on consumer prices, and raise the real wages of low-income consumers without reducing competitiveness.

B2. External Debt Policy

xv. International investors are increasingly concerned about countries' external borrowings—not only the volume but, in the wake of the Mexico crisis, their effective use. These concerns are relevant for Indonesia, where external debt is large. World Bank estimates are that short-term debt exceeds US$20 billion and the debt service ratio exceeds 30 percent. Moreover, higher infrastructure spending and the financing of other large projects will increase private external debt further.

xvi. The Government needs to manage debt carefully within an overall, coordinated framework. The Commercial Offshore Loan Team's role needs to be strengthened, and ceilings should limit public or quasi-public external borrowings to prudent levels over the next few years. The Government also should avoid providing guarantees to private projects and their associated external lenders. Commercial lines of credit at Bank Indonesia should be set aside to protect against unforeseen adverse external events, and not used for off-budget finance. There is scope for refinancing and pre-paying expensive external debt.

xvii. To maximize the efficient use of external borrowing the Government needs both open markets and a sound regulatory framework. The May 1995 deregulation package will improve the efficiency of external borrowings, by helping ensure that private investment goes into more internationally competitive activities. The Government could further improve efficiency by deregulating non-tariff and tariff barriers in agriculture, removing the still numerous barriers to exports and improving domestic competition. Together with the May 1995 package and last year's PP-20 deregulation of direct foreign investment, this would promote the growth in non-oil exports necessary to reduce the debt service burden. A sound regulatory framework for private infrastructure investment, including clear, competitive bidding for concessions and unbundling of public enterprise functions to allow more market-based competition, will lower costs of investment and, directly or indirectly, will contribute improved debt servicing capacity (Section C).

B3. Investor Confidence

xviii. Continued sound macroeconomic fundamentals are the foundation of investor confidence. Standard and Poor's recent upgrade of Indonesia's credit rating to BBB reflects past successes in this area. However, these policies alone might not be sufficient to insulate Indonesia from sudden adverse shifts in portfolio preferences (as happened to some degree after the Mexican peso crisis). To reduce this vulnerability, short-term debt needs to be carefully monitored, international reserves maintained at higher levels to guard against the increased volatility of capital flows, and interest rates adjusted agilely in light of international developments. If necessary, a forceful tightening of monetary policy and significant fiscal action would minimize the danger of major capital outflows.

xix. Further progress on the financial sector also will be crucial. Despite progress over the past year, many banks are still burdened by non-performing assets. It will be vital for the Government and Bank Indonesia to persist with policies to improve the banking system (which is discussed below in Section C). An additional important issue is to strengthen regulation of the non-bank sector, particularly of the security of investments and the exposure limits of pension and insurance funds. Prudential regulations, particularly with regard to public pension and insurance companies and non-bank finance companies, are important to ensure the stability of the financial system, that productive investments are made and that the Government is not left with large unfunded obligations to pensioners.

C. Encouraging Efficiency and Equity

xx. Long-term growth in Indonesia will depend on macroeconomic stability but also on increasing productivity and efficiency in the private, market-based economy; providing better infrastructure; and strengthening human resources. Changes in the Government's role, in particular improvements in markets and the regulatory

frameworks, greater reliance on the private sector, and more efficient public investment and services, will be critical to these efforts. These changes would also further equity objectives. This Report does not provide an exhaustive treatment of all aspects of a changing role of the public sector. For example, it treats regional development and decentralization of public services only briefly. Also, education sector policy issues are not discussed, as the necessary analysis is still ongoing. The Report focuses on the changes needed in the regulatory role of the Government in markets and infrastructure, and ways to improve public services, including greater reliance on the private sector. It discusses issues in the health sector, as one example of the transition challenges in improving human resources and the role of the public sector.

C1. Enhancing Competitive Market Outcomes

xxi. With most future growth to come from the private sector, Indonesia will require more than a high rate of private investment. It must also use investment productively. The Government will need to provide an incentive framework that encourages efficient private enterprise by instituting policies and enforcing regulations that ensure greater openness to trade, and improved domestic market competition and institutions. Improved efficiency also would come from privatization of public enterprises, particularly in competitive sectors. Greater efficiency will be critical to generating the non-oil export growth needed to achieve broad-based growth and reduce the debt burden. Broadly based deregulation can also help promote small and medium-enterprises, encourage agricultural smallholders, and produce substantial benefits for consumers, including low-income consumers.

xxii. **Deregulating International Trade.** Openness to international trade helps economies achieve higher productivity and faster growth, including exports. With the May 1995 deregulation package, Indonesia has embarked on a rules-based, pre-announced program of tariff cuts, the most significant since 1991. The package will encourage a shift of resources to sectors where they are the most productive, and produce greater competitive pressures in the economy.

xxiii. The May 1995 trade reform package reduces the average tariff to 15 percent with cuts of tariffs on 4,500 items by five percentage points, on 1,050 items by ten percentage points, and 500 items by 15-35 percentage points. In addition, the package reduces surcharges and sets out a schedule for reaching a 7 percent average tariff by 2003.

xxiv. However, the May 1995 deregulation package left agricultural trade and exports largely untouched. Eliminating non-tariff barriers on products such as sugar, wheat and wheat-flour, and soybean processing, would lower food prices and benefit consumers, especially low income consumers, and raise real wages without raising industrial costs. It would also reduce the high costs of agricultural inputs for agro-processing. Finally, it would reduce distortions. For example, sugar restrictions lead to a misallocation of about 2 percent of rice land to sugar, at a cost to the rice self-sufficiency program and national efficiency—Indonesian rice is much closer to international competitiveness than is sugar.

xxv. Indonesian exports also are regulated and controlled, especially agricultural exports There are now export bans on 72 specific products, and another 1,827 products are regulated exports, which

can only be handled by approved exporters. Another 105 products are supervised exports that require approval, and 80 products are subject to special export taxes. By value, controls affect fully half of all non-oil exports and nearly two-thirds of agricultural exports. Such restrictions inhibit producers and rarely achieve their stated objectives of raising quality, promoting efficient down-stream industries, or stabilizing domestic supplies. They do, demonstrably, deter export growth. Eliminating these export restrictions would stimulate agricultural exports and raise smallholder incomes, especially in the outer islands.

xxvi. An across-the-board elimination of export restrictions is thus warranted for all commodities (except textiles, which are now locked into Multi-Fiber Arrangement quotas, and endangered species). In forestry, higher logging fees would encourage more sustainable practices, raise budgetary revenues and encourage more efficient wood-based industries. (At current rates of exploitation and with today's inefficient logging and industry practices, supplies of commercially sized logs will come into short supply by the year 2010 or earlier).

xxvii. **Increasing domestic competition.** Significant deregulation of foreign and domestic investment restrictions and licensing procedures, and the deregulation of external trade barriers have increased competition. However, many restrictions on domestic trade still hinder efficiency and contribute to a high-cost economy: industry cartels, price controls, entry and exit controls, exclusive licensing, public sector dominance, non-transparent Government bidding and procurement processes, and Government intervention in favor of specific firms or industries. Some restrictions are imposed by the national Government, others by sub-national Governments, and still others by Government-sanctioned industry and trade associations.

xxviii. There are several policy directions that the Government can follow to encourage greater domestic competition. A rules-based approach to domestic trade deregulation, as in the case of external trade deregulation, is needed. The Government should eliminate any Government-sponsored or sanctioned monopolies controlling marketing and distribution of "strategic" and other commodities, and open the distribution (wholesale and retail) sector to foreign investment. It can make sure that restrictions on engaging in domestic trade are minimal. An ordinary business license, for instance, rather than membership in commodity or trade associations, should be the only permit required. Domestic trade deregulation should also follow the lowering of tariffs and the elimination of non-tariff barriers to imports and exports. Commodity-specific taxes, provincial Government levies (*retribusi*) and taxes on trade, and other trade restrictions should be eliminated. The main objective of competition law should be to promote and maintain competition, to benefit consumers. Public contracting, including that by public enterprises, should follow regulations and rules requiring competitive bidding and transparent procedures. Limits on bank exposure to related business groups should be enforced, as scheduled.

xxix. **Public enterprise reform and privatization.** Public enterprises lag behind their private competitors in both returns to assets and quality of service. Moreover, public enterprise performance deteriorated between 1990 and 1994.

xxx. To improve the performance of public enterprises, Indonesia needs to develop a comprehensive program of enterprise reform, focusing on privatization of firms operating in competitive markets. In these

sectors competition, particularly if increased through the measures recommended above, could ensure better service at lower cost. Too often, the public firms end up providing an umbrella for inefficiency. Partial privatization through the stock market alone is unlikely to do the job. Competent private partners are needed to manage the firms, and transparent and competitive procedures are required to attract their entry. Finally, oversight arrangements would need improvement for enterprises that remain in the public fold. Major steps will be appointment of professional managers and boards, granting of greater autonomy to managers (especially from sectoral ministry oversight and interventions), and instituting a performance monitoring system accountable to a single, independent body (such as a public enterprise board).

xxxi. **Developing Efficient "Rules of the Game".** Improvements in the rules of the game would promote sustainable, and efficient private sector led growth. The Government has a major role in these areas: the financial sector, because market mechanisms alone cannot adequately protect the soundness and safety of the system; the environment, because of large externalities; and the legal framework, where a modern enforceable system is needed for competitive markets to work.

- **Regulating the Financial Sector.** Although the legal and regulatory framework for the banking sector has improved, more progress is necessary. Policies should be strengthened to recover overdue loans, strengthen banking supervision, improve disclosure by requiring more frequent publication of audited balance sheets, reduce banks' exposure to single-client groups, merge weaker banks with stronger ones, and improve the capacity to handle bank liquidation. As their financial condition improves the Government should prepare the stronger state commercial banks for privatization. Non-bank financial institutions (e.g., leasing, consumer-finance, and other), whose activities are growing very fast, need better prudential regulations, particularly more disclosure of accurate financial information to investors. Public pension and insurance schemes need particular attention to ensure that productive investments are made and that the Government is not left with large unfunded liabilities.

- **Setting the Rules for Private Market Activities.** Indonesia's present lack of transparent, predictable and enforceable rules for business puts it at a competitive disadvantage and, by discouraging entry and competition, reduces efficiency. Improving the legal environment is therefore a key item on the policy agenda. The recent enactment of Company Laws is an important step. But credit and security (e.g., collateral) laws also need to be updated, including the recognition of a wider variety of legal security, more systematic rules for the titling, transfer, and mortgage of land, and a system for registering and enforcing collateral. Commercial arbitration and the functioning of the court system also needs urgent attention. While initiatives are underway, business would benefit from a few expeditious reforms—such as setting up specialized commercial courts, publishing court decisions, and improving arbitration laws and procedures. Rules preventing the abuse of market power would also help support market institutions. To improve the functioning of capital markets, protection of minority shareholders and takeover regulations (following the new Company Law) need to be enforced. Finally, the draft capital markets law will provide a better

institutional foundation for capital market development.

- **Managing the Environment**. There is strong complementarity between good economic policies and an effective strategy for environmentally sustainable growth. Moreover, the Government also needs to set an appropriate regulatory/incentive framework for environmentally responsible behavior. This is because unregulated markets often fail to reflect the environmental costs of firms' actions. In land policies, creating a transparent land market and adequate property rights is essential: reforming the process of granting land permits to private developers, moving to market-based prices for state lands (including transparent public auctions), adequate resettlement policy for public land acquisition, and simple, focused land-use planning activities. In forestry, higher concession fees (IHH) and better regulation over concessionaires and protection of local communities are critical to ensure sustainability. Water management will also benefit strongly from better pricing, and improved river basin management. Urban development will require a larger role for market forces and better institutional arrangements (discussed further in the infrastructure section below). In industry, pollution control efforts need to be targeted and institutional capacity for monitoring and enforcement strengthened. Reducing future pollution requires focusing on environmental assessments and pollution abatement for new plants. In addition to these regulatory/incentive issues, more public (and private) investment in improving the environment will be needed.

C2. Managing Infrastructure Services

xxxii. Rapid industrial growth and associated urbanization are beginning to overload Indonesia's infrastructure. Although capacity has increased substantially, further improvements are needed to sustain rising living standards, international competitiveness, and equity improvements.

xxxiii. With macroeconomic prudence limiting the volume of infrastructure investment, increased efficiency in infrastructure investment and operation is essential to achieving these goals. Increased private participation, under a sound regulatory framework, would contribute to increased efficiency and is programmed under REPELITA VI. The Government will continue to have a major role in infrastructure, but one that focuses less on investment and more on improved management of the overall investment program, public and private; of the regulatory framework; and public infrastructure. This will entail: rationalizing the investment program and balancing public/private interactions, developing a clear and competitive regulatory framework to maximize the benefits of private finance, and unbundling public activities so that better use can be made of private sector participation and investment. Another important element is improved pricing of services, to recover costs, finance capacity expansion, manage demand and encourage more efficiency. To improve the quality of public services, the Government needs to run public enterprises more like a service business, responsive to consumers, clarify institutional responsibilities within the Government, and decentralize and increase local participation.

xxxiv. **Rationalizing Investment and Improving Capacity Utilization**. Proposed infrastructure investment, public and private, is about 50 percent larger (as a percentage of GDP) than during REPELITA V. Unless investment is rationalized, it is likely that the current account deficit will widen. Of course,

proposals may not turn into actual investments, particularly in the context of tighter world capital markets. Thus the Government must steer a careful course between overheating and undercapacity. To do this, it must rationalize sectoral investments on the basis of efficiency. Public investment will need to be concentrated on critical areas where private investment is likely to be low, and equity impacts high.

xxxv. For example, more emphasis should be put on power transmission and distribution (which is the underlying cause of poor power delivery) rather than on generation (where substantial excess capacity already exists on Java-Bali). Better use of existing capacity depends primarily on improving transmission and distribution; together with more efficient management of capacity, this could permit about 15 percent more sales from existing generation capacity. Power generation and telecommunications could rely more on private investment, perhaps even going beyond REPELITA VI guidelines if the regulatory framework improves. Finally the Government needs to follow through on planned investments in underserved sectors to improve such vital services as urban water, sanitation and transport, as well as access to services in the rural areas.

xxxvi. **Developing a clear, competitive regulatory framework to maximize the benefits of private finance and increase efficiency.** A steady flow of private investment, at reasonable cost, will depend on a switch from the negotiated deal-by-deal approach to a clear, competitive regulatory framework. The first step is to define the concessions clearly, up-front, and award them through transparent, competitive bidding (with specific conditions depending on the sector). This approach has lowered costs in the Philippines and in Indonesia itself. The framework also needs to manage risks prudently by allocating them to parties most competent to manage them, and by managing prudently and pricing appropriately scarce public sector credit guarantees and contingent liabilities.

xxxvii. **"Unbundling" public sector functions, within a framework of more competition and appropriate regulation, could encourage efficient private participation and produce gains for consumers.** An easy first step that would reduce costs would be to encourage public firms to contract-out maintenance, billing, management, construction, and other non-core services competitively. A more complicated, but eventually necessary task to improve efficiency, would be to split-up (unbundle) production, transmission, and distribution in power, gas, and water. This would open up possibilities for efficiency gains through direct competition, in addition to the indirect, bidding competition for concessions. Unbundling would also permit firms to sell power, gas or water through grids directly to users. Finally, sector regulatory frameworks will be needed. In this regard, it will be important to separate public regulatory functions from public enterprises to prevent conflicts of interest.

- *Power.* Currently, private firms are expected to generate and sell electricity to PLN on "take-or-pay" contracts. These contracts generally have been negotiated with pre-selected bidders rather than being put out to open competitive bidding. In light of PLN's financial position and the need to concentrate resources on transmission and distribution, the private sector should be encouraged to competitively bid for all new generation plants, which will also depend on improved access to gas supplies. Private firms should also be encouraged to sell directly to users through the grid (wheeling). This would reduce the risks of excess capacity that are inherent in

take-on-pay contracts, and return some of the commercial risk of projecting demand to the private sector.

- *Telecommunication*. PT Telkom is being reorganized into 7 regional companies, 5 of which are entering into joint operating ventures with competitively chosen private operating companies, to manage regional phone systems and install 2 million phone lines. PT Telkom will manage the Jakarta and Surabaya systems, installing another 3 million lines. PT INDOSAT has already been listed on the stock market and PT Telkom's listing is planned. In international services, and cellular phones, PT Satelindo was given franchises and Deutsche Telekom recently bought a one-quarter interest in the company for US$586 million. Important issues will be to introduce further competition in all segments of the sector and to adopt a more structured approach to tariff issues and sector regulation that ensure a pass-through of efficiency gains to consumers.

- *Gas*. Concessions need to be opened up to develop small gas fields. A better pricing and regulatory framework is needed to encourage development and expand the transmission and distribution network with private participation, in order to make better use of this clean, low-cost fuel. The industry should be unbundled to form a structure of multiple producers that sell, through a transmission grid, to multiple buyers. Greater private participation, through competitive, transparent selection procedures would reduce costs.

- *Water*. To reach REPELITA VI targets, the companies need to be run more like service businesses, focused on delivering water. This will entail better maintenance and reduction of unbilled water, higher tariffs in most areas, better billing and improved financial and operational management. These measures will generate the resources to improve access, particularly by investment in distribution and water quality. The institutional structure needs to be revamped, with clearer assignment of responsibilities and greater accountability for managers and elimination of transfers to local governments. The smaller water companies need to be regrouped to enhance economic viability and improve water basin management. Finally, concessions for private participation should be considered, as is used in many parts of the world.

xxxviii. **Pricing for efficiency and equity.** Adequate pricing is critical to manage infrastructure services better, whether private or public, and to increase access. Key elements are smaller, better-targeted subsidies in power, water, rail and public buses; higher average water tariffs; fees for road use and congestion; and competition to lower power generation and telecommunications prices over time. Poor cost recovery largely subsidizes the better-off, because the poor lack access to services. The resources that are mobilized by better pricing could be used to expand access to services, which would benefit the poor. The public, including the poor, are willing to pay for better access to quality services. However, mechanical reliance on cost-plus pricing will reduce efficiency and international competitiveness. The basic aim is to emulate pricing in a competitive market.

xxxix. **Rationalizing sector management, reducing institutional complexity and assigning responsibilities better** by clarifying roles, functions, and authority, especially in urban services. The current fragmentation and overlap of responsibilities leads to poor policies, inefficient investments, lack of accountability, and difficulties in private participation. In addition to separating

the regulatory role from other functions, the central Government should shed implementation to lower levels of Government, public enterprises and private operators, except as warranted by prudent management of public borrowing. Instead, it should focus on establishing policies and sectoral frameworks, developing technical and financial standards and procedures, and giving technical guidance and assistance to lower levels of Government.

Running public services as businesses, responsive to consumers. Public institutions need fewer goals, focused on the quality of services, and more managerial autonomy and accountability, as well as more reliance on the private sector (see above) to improve their performance. Decentralization would improve efficiency in many cases, since most infrastructure (such as local roads, water supply, sewerage, solid waste disposal, and flood control) yields largely local benefits. For example, linking urban services more closely to revenues through user charges and higher property taxes/better assessments (which, other than in Jakarta, are among the lowest in developing countries) would improve accountability and service quality; it also would generate the resources needed for service expansion. Where markets do not match service demands and costs effectively, Governments need to involve users and stakeholders in the decision-making process to improve investment efficiency.

D. Improving Human Capital—Transition Challenges in the Health Sector

xli. Indonesia has made substantial progress in human resource development over the past decades. It needs to improve its human resources further, as called for in Repelita VI, to enhance the welfare and equity of its citizens and to compete more effectively in world markets. The Report discusses the health sector, as one example of the transition challenges in improving human resources and the role of the public sector. To improve health services, the Government needs to: (a) re-examine public spending needs and priorities; (b) improve public service efficiency and quality, especially with regard to basic services for the poor; and (c) improve its regulatory and enabling role with regard to private sector provision of services.

xlii. One key role of the Government is in financing basic health services. The public health system's widespread provision of local health centers, clinics, and district hospitals has ensured reasonable access to essential services. Indonesia has also achieved success in providing key services such as universal child immunization, micronutrient supplementation, and family planning acceptance. However, overall spending on public health is still low (compared to other developing countries). There is need for more public spending on basic health services and complementary inputs such as adequate investment in safe water and sanitation, to provide a minimum desirable level and quality of essential services, especially focused on the poor.

xliii. Although the Government has expanded public health services and health personnel substantially, the utilization of public health services (e.g., average visit rates

at health centers) remains low. The use of health services by the poor is also low, and appears to have dropped between 1987 and 1992, according to SUSENAS data. One factor in low utilization and demand for services appears to be related to the low quality of existing health services. There are indications of nurses with inadequate training, of perfunctory physical examinations, of inconsistent diagnoses and prescriptions, and of poor client practices. More attention is thus needed on improving the quality of public health services, differentiated by area-specific health conditions, and focused on poor households and regions.

xliv. A third key area for improvement is the Government's regulatory and enabling role in improving private health services. Purchases of medicines are a large part of household expenses for health, and diseases that are easily treatable with medicines often go untreated because costs are too high and public supplies and dispensing practices are poor. The private pharmaceutical producers appear to enjoy high rates of protection and to lack competition. Private medical services, which are growing rapidly, also appear to be of low quality. The Government has an important role in raising the quality of health manpower by establishing better training, accreditation and standards.

xlv. With improvements in the above areas, it should be possible for Indonesia to make further substantial progress in improving health outcomes. The Report recommends that the Government:

- **Increase public health spending, focused on essential health services and the poor.** Public spending on health is low (about 0.7 percent of GDP, compared to 2.0 percent of GDP in all developing countries). The Government needs to spend more on health, to assure an improved level and quality of services and complementary inputs (e.g., safe water and sanitation). The Government is aware of these needs, and intends to raise spending progressively.

- **Improve health services for the poor**, by being more responsive to local needs, and increasing spending on health centers and clinics that are most effective in reaching the poor. Providing free health care cards to the poor may not be enough; better incentives for health personnel to treat the poor are also needed.

- **Improve the quality and efficiency of basic public services**, by improving the management of front-line health facilities, providing them with more resources, changing staff incentives, establishing quality assurance programs, and encouraging more community outreach programs. In regard to health staffing, policies should be geared to meeting local needs and demands, with more authority given to local governments and public facility managers responsible for district services. Adequate staffing of remote and rural facilities will need attention, as will entry requirements, selection and training of bidan desa (village midwives).

- **Improve supplies of medicine to public facilities**, and institute better dispensing practices; continue to deregulate the pharmaceutical trade to lower costs of medicines.

- **Encourage private medical practice and improved standards** by allowing and encouraging non-profit organizations to deliver public health services; encouraging private rather than Government-provided health insurance; improving the existing mechanisms of assessments of medical schools,

curriculum reviews and student examinations to raise the quality of medical personnel; and preparing appropriately to deregulate private health services to permit the entry of foreign medical practitioners and health management professionals into medical practice.

E. External Financing and Foreign Assistance

xlvi. Indonesia's external financing needs over the medium-term can be met provided key policy steps as outlined in the preceding sections are taken by the Government on a timely basis. Gross financing requirements would expand appreciably in 1995/96, owing to higher investment by the private sector (the associated imports widen the current account deficit), rising interest and principal repayments, (related in part to cross-currency movements). In addition, recent volatility in international currency markets suggests that it would be desirable to build-up reserves in FY1995/96. Increased financing would come largely from the private sector, that is, higher foreign direct investment and associated private lending.

xlvii. Over the medium-term, the current account would tend to narrow as a percentage of GDP, reflecting steps to avoid overheating, but repayment of debt would increase and international reserves would continue to be accumulated at a prudent pace. Consequently, total financing needs would continue to rise, by roughly US$2 billion per year. This medium-term rise in financing needs would be met entirely by the private sector (that is, by foreign direct investment, medium-and long-term lending and short-term trade related inflows). Disbursements of official assistance would remain approximately unchanged, while public borrowing from private sources would increase only slightly.

xlviii. Despite the rising importance of the private sector in Indonesia's external financing, official assistance will continue to play several strategic roles. First, official assistance is the concrete means by which foreign Governments and external agencies signal their support for Indonesia's development policies. Second, the availability of adequate amounts of assistance ensures an orderly transition to more diversified sources of financing. Third, it ensures adequate provision of financing for those areas of development that are not of interest to the private sector, for example, human resource development and some areas of public infrastructure. Finally, the term and risk diversification associated with official assistance improves the structure of external finance; it also helps to maintain Indonesia's access to international capital markets and improves the country's attractiveness as a destination for foreign direct investment.

xlix. On the basis of the projections presented in Chapter 1, and the availability of sound projects, commitments of financing assistance (including grants) from Indonesia's Consultative Group (CGI) similar to last year's US$5.2 billion would be desirable. After allowance for the existing pipeline of assistance, this would result in disbursements of over US$4 billion, including grants. The rest of the rise in financing needs in FY1995/96 would be met by disbursements from other sources.

l. As recognized by both the Indonesian Government and donors at the CGI Meeting of July 1994, Indonesia's priority needs favor a composition of this assistance that emphasizes human resource development, poverty reduction and the provision of physical infrastructure that eliminates bottlenecks to private sector. Developments since last year's CGI Meeting have underscored the interest of the private sector in significantly increasing its financing of

development of Indonesia's infrastructure. Accordingly, the priority areas for new assistance are human resources development, poverty reduction, protection of the environment, and the provision of physical infrastructure complementary to activities of the private sector.

1
MACROECONOMIC DEVELOPMENTS AND POLICIES

A. Overview

1.1 Indonesia has a solid track-record of macroeconomic management. During the past two decades incomes have risen appreciably; the incidence of poverty has fallen significantly; the Government has dealt successfully with a broad range of macroeconomic difficulties; and the strong growth of recent years has raised Indonesia into the category of Lower Middle-Income Countries.[1] These results are all the more impressive given the country's large, diverse population and its late start in development. However, as the Government is aware—and intends to achieve—much more is possible. Continued prudent macroeconomic management, the subject of this Chapter, is a pre-condition for such progress.

1.2 Following a cooling-off period in 1992 and early 1993, all major sectors of the economy (excluding agriculture) have expanded rapidly. In 1994, GDP grew by 7.3%, according to the new, rebased National Accounts (see Annex I). Growth was led by construction and domestically-oriented manufacturing. Agriculture suffered a second, consecutive year of weakness, on this occasion stemming from a severe dry season.

1.3 However, the successes of last year were tarnished by emerging signs of inflationary pressure in 1994 and early 1995. In 1994 inflation was near 10% for the second consecutive year and in the first four months of 1995, it was 4.8%. The pattern of price increases suggests that inflationary pressures were partly a consequence of continued strong demand growth. Also, real wages have been rising rapidly, an indicator of widening inflationary pressures. In addition, the non-oil trade balance deteriorated by almost US$1.5 billion as a result of rapid import growth, although the overall deficit on current account widened only slightly owing to strong oil receipts.

1.4 To contain these strains, monetary policy tightened towards the middle of 1994—principally by following rising international interest rates. Initially, Bank Indonesia lagged behind the rise in international rates, which combined with other factors to produce large capital outflows from February to May of 1994. By contrast, interest rate adjustment by the Central Bank was very prompt later in the year. Similarly, fallout from the end-1994 Mexican crisis was well-managed, with only a small capital outflow taking place in early 1995. For its part, fiscal policy was budgeted to be tight in FY1994/95, and the estimated outturn appears to be a very modest overall surplus, which represents about half a percentage point of GDP improvement over the previous year's outcome. The Budget for FY1995/96 is less contractionary, largely reflecting the income tax cuts announced last September.

1.5 Medium-term prospects for the Indonesian economy are excellent, provided policies are tightened and measures are taken to improve efficiency (see Chapters 2-4). The May 1995 deregulation package represents a major step in this direction; it reduces tariffs substantially up-front, and sets a rules-based program for reaching a low, fairly uniform multilateral tariff by 2003. With this package, Indonesia continues progress toward open markets in trade and investment, following up on last year's PP-20, which significantly reduced barriers to foreign investment, and its hosting of the APEC meeting at Bogor.

1.6 Sustained economic growth of around 7% per annum should allow per capita incomes to reach US$1,000 before the turn of the century, generating the rapid employment and income growth that is vital to reducing poverty. Concurrently, non-oil exports would continue to expand at a healthy pace and other key macroeconomic indicators would strengthen. However, to attain these outcomes, it will be necessary for the Government to: (a) maintain macroeconomic stability, especially in the light of possible overheating; (b) maintain investor confidence (including by strengthening and adding depth to the financial system); and, (c) manage external debt prudently.

1.7 **Policies to Maintain Macro Fundamentals and Avoid Overheating.** After two years of strong growth, some signs of overheating seem to be re-emerging. To be sure, caution in international markets following the Mexico crisis may provide a brake on activity. Nevertheless, the non-agricultural sector is currently booming; inflation and import growth are already high; and some supply bottlenecks are being encountered. Tighter policies would also help to contain demand pressures from the anticipated major rise in foreign investment and spending on infrastructure.

1.8 Fiscal policy should take the lead in containing any tendency towards overheating; monetary policy should provide support and aim at a healthy rise in official international reserves. However, the Budget for FY1995/96 is somewhat looser than the FY1994/95 Budget, owing to the income tax cuts announced last September and rapid expansion in routine spending. In this context, it will be important for the Government to tighten in those fiscal areas where it still has flexibility, for example: maintenance of strict control over off-budget spending; improved tax administration; higher non-tax revenues; increasing forestry (IHH), luxury, excise and urban property taxes; and efficient pricing of public infrastructure services. In addition, extra tightening will be needed to offset higher debt servicing costs resulting from recent cross-currency movements; privatization receipts and any other exceptional increases in revenues should be used to pre-pay public debt.

1.9 To complement fiscal policy, monetary policy will likely need to be tightened further (see below). Deregulation policy should intensify, to keep pace with Indonesia's international peers and to avoid losing the leadership established by PP-20, the APEC Declaration of Bogor, and the May 1995 package. Furthermore, the Government needs to proceed cautiously with increases in minimum wages. Wages are only one of many costs of doing business, but the impact of rapid increases in legislated minimum wages on labor-intensive industry will be counter-productive if the resultant cost increases cannot be offset by productivity growth.

1.10 **Policies for Maintaining Confidence.** Continued sound macroeconomic policies are the foundation for investor confidence and future growth, as reflected in Standard & Poor's recent upgrade of Indonesia's rating to BBB status. However, large amounts of short-term external debt (20% of the total) make Indonesia vulnerable to sudden adverse shifts in investors' portfolio preferences. Indonesia managed well through the year-end Mexican peso crisis, but international markets remain turbulent and are nervous about developments such as the early-1995 appreciation of the yen. One immediate implication is that governments now have significantly less margin for error is setting their financial policies. Another is that international investors are more concerned over both the size of borrowings and the quality of the resulting investment in terms of generating a stream of debt service (see Box 1.1).

1.11 As protection in this regard, the Government needs to further strengthen its international reserves; closely follow

Box 1.1: Lessons from Mexico's Peso Woes

As 1994 drew to a close, investors sharply accelerated their pullout from Mexico, which brought on a severe payments crisis. In one week alone, the peso lost 40% of its value against the dollar. A definitive post-mortem is unlikely to be available for some time, but lessons are emerging:

- *Prudence in fundamentals matters.* In hindsight, the crisis may have been inevitable. Mexico ran very large current account deficits (about 7 to 8% of GDP over 3 years); much of the off-setting capital inflows financed consumer spending; and economic growth was low. Mexico's commitment to a nominal exchange rate target—adopted as an anti-inflationary device—led to a large overvaluation of the peso. Inflation was brought down, but at the cost of unsustainable current account deficits, which widened from US$6 billion in 1990 to US$25 billion in 1994. Finally, in the run-up to the 1994 election, fiscal and monetary policy loosened.

- *Short-term debt raises vulnerability.* To make matters worse, much of Mexico's financing was short-term, eg, by replacing peso bonds with dollar-indexed bonds (*tesobonos*) in early 1994, as the Mexican Government attempted to hold down borrowing costs. But short-term capital can (and will) flee at short notice, in rational response to uncertainty, stemming perhaps from bad luck, shocks or imperfect information (such as that on the Central Bank's level of official reserves). Short-term capital is also particularly susceptible to contagion effects and "herd behavior", which heightens the potential for instability.

- *Foreign funds must be used productively.* Much of the increase in Mexico's external borrowing financed a surge in consumer spending, not internationally competitive investments. As a result, economic growth was low and falling, and there was little additional output to service the rise in debt.

- *Social-governance issues are important.* Investor confidence was further undermined by social and political discontent at the grassroots level, as reflected in the Chiapas uprising and the assassinations of key political figures during the run-up to Presidential elections. These signalled a failure on the part of the Government to meet basic social needs, especially in the poorer, rural regions.

- *Restoring confidence requires large reserves and credible policies.* To sustain investor confidence, large reserves are not sufficient. In the case of Mexico, early 1994 provided an early warning when capital outflows accelerated in the wake of a rise in US interest rates and internal political uncertainties. But instead of tightening monetary and fiscal policy, the Government used foreign reserves to defend the peso. As a result, reserves plummeted, from over US$26 billion to less than $5 billion by year end, further damaging investor confidence.

- *Prudent debt management is vital.* Much of Mexico's borrowing was private and did not appear in the official budget statistics. In part, this was driven by the eagerness of foreign portfolio investors to lend; but from the country's perspective, the important issue is the *sustainability* rather than the *availability* of financing. Strict supervision of all public and quasi-public borrowing, and raising the costs of moving "hot money" (for example, by widening exchange rate bands) would have helped to curb excessive reliance on short-term borrowing.

- *Financial systems must be strong.* Many of the smaller banks had weak portfolios; these put upward pressure on interest rates and contributed to loss of investor confidence.

In the aftermath of Mexico's problems, international lenders may maintain a lower exposure to developing countries for some time. They will also be scrutinizing borrowers' policies more closely—and especially the policies of other large debtors.

movements in international interest rates; avoid any expansion in liquidity from domestic sources; and counter any sudden adverse shifts in sentiment by tightening policy aggressively.

1.12 Despite significant progress in 1994, the domestic banking sector remains a concern. The Government will need to persist with recovering overdue loans, strengthening

banking supervision, reducing banks' exposures to single-client groups or risky sectors, merging banks, privatizing the state banks, and developing a capacity to liquidate banks. Prudent development of the growing non-bank sector, including improved regulation, would also be helpful in deepening financial intermediation. Finally, strong deregulation (Chapter 2) and development of a clear, competitive regulatory framework for private infrastructure (Chapter 3) will ensure productive use of investment funds.

1.13 **Policies to Manage External Debt.** The nation's large external debt remains a major constraint on economic development. Preliminary indicators suggest that currency re-alignments in 1994 and early 1995 further inflated external debt substantially. To manage this burden and to improve the country's creditworthiness, the Government needs to persist with careful macroeconomic management to hold down its borrowing requirements. Additional steps would also be helpful. For instance, the Commercial Offshore Loan Team, COLT, should be strengthened and ceilings should limit public and quasi-public external borrowing to prudent levels over the next few years, including off-balance sheet liabilities, such as guarantees. Also, commercial lines of credit should be set aside to protect against external shocks, not used for off-budget financing. Moreover, there is further scope for pre-paying and re-financing expensive external debt. Finally, public enterprise borrowing on the domestic capital market needs closer surveillance.

1.14 In the medium-term, reliance upon foreign savings (that is, the deficit on current account of the balance of payments) needs to be reduced to around 2% of GDP. With few direct instruments to raise private savings, increased public resource mobilization, through fiscal measures noted above, will be a key.

1.15 The other vital policy objective in this area is to ensure that domestic and foreign savings are used to maintain the growth of non-oil exports. As noted, this entails continuing trade policy deregulation, which enforces the discipline of the international marketplace, and putting in place a clear, competitive regulatory framework for infrastructure.

1.16 In addition, the Government needs to continue its practice of avoiding public guarantees of private debt. The Government should re-assert, at every opportunity, that it maintains a strict dichotomy between its own liabilities and those taken on by the private sector.

1.17 The remainder of this Chapter reviews macroeconomic developments and policies in 1994, and provides some suggestions for continued success. Recent economic developments are reviewed in Section B; monetary and fiscal policy are studied in Section C; and there is a brief discussion of External Risks in Section D. Section E outlines the medium-term prospects for the economy, including an estimate of external financing needs for the coming year. The Chapter closes with Section F, which summarizes priority items on the macroeconomic agenda.

B. Recent Economic Developments

Domestic Developments: Growth, Inflation and Wages

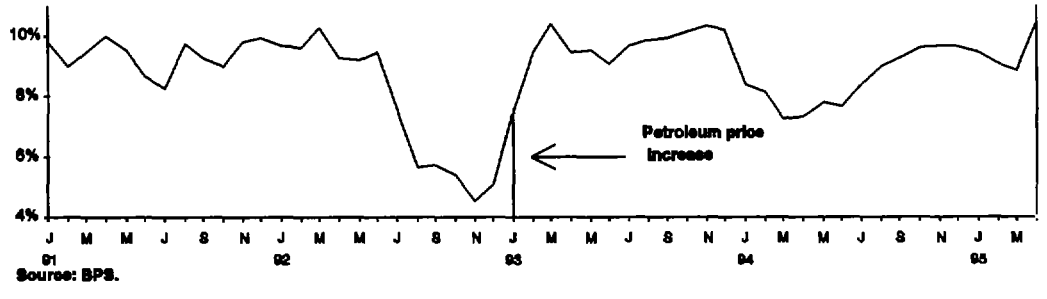
1.18 **Continued Strong GDP Growth.** In 1994, the overall economy maintained a rapid pace of expansion, of 7.3% (see Annex I). The non-agriculture economy expanded even more rapidly (by 8.9%), which appears to be markedly above the two previous years. Among the various sectors, construction grew

by nearly 15%, which marks several consecutive years of double digit growth (see Box 1.2). Manufacturing, the other booming sector, also continued to expand at a double digit pace led by domestically-oriented production (e.g., automobile production which was up about 50%) and some exports (e.g., electronic goods and tourism). Among other sectors of the economy, strength was fairly widespread, encompassing mining and quarrying (principally coal, nickel and tin), utilities, and virtually all private services. The only significant weakness was in agriculture, where the severe dry season in much of Java and Sumatra caused rice production to drop by approximately 4%; agriculture as a whole barely increased, apparently by even less than in 1993 when growth was held down by extensive floods.

1.19 On the expenditure side of the national accounts, much of real growth in 1994 was accounted for by domestic demand, particularly fixed investment which rose by 12.6%. Private consumption rose by 5.8% while exports of goods and services expanded by only 7.3%, largely indicative of the weakness in non-oil exports in the first quarter of calendar year 1994 (see Box 1.3). Reflecting the strength of domestic activity, imports of goods and services soared by 13.3% in real terms.

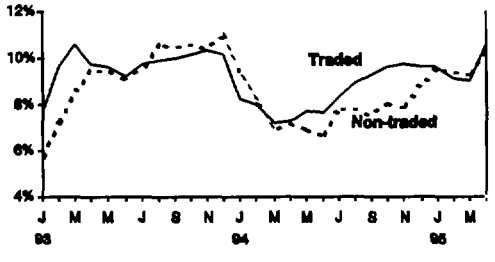
1.20 **Inflation: Remains Near 10%.** For the second consecutive year, consumer prices rose by nearly 10% (measured on a December-over-December basis). Food prices, which increased by almost 15% during the year (versus 5.1% during 1993), accounted for a substantial portion the inflation. Within food, the largest contributor was rice prices which increased by more than 20%, owing to the drought noted earlier. Rice prices surged despite large drawdowns of Bulog's buffer stocks and imports of roughly 500,000 tons of rice towards the end of the year. Some

Figure 1.1:
Trends of Inflation: Consumer Price Index
(12-month percentage change)



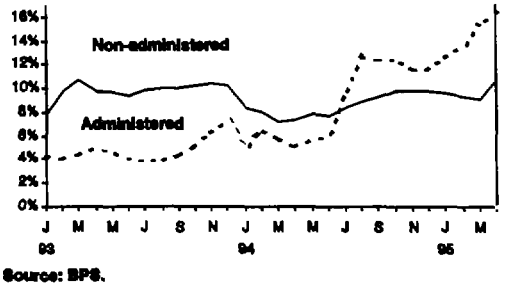
Source: BPS.

Trends of Inflation: Traded and Non-Traded Consumer Prices
(12-month percentage change)



Source: BPS.

Trends of Inflation: Administered and Non-Administered Consumer Prices
(12-month percentage change)



Source: BPS.

Table 1.1 Indonesia: Summary of Principal Macroeconomic Indicators

	Average 1973-82	*Average 1983-85*	*Average 1986-88*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*
***Domestic Outcomes** (% p.a. except where noted)* [2]									
GDP	7.5	6.0	5.4	7.5	7.2	6.9	6.4	6.5	7.3[6]
Non-oil GDP	4.1	5.3	6.6	8.2	7.6	6.5	8.4	7.8	7.8[6]
Non-agric. GDP	8.4	4.7	6.2	8.6	8.6	8.2	6.4	7.6	8.9[6]
Inflation (CPI)	18.2	9.0	8.6	6.5	7.4	9.2	7.5	10.2	9.6
Gross Fixed Inv. (% real GDP)	n.a.	23.4	24.3	26.5	28.4	28.3	27.9	26.3[6]	27.6[6]
***External Sector** ($ billion, except where noted)*									
Oil & Gas Exports [2]	9.9	15.0	8.2	8.7	11.1	10.9	10.7	9.7	9.7
Oil price ($/bbl., avg OPEC price)[4]	18.7	27.9	15.0	18.2	20.2	16.8	15.9	14.4	13.9
Non-oil & Gas Exports [2]	3.5	5.6	8.9	13.5	14.6	18.2	23.3	27.1	30.4
Curr.Acct.(FY, % of GDP)[1 2 6]	-1.7	-3.4	-3.8	-1.6	-3.2	-3.3	-1.8	-1.8	-1.9
Net Official Reserves (FY, end period)	n.a.	5.8	5.3	5.7	9.6	10.5	12.0	12.7	13.3
Net Foreign Assets of Bank Indonesia (end period; Rp. trillions)	n.a.	8.5	10.6	10.8	17.1	24.4	33.8	38.8	37.3
***Policy Variables** (% p.a. except where noted)*									
Broad Money Growth [1]	31.9	27.9	23.4	38.5	45.3	17.0	20.2	22.2	19.7
Fiscal Balance (FY, % GDP)[4 6]	n.a.	-2.4	-2.9	-0.2	1.9	-0.3	-1.3	-0.6	-0.1
Govt. Expend. (FY, % GDP)[4 6]	n.a.	20.8	18.7	18.3	17.5	16.9	17.4	17.1	16.1
Deprec.in Real Exch. Rate [3]	n.a.	2.9	15.9	1.4	2.0	2.3	3.8	-2.9	3.2
Chg. Ext. Pub. Dbt.($ bil.)[5]	1.4	2.8	4.3	-0.2	3.9	3.7	0.7	3.0	4.0[4]

Sources: [1] BI; [2] BPS; [3] IMF, *Inter. Fin. Stat.*; [4] World Bank staff estimate; [5] *World Debt Tables*. [6] Based on new re-based National Accounts, which are only available publicly for 1993 and 1994; see Annex I.

estimates indicate that allowing private imports would have dampened the impact of the drought on consumer prices, despite higher international rice prices (see Chapter 2). Among other food prices, soaring international prices pushed up the prices of other commodities that are consumed locally. For instance, international prices of coffee and crude palm oil (which is widely used in cooking oil) rose by roughly 100% and 40% respectively during the first half of the year.

1.21 Although these special factors are important, there are also signs that domestic overheating began to appear in 1994 and early 1995. For example, virtually all major breakdowns of the consumer price index (CPI) accelerated during the second half of the year and were approaching 10% by year-end (see Figure 1.1). During the first four months of 1995, consumer prices increased by 4.8%.

1.22 Two important categories of the CPI are of particular note. First, the "core inflation" category of non-food, non-energy was 8.1% during 1994, with the bulk of the increase coming after mid-year. Second, housing prices increased at an annual rate of more than 13% during the second half of the year, reflecting movements in land prices in Jakarta, capacity constraints in the cement industry and rising real wages (see immediately below). Also, an element of indexation was built into electricity prices last October, when the Government announced its intention to increase electricity tariffs every three months in line with developments in fuel prices, depreciation of the rupiah and the country's

Figure 1.2: Real Wage Trends in Manufacturing, 1982-1994

/a 1994 is partly staff estimate.
/b Average of regional minimum wages.
Source: CBS.

inflation rate. The increase is subject to approval by the President of the Republic.

1.23 **Real Wages on the Rise.** Reliable wage data are in short supply in Indonesia. However, such information as does exist suggests that real wages have increased significantly in recent years (see Figure 1.2). Following several years in the 1980s when real wages remained virtually unchanged, real earnings in manufacturing are estimated to have jumped in 1990 and to have climbed fairly steadily upwards since then.

Box 1.2: Jakarta's Property Sector Boom

During the past few years, Jakarta and much of West Java have experienced a major property boom. Developers are putting up integrated residential zones (complete with their own luxury hotels, schools, hospitals and recreational facilities) at a rapid pace all around the city. On the north Jakarta waterfront, plans are in place to eventually reclaim some 6,000 hectares. Further afield, recreational resorts are springing-up from the mountains in the south, to the beaches in the west and towards the national park in the southwest. Most striking are the high-rise apartment buildings, which were an oddity in Jakarta even five years ago; today, they are mushrooming across the city's skyline. Demand for the apartments has been strong, much of it financed by a rapid rise in credit from the banking system (see para 1.43 of the main text). Buyers may be gambling on a large capital gain; although the evidence is mixed, as of today many of the new units appear to remain unoccupied.

There are many reasons why investors are betting on large capital gains. At the most basic level, the price of land on a small, crowded island like Java is likely to go up rapidly during periods of strong economic expansion. Also, real estate prices in choice areas are judged to have doubled every few years during the past decade. Moreover, the recently introduced "strata titles" have contributed to increased demand, and foreigners may be permitted to purchase in due course. Nonetheless, the 1994 pace of expansion looks excessive, and activity in the volatile property sector would be one of the first to feel the impact of a slump in overall economic activity, of higher interest rates, or of supply bottlenecks.

Recognizing the potential dangers, the Government has already taken some actions. For example, the 1995 Budget levied a 5% capital gains tax on certain land transactions and a 10% tax on luxury residences; targets for overall credit expansion have been lowered for the coming year; and the Central Bank is monitoring sectoral credit more closely. These measures may be sufficient to keep growth in this sector running at a sustainable pace, but the Government will need to continue to monitor the situation carefully to judge whether further measures are needed.

Table 1.2: Indonesia: Balance of Payments, 1985/86-1994/95

	1985/86	*1990/91*	*1992/93*	*1993/94*	*1994/95*
	(in billions of US dollars)				
Gross merchandise exports	18.8	28.1	35.3	36.5	42.0
Oil & LNG	12.8	12.7	10.4	9.4	10.3
Non-oil	6.0	15.4	24.8	27.2	31.7
Gross imports (cif)	-14.1	-25.8	-30.2	-32.3	-38.2
Oil and LNG	-2.9	-4.2	-3.8	-4.2	-4.1
Non-oil	-11.2	-21.6	-26.4	-28.1	-34.0
Trade Balance	4.8	2.3	5.1	4.2	3.9
Net Non-Factor Services	-2.4	-0.5	-1.4	-1.2	-0.9
MLT Interest Payments	-2.2	-3.4	-3.7	-4.1	-4.2
Other Factor Services and Transfers	-1.9	-2.0	-2.5	-1.9	-2.3
Current Account Balance	-1.7	-3.7	-2.6	-2.9	-3.5
Oil/LNG current account	6.2	6.0	4.1	2.7	3.5
Non-oil/LNG current account	-8.0	-9.7	-6.6	-5.7	-7.0
Capital Account Balance	1.9	9.0	7.3	3.2	2.1
Net Disbursements of Public MLT Debt	1.2	0.6	2.5	1.2	0.8
Disbursements	4.0	5.2	7.7	6.8	6.9
Amortization	-2.8	-4.6	-5.2	-5.7	-6.2 [a]
Direct Foreign Investment	0.2	1.4	1.7	2.0	2.5
Other Capital (net)	0.5	7.0	3.1	0.0	-1.2 [a]
Change in Net Foreign Assets (- = increase)	-0.1	-5.2	-4.8	-0.3	1.4
Memo items:					
Official Reserves	5.8	9.6	12.0	12.7	13.3
Net Official Reserves (in months of imports)	4.9	4.4	4.8	4.7	4.2
Total BI NFA (in months of imports)	6.2	5.2	7.3	6.9	5.4
Current Account/GDP (%) [b]	-2.0	-3.2	-1.8	-1.8	-1.9
Non-Interest Current Account/GNP (%) [b]	0.9	0.2	1.4	1.3	1.2
MLT Debt Service/Exports (%) [b]	25.9	29.3	28.9	31.3	29.3

[a] Includes debt prepayment with receipts from Indosat privatization.
[b] Based on new National Accounts (see Annex I).

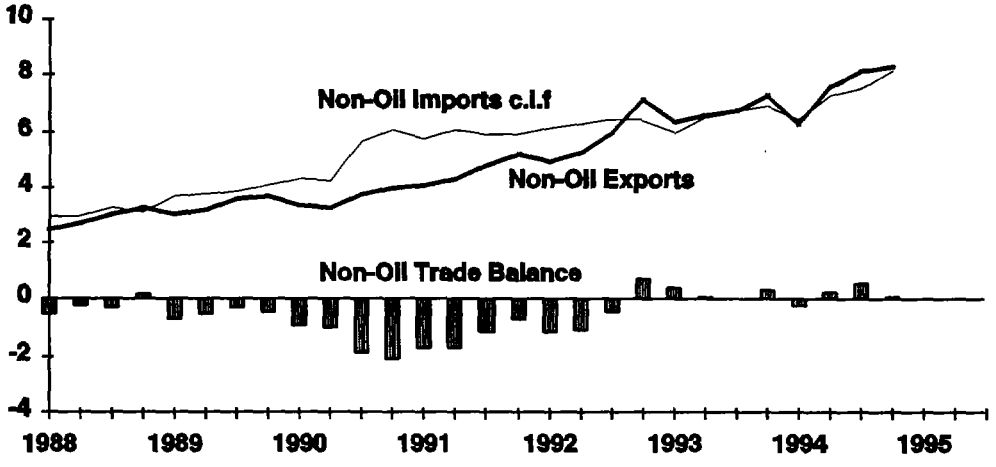
Source: Bank Indonesia, BPS and World Bank staff estimates.

1.24 In 1994, minimum wages also increased markedly: by 40% in January for Jakarta and West Java; and by 15-50% in April for 16 other provinces, including East Java, Bali, Kalimantan, Sulawesi and parts of Sumatra. In the remaining nine provinces (including Aceh and North Sumatra), the daily minimum wage was raised by 21%-38% with effect from early August. Effective April 1, 1995 the Government increased minimum wages by a further 10-35%. In a related development, in September of 1994 the Ministry of Manpower issued a decree making it compulsory for all private and state companies to pay an annual bonus equivalent to one month's basic salary plus fixed allowances, in advance of particular religious holidays.

External Developments: Balance of Payments

1.25 In 1994/95, the current account deficit remain roughly unchanged as a percentage of GDP. However, this outcome conceals some diverse movements. Non-oil imports grew

Figure 1.3: Quarterly Non-Oil Trade, 1988-1994 (US$ billions)



Source: BPS. Data on customs basis.

considerably faster than envisaged in REPELITA VI, but this was partly offset by strong oil receipts. Non-oil exports rose in line with the REPELITA VI expectation of 16.8%.

1.26 **Non-oil Merchandise Trade.** Non-oil exports have been the driving force behind Indonesia's growth of the past several years, averaging 21% per annum in value terms between 1985 and 1993 (see Table 1.3). However, in the first months of calendar year 1994 their level dropped-off sharply in nominal terms, causing the quarterly trade balance to slip back into deficit for the first time in several quarters (see Figure 1.3). Much of this decline in the early months of 1994 was accounted for by a drop-off in textiles & garments and plywood, which is discussed in Box 1.3. Although growth picked-up subsequently, the episode prompted legitimate concern that Indonesia's non-oil export drive was stalling, one important factor that motivated the deregulation packages of May and June 1994 (see Chapter 2).

1.27 After this hesitant start to calendar year 1994, growth of non-oil exports picked-up markedly in subsequent quarters. For 1994/95 as a whole, nominal growth reached 16.7% (or 5.2% in real terms; see Table 1.3), fully in line with the target of REPELITA VI. Like many recent years, manufacturing exports were the strongest category, although strength was somewhat more balanced among major components in 1994 (see Box 1.4). This is an encouraging indication of diversification that is serving to offset the weakness in textiles & garments and plywood. Indonesia's continued success in this regard will largely depend upon maintaining price competitiveness in world markets; making the most of Indonesia's abundant human resources; improving supply capacity (especially as regards infrastructure); and sustaining momentum in the policy of deregulation (see Dasgupta *et. al.*). As a longer-term strategy for maintaining growth in non-oil exports, Indonesia should be looking to follow the successes of countries such as Malaysia and Thailand. Attempts to force the pace at which Indonesia is climbing the technology ladder would probably constitute a costly mistake.

Box 1.3: The Slump in Non-oil Exports in Early 1994

Despite Indonesia's success in export diversification during the past decade, the country continues to be fairly reliant upon the fortunes of a relatively narrow range of products. Especially noteworthy are textiles & garments and plywood, which taken together account for almost 40% of non-oil exports in recent years (see accompanying Table). But as 1993 drew to a close, exports of both these industries slumped and the situation tended to deteriorate into 1994, prompting concern that Indonesia's non-oil export drive had stalled. The experience also raised structural issues surrounding the prospects for continued growth in these sectors. The non-oil drive subsequently rebounded (see Box 1.4), but understanding the reasons for this slump are important for assessing the implications for Indonesia's economic outlook.

Indonesia: Exports of Selected Commodities

	1993				*1994*		
	Q1	*Q2*	*Q3*	*Q4*	*Q1*	*Q2*	*Q3*
	(in millions of US dollars)						
Total Non-oil Exports	6.40	6.57	6.83	7.30	6.30	7.60	8.10
Manufacturing:	5.50	5.60	5.70	6.10	5.40	6.50	6.70
of which							
Textile & Garments	1.60	1.60	1.50	1.40	1.10	1.60	1.51
Volume [a]	153	154	193	100	160	194	185
Price	10.46	10.39	7.77	14.00	6.88	8.25	8.16
Plywood	0.80	1.20	1.20	1.00	1.10	0.90	0.89
Volume [a]	1.40	1.59	1.51	1.30	1.50	1.40	1.20
Price	571	755	795	769	733	643	742

[a] In thousands of tons.

Source: BPS. Data on a customs basis.

Textiles & garments have been one of Indonesia's great success stories. According to official statistics, exports increased by a factor of ten during the seven years ending 1992; profitability was high owing to the combination of rising export prices, Indonesia's low-cost labor and deregulation policy. This is an impressive record, although the numbers may be inflated by attempts to take advantage of a subsidized export scheme (*WESEL EKSPOR*), which was active until May 1993.

But change was in the wind in the early 1990s. New investment in the textiles & garments industry appears to have peaked in 1991, and export prices flattened out in 1992 and 1993, before dropping off sharply in 1994. Adding to the industry's troubles, in mid-1992 a duty-drawback scheme was changed in a way that increased the administrative costs to producers (the process now applies to individual import shipments rather than a consolidated application at end-of-period). Add to these, sharply higher minimum wages since 1990 plus competition from new low-cost producers (for example, China, India and Viet Nam), and the economic fundamentals for a slowdown look to be in place. Moreover, the image of the industry in Indonesia was damaged in 1994 by controversy surrounding a failed textile factory in Central Java.

Despite these various pressures, the volume of textile & garment exports held up reasonably well during the recent slump. In the first three quarters of 1994, volumes were up by a healthy 13% relative to the same period a year earlier. However, the value of exports was down about 10%, owing to a drop of almost 20% in export prices.

As regards plywood, exports flattened-out in the third quarter of 1993, before declining sharply in the first half of 1994. As reported by the Central Statistics Bureau, this decline was due to a drop-off both in volume and prices through mid-1994. These declines apparently stem from various sources, including marketing strains that developed among both suppliers and buyers in 1994. Among the suppliers, there have been accusations of dumping, and Indonesia's system of marketing has come under increasing fire. On the side of the buyers (mainly Japan and Korea), construction growth appears to have slowed (at least prior to the Kobe earthquake) and there seems to have been substitution away from Indonesian sourcing, to Brazil, Malaysia, China and Russia. Other long-term structural factors, such as sustainability, are beginning to constrain Indonesia's plywood industry.

continued ...

continuation from Box 1.3

What lessons are to be learned from the early-1994 downturn? There are solid economic policies that can assist these sectors to grow at a more sustainable pace. First, the slow-moving bureaucratic systems for allocation of quotas and BAPEKSTA are long-standing complaints among garment & textile producers. Second, lower duties on inputs would raise exports and obviate the need for BAPEKSTA. By contrast, textile & garments exports would suffer from increased up-stream protection of the petro-chemicals industry, which would drive-up the cost of synthetic fibre. Third, forestry exports will suffer from overcutting, and projected pulp and paper plants will only accelerate that process; unless cutting is reduced to a sustainable level, forestry-based exports will fall sharply within the next ten years. On the other hand, with sustainable forestry management, exports would drop-off in the short-run (by roughly US$300 million) but eventually rise again, albeit gradually. From a longer-term perspective, there needs to be broader recognition that the heady years of 25 to 30% non-oil export growth are probably over. Growth at a more modest pace, say 15 to 20% per annum (as laid out in REPELITA VI), would be more sustainable and adequate for progress towards national goals, provided imports increase a bit slower.

1.28 The growth in non-oil imports in 1994/95 reflected the booming domestic economy and weakness in the agricultural sector. Following two years of weakness when growth averaged just over 8% per annum in nominal terms, it jumped to 21%in 1994/95; roughly half of this acceleration reflected larger volumes (see Table 1.3). The composition of non-oil imports is indicative of the breadth of the strength of the booming economy; all major categories increased rapidly, although the increase was pronounced in the case of consumer goods (especially food and automobile components), which increased by more than 35% in nominal terms. An extra boost was provided by completion of the Chandra Asri petro-chemicals project, which accounted for roughly US$1/4 billion in imports last year.

1.29 **Oil/LNG.** Indonesia is the third oldest oil producer in the world (after the United States and Russia). However, the relative importance of this sector peaked in the early 1980s. Oil export earnings have declined as domestic consumption has risen while production has been virtually stagnant. Declining oil exports have been partly off-set

Table 1.3: Indonesia: Non-Oil Merchandise Trade

	Current Value (in Billions of US$)				*Real Growth Rates (% per annum)*		
	1985/86	*1990/91*	*1993/94*	*1994/95*	*1990/91 to 1992/93*	*1992/93 to 1993/94*	*1993/94 to 1994/95*
Non-oil Exports	6.0	15.4	27.2	31.7	30.4	12.1	5.2
Agriculture	2.9	3.8	5.0	6.1	13.2	9.2	5.8
Metals & Minerals	0.8	2.9	4.8	5.3	48.7	-7.0	2.2
Manufactures	2.3	8.6	17.4	20.3	30.5	11.4	12.3
Non-oil Imports	11.2	21.6	28.1	34.0	15.0	11.3	17.5
Consumer goods	1.2	1.0	1.8	2.5	34.4	10.0	35.6
Intermediate goods	14.6	10.4	13.8	17.1	16.6	10.8	20.4
Capital goods	5.4	10.3	12.6	14.4	11.2	12.1	11.7

Source: Bank Indonesia and World Bank staff estimates.

Box 1.4: Indonesia's Stars of Non-oil Exports in 1994

Despite the downturn in some key products in early 1994 (see Box 1.3), non-oil exports recorded respectable growth of more than 12% in 1994. Certain characteristics of this growth are important. For example, in contrast to several previous years when manufactures led the growth in non-oil exports, the growth in 1994 was more balanced among the major components, including agriculture and metals & minerals, which taken together still account for approximately 15% of total non-oil exports.

The commodity price boom of 1994 gave a strong boost to several agricultural exports. Export prices for *coffee and cocoa* surged by 163% and 29% respectively, while shrimp and pepper prices jumped, too. Mining exports also expanded rapidly, especially *coal and copper*, the two main products in this area, but the increase stemmed mainly from higher volumes.

Indonesia: Selected Non-oil Exports 1993 - 1994

	Value			Volume		
	1993	*1994*	*% change*	*1993*	*1994*	*% change*
	(in billions of US$)			(in thousands of tons)		
Total Non-oil Exports	27.08	30.36	12.1	106,386	143,478	34.9
Agriculture	2.30	2.82	22.7	1,759	1,606	-8.7
Coffee	0.30	0.70	128.5	308	267	-13.3
Cocoa	0.17	0.21	28.8	200	200	0.2
Metals & Minerals	1.46	1.80	23.1	29,267	36,253	23.9
Copper	0.69	0.86	23.5	923	1.076	16.5
Coal	0.64	0.82	27.6	18,717	25,364	35.5
Manufactures	23.9	25.70	10.3	24,512	24,466	-0.2
Electrical goods, etc.	1.67	2.38	42.4	173 [a]	208 [a]	20.1
Gold bars	0.23	0.72	214.9	1,034	545	-47.3
Footwear	0.52	0.60	14.9	871	1,089	25.0
"Other" manufactures	1.66	1.89	13.7	161	173	7.4

[a] In tons.

Source: BPS. Data are on a customs basis.

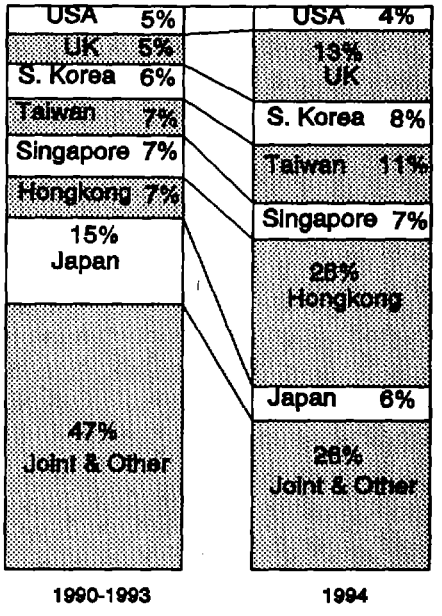
In 1994, manufactures (which includes several resource-based products, such as plywood, pulp and paper and base-metal products) continued to diversify rapidly in 1994, and several products moved up the value added ladder. One of the brightest spots is *electronics* (including appliances and audio-visual equipment) whose value rose by 42%. Diversification is underscored by *another twenty-five or so smaller categories*, which rose in value by at least 30%, albeit from a low base in many cases. Sales of *footwear*, which now account for 7% of manufactures, continue to show strong growth, expanding by 15% in value terms. Also, the residual "*other manufactures*" category continues to record high growth rates. Indonesia's world market share in most manufactures is small, and the main constraint to further growth is competitiveness.

by rapid expansion in exports of natural gas (LNG and LPG). Indonesia is now the world's leading exporter of LNG. Many of these long-term trends continued in 1994/95. The volume of oil and LNG exports declined a little, but this decline was more than fully offset by higher export prices, owing in part to the fillip in international prices around mid-year. Oil imports increased only a little. Consequently, the surplus on oil trade widened appreciably, from US$5.2 billion in 1993/94 to US$6.2 billion in 1994/95.

1.30 **Transactions on Services Account.** The deficit on services continued to widen in FY1994/95 to US$7.4 billion, compared with US$7.2 billion in 1993/94. Interest payments increased, reflecting rising levels of public and private debt, higher international interest rates and the rise in the value of the yen relative to the US dollar; factor service payments on foreign direct investment also increased appreciably. The impact of these negative factors was partly offset by strong tourism inflows; the tourism sector has been booming for some time, and it has now become the largest single source of non-oil foreign exchange earnings.

1.31 **The Capital Account of the Balance of Payments.** Transactions on capital account consist of rising levels of foreign direct investment, often-volatile flows of short-term capital, and large gross flows of public debt (see later in this Chapter for developments concerning debt). The net inflow of foreign investment in 1994/95 was US$2.5 billion, compared with US$2 billion in 1993/94 and US$1.7 billion the year before. This is a substantial rise, but minor in comparison to the extraordinary increase of 190% in the value of foreign investment projects that were *approved* in 1994. Approvals, which totalled US$23.7 billion for the year, surpassed the previous record level by July. (It should be noted that the value of investment approvals covers the entire cost of a project; foreign direct investment measures only the foreign equity component of a project.) Seven large projects (4 oil refineries, 2 power plants and 1 steel mill) accounted for more than 1/3rd of these approvals; but even excluding these projects, it was still a strong year, and approvals continued at a record pace into 1995. Moreover, in 1994 the strength by industry was pretty much across-the-board in the primary and secondary sectors (excepting textiles): the tertiary sector was roughly flat. Geographically, much of the planned activity is in West and East Java, Riau (Batam) and South Kalimantan. By country of origin,[2] exceptionally strong inflows originated in Taiwan and the U.K. The emergence of Taiwan and the re-emergence of Hong Kong as major investors are notable new developments (see Figure 1.4).

Figure 1.4: Changing Composition of Foreign Investment Approvals, 1990-1994



Source: BKPM.

1.32 At the end of 1994/95, official international reserves stood US$13.3 billion (equivalent to 4.2 months of imports), up from US$12.7 billion at the end of FY1993/94 (4.7 months of imports). However, there were large fluctuations in the course of the year, mirroring the swings in capital flows. During the first five months of the year, there were substantial outflows of capital that reversed inflows of the previous year, causing Bank Indonesia to sell large amounts of net foreign assets. By end-May, official reserves were down to US$11.7 billion, compared with US$12.7 billion at end-March 1994 and US$12 billion at end-FY1992/93. By the end of the year, official reserves had recovered to

US$13.3 billion. However, net foreign assets were still down somewhat in rupiah terms despite the appreciation of the yen.

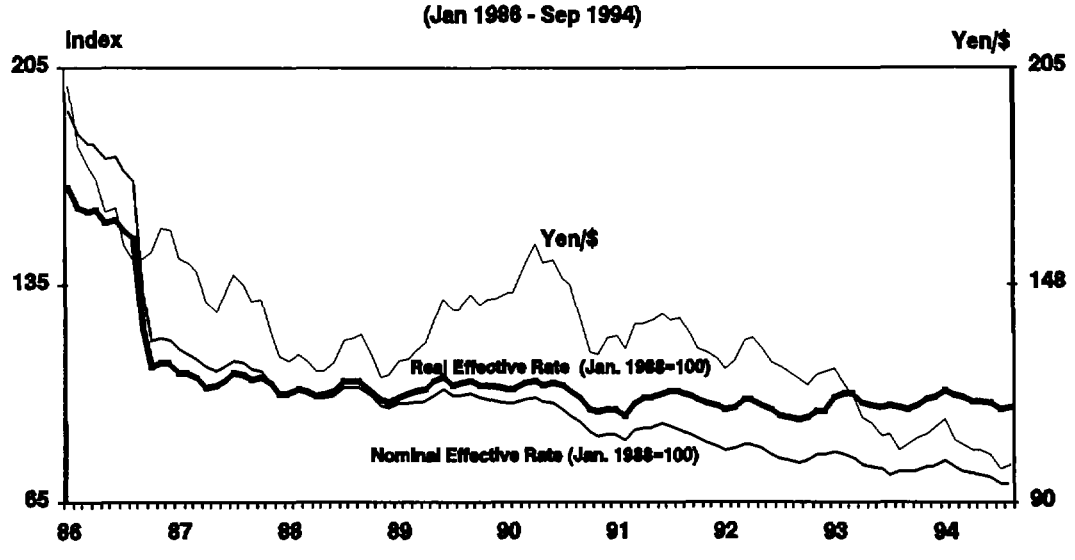
1.33 As mentioned, the year-end currency crisis in Mexico led to a short-lived run on the rupiah and other Asian currencies in early 1995. These outflows reflected a portfolio shift on the part of foreign investors, who became nervous about the prospects for emerging markets. Similar outflows occurred throughout much of South-East Asia, and their impact depressed stock markets in the region. Confidence in the rupiah was restored in short order by a combination of market intervention by the Central Bank, modest interest rate increases (of 50 basis points on Bank Indonesia's monetary instruments), and strong public commitments by the Government to the existing exchange rate regime. Above all, recognition of Indonesia's strong economic fundamentals prevailed.

External Developments: Exchange Rate Movements

1.34 Both the real and nominal effective exchange rates of the rupiah depreciated throughout 1994. In the case of the nominal effective rate, the total decline amounted to some 9%. This decline stemmed in roughly equal measure from a gradual decline (of 4 1/4%) in the value of the rupiah relative to the US dollar, and from a decline in the value of the dollar vis-a-vis third currencies (see Figure 1.5). However, the real effective rate declined by only 3%, as Indonesia's inflation differential offset most of the depreciation in the nominal effective rate. Viewing these developments in a longer-term perspective, Indonesia's real effective exchange rate at the end of 1994 had depreciated by about 12% relative to its value immediately after the 1986 devaluation (see Figure 1.5).

1.35 **Giving the Market More Room to Work.** Twice during 1994, Bank Indonesia widened the exchange rate band (the so-called bid-offer spread) of the rupiah. On the first occasion, effective January 1, 1994, the band was widened from 10 to 20 rupiah; as follow-up, in September 1994 Bank Indonesia widened the band further from 20 to 30 rupiah. These actions, which were well-executed, are significant in two respects. First, the wider band provides more room for monetary policy

Figure 1.5: Exchange Rate Indicators
(Jan 1986 - Sep 1994)



Source: IMF.

to work, and for price adjustment in the foreign exchange market to absorb often-volatile short-term capital flows. And second, allowing more price adjustment gives more room for private market-makers, which transfers more exchange rate risk from the central bank to foreign exchange speculators. This helps deter short-term speculation. However, it is doubtful whether the current band of 30 rupiah (the equivalent of less than 1 1/2% of the currency's value) provides an adequate absorptive margin, considering the potential magnitude and volatility of Indonesia's short-term capital flows. For example, the band around the Chilean peso (relative to the US$) is 20% and the band between the Deutsche Mark and most other European currencies is 15%; the band between the Dutch Guilder and the Deutsche Mark (currencies regarded as fixed against each other) is 2 1/4%. It would seem advisable for the authorities to further widen the bands when the turbulence on international foreign exchange markets has calmed.

C. Monetary and Fiscal Policy in 1994/95

Monetary Policy and Related Developments

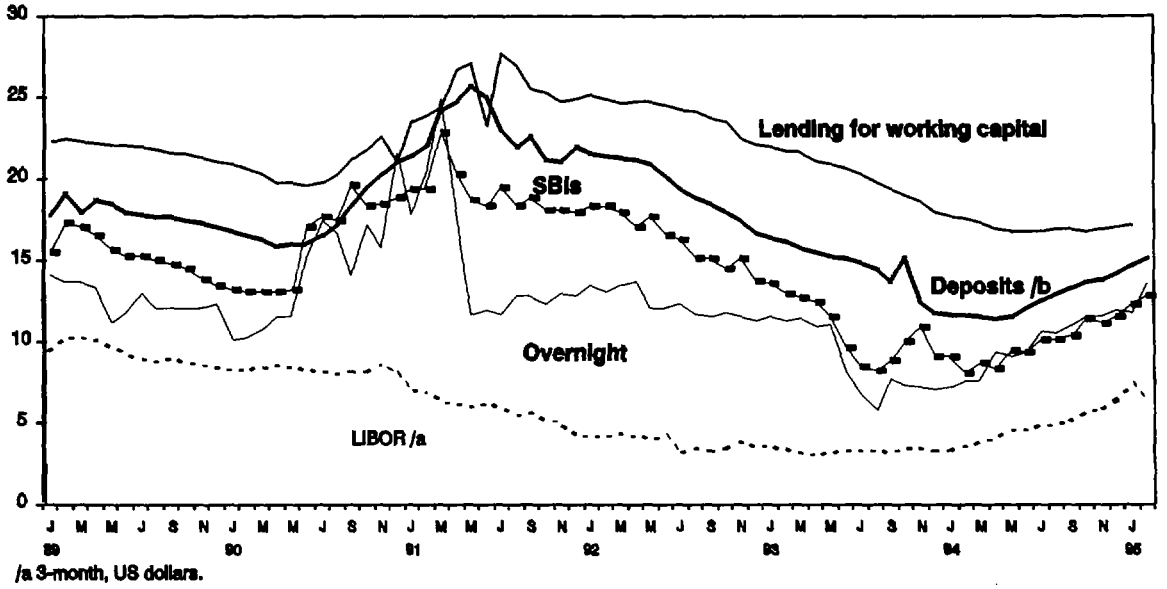
1.36 Three inter-related developments dominated monetary policy and the financial sector during 1994: i) rising international interest rates through most of the year; ii) the outflow of international reserves early in the year; and, iii) the bad debts situation, especially at the state banks.

1.37 **Delayed Interest Rate Increases Contribute to Capital Outflows Early in 1994.** In early 1994 several factors came together to cause a substantial capital outflow. There was labor unrest in Medan; expectations of an accelerated depreciation brought on by statements of public officials; investor reactions to unfolding revelations of malfeasance at BAPINDO; and a negative report by Standard and Poor's on the Indonesian banking sector. Also, international interest rates turned upwards in early 1994, after more than a year at sustained low levels (see Figure 1.6). Initially, Bank Indonesia resisted the upward pressure but, as the nominal spread between rupiah and foreign rates narrowed, capital began to flow out of the country in substantial amounts. The selling pressure on the rupiah abated by early June, when the combination of higher domestic interest rates, strengthening international oil prices, and the May/June deregulation packages stemmed the outflows.

1.38 **Prompt Adjustment Subsequently.** Since June, Bank Indonesia raised interest rates quickly on three occasions following the US Federal Reserve Board and avoided any widening of interest rate differentials that might have sparked another capital outflow. Between mid-July and late August, SBI and SBPU rates were raised by 50 and 100 basis points, respectively, compensating for movements abroad during the same period. The impact of the Central Bank's quick moves on interest rates was probably reinforced by continued strong oil prices and favorable assessments of the deregulation packages. In mid-November and in February 1995, Bank Indonesia moved even more decisively, within days raising SBI and SBPU rates by 75 and 25 basis points respectively, approximately matching similar increases by the U.S. Federal Reserve.

1.39 Changes in deposit rates at commercial banks have reflected these rate movements on monetary instruments with a short lag. By contrast, lending rates declined marginally in the early part of 1994, and were approximately flat through the end of the year when they rose by 50 basis points or so. With deposit rates rising appreciably, banks' interest rate margins are being squeezed. Unless offset by rising fees and other income, the impact on profitability could be substantial in 1995, especially on the state banks where volumes of lending are barely rising.

Figure 1.6: Rupiah Interest Rates (annual percent)



/a 3-month, US dollars.
/b 3-month.
Source: Bank Indonesia.

1.40 **Monetary and Credit Growth Decline.** For operational purposes, one of Bank Indonesia's primary concerns is interest rates. It also keeps a close eye on the growth of money and credit aggregates, but these aggregates are difficult to manage in the context of Indonesia's open economy, owing to interest-elastic capital flows that tend to offset open market operations (see Chapter 1 of World Bank 1994a). In the course of 1994, the rate of expansion of the monetary aggregates and broad measures of credit came down somewhat (see Table 1.4). By early 1995, the 12-month growth rates of all the major monetary aggregates were a few percentage points below their peaks in 1994; the growth of total liquidity was 18.5% versus 22.2% around mid-year, reflecting a similar drop-off in the growth of narrowly-defined money supply. Likewise, reserve money growth was down to 22% from a peak near 30% just half a year earlier. On the asset side of the monetary accounts, credit expansion has slowed in similar fashion.

1.41 In early September, Bank Indonesia relaxed the limit on net open external positions of financial institutions. Under the new regulations, banks should not maintain a consolidated net open position (including both on- and off-balance sheet assets and liabilities) of more than 25% of capital. Previously, the limit was 20%. In effect, this change allows banks to borrow more off-shore.

1.42 ***De Facto* Privatization of the Banking System.** Private banks' share of commercial bank credit has been increasing rapidly in recent years, in line with the expanding role of Indonesia's private sector. In 1994, the share of private banks' in total outstanding loans exceeded 50%, well above the 25% share of a decade ago (see Figure 1.7). By way of example, in September of 1994 the 12-month growth in the private banks was 36% compared with 12% at the state banks. The private banks' success in this regard reflects several factors. The private banks have been quick to move into new areas of lending and they are

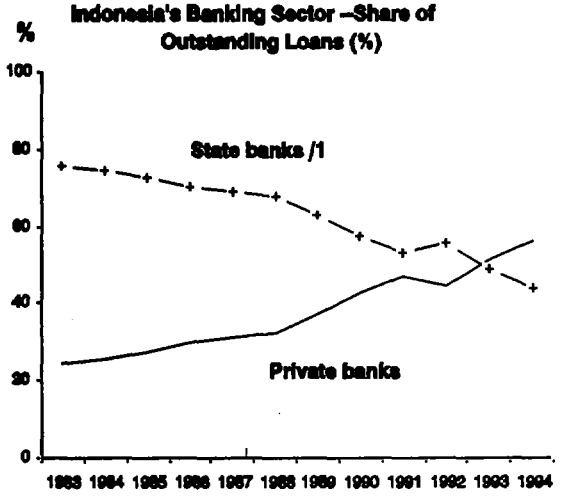
price-competitive. By contrast, credit growth at the state banks has been held down by efforts to resolve bad debts and to meet exposure limits. Furthermore, the developments at BAPINDO probably have slowed down credit growth at all state banks.

1.43 **Changes in the Sectoral Composition of Credit.** Real estate credit has been increasing rapidly, reflecting the factors described in Box 1.1. During the period January to September of 1994, real estate-related financing by private banks expanded at an annual rate of 65% (from a small base), with its share of total loans estimated to have risen from 8 1/4% to 9 1/2%. This shift in the composition of private banks' asset portfolios towards longer term assets,[3] has not been accompanied by a commensurate shift in liabilities. Time deposits—virtually all of which are less than one year's maturity—still account for one-third of private banks' funding, with the rest concentrated in very short-term liabilities including savings and demand deposits as well as some borrowing in the inter-bank market. For those banks extending credit at fixed-rates, the resulting mismatch in maturity structures leaves them vulnerable to a squeeze on interest margins, if deposit rates continue to rise. For those banks with variable rate loans, the higher cost to borrowers of rising rates, would increase default risk of banks' loans. Also, it may be difficult to rollover short-term deposits, forcing them to rely excessively on borrowing in the inter-bank market, or to borrow more abroad. However, funding from abroad is already expanding rapidly, which increases the potential for banks' currency risk.[4]

Institutional Developments in the Banking Sector: Dealing with Bad Debts

1.44 The Government's strategy to improve the depth and financial health of the financial sector involves three main elements, which support *de facto* privatization mentioned above:

Figure 1.7: De Facto Privatization of Indonesia's Banking Sector –Share of Outstanding Loans (%)



/1 Total for state foreign exchange banks.
Source: Bank Indonesia.

i) For the banking system as a whole, a stronger institutional foundation has been put-in-place (see Chapter 2, Section E);

ii) Portfolios and capital of the state banks are being strengthened, and a strategy of partial privatization is being implemented (also see Chapter 2, Section E and Box 1.5 on developments related to bad debts);

iii) Concerning the private banks, progress is also being made on bad debts, Bank Indonesia's banking supervision is being improved, and problem banks are being addressed on a case-by-case basis (see Chapter 2 for details).

1.45 **Some Positive Results From the Strategy.** Despite the high-profile nature of BAPINDO's portfolio problems in 1994, positive results have accrued from the Government's strategy. As concerns the state commercial banks, targets for exposure limits are at (or being brought to) Bank Indonesia's mandated levels, and good progress is being made towards re-capitalization of the banks

Table 1.4: Indonesia: Factors Affecting Reserve Money; Money & Credit Growth
(in trillions of rupiah, at end of period)

	1993 Mar.	*1993 Dec.*	*1994 Mar.*	*1994 Jun.*	*1994 Sep.*	*1994 Dec.*	*1995 Mar.*
Net Foreign Assets	37.2	38.8	38.9	34.0	35.7	37.3	36.9
BI Domestic Credit	6.8	7.3	5.4	5.9	6.9	7.7	5.8
Net Claims on Public Sector	-10.0	-6.9	-11.1	-10.7	-10.6	-9.8	-11.4
Net claims on govt.	-10.3	-7.6	-11.8	-11.5	-11.4	-10.6	-12.5
Net claims on PEs	0.3	0.7	0.7	0.8	0.8	0.8	1.1
Claims on private sector	0.8	0.5	0.5	0.5	0.5	0.5	0.5
Claims on banks	16.1	13.7	16.0	16.2	17.0	17.0	16.7
Liquidity credits	13.4	12.3	12.6	12.9	13.6	13.2	12.6
New BI facilities	2.6	1.4	3.4	3.3	3.4	3.8	4.1
Net other items	-28.3	-28.5	-25.2	-20.8	-21.5	-22.7	-19.6
SBIs	-23.0	-23.4	-19.8	-15.2	-14.1	-15.1	-11.2
Other	-5.3	-5.1	-5.5	-5.6	-7.5	-7.7	-8.4
Reserve Money	15.7	17.6	19.0	19.2	21.0	22.2	23.2
Currency outside banks	13.1	14.4	15.5	15.8	17.6	18.6	19.1
Currency & deposits of banks	2.4	2.8	3.2	3.0	3.1	3.2	3.7
Other deposits	0.2	0.4	0.3	0.4	0.3	0.3	0.3
Memo Items:							
% Change (over previous 12 months)							
Reserve money	7.3	19.5	20.8	27.2	29.5	26.1	22.0
Narrow money (M1)	11.9	28.7	25.7	27.1	21.0	23.2	18.7 [a]
Broad money (M1+quasi-money)	22.1	22.3	21.2	22.2	19.1	19.7	18.5 [a]
Net domestic credit of banks	11.4	26.0	26.4	25.2	24.3	20.6	22.3 [a]
Bank credit to business	10.8	23.4	25.9	23.7	23.7	21.7	22.2 [a]

[a] February 1995.

Source: Bank Indonesia

(see Box 1.5). In addition, there are good prospects for at least one state banks to "go public" within the next year or so. In the private banking community, potentially serious crises (e.g., those connected with Bank Duta and Bank Summa) have been contained with no noticeable disruption to overall financial activity. Also, noteworthy consolidation (including several mergers, acquisitions and assistance to management) of private banks took place during 1994 and early 1995. Moreover, efforts continue to effect consolidations of several other banks with healthier institutions. These are all significant achievements that deserve more recognition, notwithstanding the large remaining challenges in this sector (see below).

1.46 **But a Challenging Task Remains.** Notwithstanding the progress of the past year or so, the Government faces a challenging task to return the financial sector to good health. Most obviously, BAPINDO remains a major headache for the Government. At other state commercial banks, bad debts continue to be a large problem (see Box 1.5), and certain other

Box 1.5: A Financial Check-up on Indonesia's Banks

Many Indonesian banks have weak portfolios. Generally speaking, this problem has two dimensions: i) by international standards, banks carry large amounts of "classified" assets (that is, loans classified as "substandard", "doubtful" and "loss") relative to total credit and capital; and ii) portfolios frequently exceed "legal lending limits" as banks' exposures are overly concentrated in a few borrowers or groups of borrowers.

Indonesia: Developments in Classified Credits

	Loans (in trillions of Rp)				*Composition (in percent)*			
	Oct.93	*Dec. 93*	*Mar.94*	*Dec.94*	*Oct.93*	*Dec.93*	*Mar.94*	*Dec.94*
All Banks								
Total credits	170.6	177.5	185.8	217.0	100.0	100.0	100.0	100.0
Current	143.5	152.3	159.4	190.9	84.1	85.8	85.8	88.0
Classified	27.1	25.1	26.4	26.2	15.9	14.2	14.2	12.1
State banks /a								
Total Credit	92.4	94.1	96.9	104.1	100.0	100.0	100.0	100.0
Current	72.8	75.5	77.5	84.7	78.8	80.2	80.1	81.4
Classified	19.6	18.6	19.3	19.4	21.2	19.8	19.9	18.6
Private Banks								
Total credit	74.6	79.8	85.4	108.7	100.0	100.0	100.0	100.0
Current	68.2	74.0	79.1	102.8	91.4	92.1	92.6	94.6
Classified	6.4	5.8	6.3	5.9	8.6	7.3	7.4	5.4

[a] Includes BAPINDO and BTN; excludes regional development banks (BPDs).
Data Source and Definitions: Bank Indonesia.

The overall situation of the banks has improved since late 1993, as the ratio of classified loans to total credit has declined from almost 16% of total credits in late 1993 to nearly 12% by December 1994. Progress has occurred at both the state and private banks (see tabulation above). However, two points are notable. First, the state banks (including BAPINDO) continue to carry much more classified assets than the private banks, for example, 18.6% of credits versus 5.4% in December 1994. And second, all the progress has been the result of growth in credit. Indeed, the total amount of outstanding classified assets actually increased by more than Rp. 1 trillion during 1994. This increase partly reflects better information on the true situation at some of the banks. But it also suggests that momentum may be slowing, and that greater effort is needed if these banks are to resolve their asset problem by improved collections (see Chapter 2). In the meantime, parts of the banking system are still expanding rapidly (e.g., real estate development at some private banks).

At the five state commercial banks, the Government is aiming to raise capitalization to minimum international (Bank for International Settlements) standards, that is, to 8% of risk-weighted assets (RWA) by end-1996. In this area, there has been notable—albeit mixed—progress among the five banks. For example, after a slow start in 1992, classified assets (including off-balance sheet liabilities) came down during FY1993-94 by more than 1 1/2 percentage points when measured in relation to either total assets or RWA. In addition, after taking into account the shortfall in provisioning for these non-performing loans, existing capital has increased significantly over the same period. Nevertheless, the existing level of classified assets (more than 20% of RWA) is still high by international standards. Moreover, after taking into account the shortfall in provisioning for these non-performing loans, existing capital is only about 2 1/2% of RWA for the state banks as a group. Two actions will be important in this regard: i) raising the capital of these banks to a level that makes adequate allowance for provisioning of classified assets; and ii) strictly adhering to the envisaged schedule, especially in the light of delays that have already been encountered. It should be noted that these actions are equally important for a number of private banks that are under-capitalized and that carry weak portfolios.

On exposure limits, detailed information is highly confidential. However, as of March 1994 all five state banks had met the Government's targets. To be sure, some of these targets still exceed limits set out in the Bank Act of 1992 and various decrees, which are to be observed by March 1997, with interim targets set for 1995. Broadly speaking, the state banks are on-track in this area of the Government's Action Plans to improve their respective financial positions, mainly owing to syndication of loans, risk-sharing among banks, pre-payment of large exposures, reductions in facilities and increases in capital.

fundamental issues remain unresolved (see Chapter 2, Section E). On the private banks, there is a danger that the Government's strategy may not be sufficiently fast-acting to avoid bank failures; more mergers and stronger exit procedures are needed (also see Chapter 2). Prudent development of the non-bank sector would also help in deepening financial intermediation (see Chapter 2).

Issues in Development of the Nonbank Financial Sector

1.47 Indonesia's nonbank financial sector includes capital markets (stocks and bonds) and a diverse array of financial intermediaries: insurance companies; private and state-owned pension funds; venture capital companies; factoring/leasing/finance companies; mutual funds; and JAMSOSTEK, a compulsory workers' insurance, pension and health scheme. In general, this sector is at an early stage of development, but it has been growing very rapidly, despite a lackluster bond market in 1994 (see Table 1.5, noting that another US$2.6 billion was placed in international bond issues). By way of examples in this regard, the value of contracts of leasing companies increased by almost 20% per annum between 1988 and 1992; and, the number of companies engaged in factoring and consumer finance increased from virtually nil in the mid-1980s to 76 and 77, respectively, by the end of 1992.

1.48 This sector has substantial potential for mobilizing additional amounts of financing, provided supportive policies and an appropriate regulatory framework are put-in-place (see Chapter 2). These are particularly important because of the strong linkages between banks and non-banks, the sector's potential vulnerability to external shocks, and the need to protect the growing volume of pension fund assets.

1.49 **Developing Capital Markets.** The Government has taken a number of important steps to develop capital markets since the late 1980s. Most notable among these are: a stronger legal foundation; permitting foreign ownership of up to 49% of the voting shares of Indonesian companies; and transforming the Jakarta Stock Exchange (JSE) into a private member-owned organization. Issues for further development of the capital markets can be broadly categorized as: regulatory (see Chapter 2); and, market structure (i.e., a narrow investor base, the role of foreign investors, and a weak secondary market). On market structure, trading on the JSE is still

Table 1.5: Indonesia: Outstanding Issues on the Capital Market

Year	*Bonds on Stock Exchange*		*Stocks on Stock Exchange*		*Parallel Bourse*	
	Companies (number)	*Value (trillions of Rp.)*	*Companies (number)*	*Value (trillions of Rp.)*	*Companies (number)*	*Value (trillions of Rp.)*
1988	6	0.9	24	0.2	0	0.0
1989	17	1.4	51	1.7	8	0.1
1990	20	1.9	124	13.1	8	0.1
1991	21	2.2	139	27.6	6	0.1
1992	25	1.8	153	24.8	10	1.2
1993	28	2.5	172	69.3	13	3.5
1994	31	2.9	217	103.8	18	3.7

Source: Bank Indonesia

very thin and heavily dependent upon foreign investors. To assist in this regard on the demand side, open-ended mutual funds should be permitted and a secondary market for bonds developed. On the supply side of the market, privatization of state enterprises through the JSE would be helpful.

1.50 **Contractual Savings Institutions.** Issues in this area may be conveniently categorized into four main areas: i) financial (that is, the quality of financial control; solvency issues and the extent of funding for long-term liabilities); ii) regulation (see Chapter 2); iii) systemic (which is to say, the quality of supporting infrastructure, human and otherwise); and iv) the quality of design of individual schemes. A special word is in order as concerns JAMSOSTEK, which has the potential to become by far the largest contractual savings fund in Indonesia. In light of the potential for financial liability of the Government for health care and pensions, as well as the large amount of assets that could be built up (one government agency has estimated Rp.20 trillion by the year 2000), it is vital that responsible financial control is maintained and that strict oversight be exercised by the Ministry of Finance (see Chapter 2).

Fiscal Policy and Related Developments

1.51 In the wake of the drop in oil prices at the end of 1993, the Budget for FY1994/95 adopted a restrictive stance (see Table 1.6), as described in last year's Economic Report. The overall fiscal balance was expected to shift from a modest deficit (equivalent to 0.6% of GDP) in FY1993/94 to a small surplus (of 0.3% of GDP) in FY1994/95; expenditures were to decline in real terms while revenues would rise appreciably faster than inflation. As one part of this fiscal prudence, there was no general pay increase awarded to the civil service in 1994.

1.52 **Outturn for FY1994/95.** Fiscal policy was significantly tighter in FY1994/95 than in FY1993/94, although it was more expansionary than had been budgeted (see Table 1.6). Revenues rose roughly in line with expectations. As usual, non-oil taxes were the strongest component of revenues, rising rapidly as a result of the booming non-agriculture economy and higher-than-expected inflation. For their part, oil revenues benefitted from the fillip in international oil prices just before mid-year. On expenditures, personnel spending was well-contained during most of the year, but other expenditure categories, including subsidies and off-budget spending,[5] increased by somewhat more than programmed. In addition, the decision (in the FY1995/96 Budget, see discussion below) to award a pay increase to some civil servants effective in January 1995 pushed personnel spending a little over-budget.

1.53 Reflecting these various factors, the overall balance in FY1994/95 is estimated to have narrowed by more than 1/2 percentage point of GDP (from a deficit of 0.6% of GDP in FY1993/94 to virtual balance in FY1994/95). In FY1994/95, financing was provided by net external borrowing in the amount of Rp.0.2 trillion and by privatization receipts (from the partial sale of Indosat; see below) in the amount of Rp.1.7 trillion. On the side of domestic financing, there was a large build-up in government bank deposits, which constitutes negative financing, of Rp.2.1 trillion.

1.54 **The Tax Reforms of 1994.** On September 3, the Minister of Finance proposed large cuts to direct taxes, as well as other significant changes to Indonesia's tax system, the first since tax reform was enacted in 1983. Parliament passed a new tax law in October 1994 with effect from 1 January 1995; its main features include:

i) basic deductions were approximately doubled and direct tax rates were cut by roughly one-third;[6]

ii) relatively restrictive tax incentives were introduced for certain investments in export activities or remote regions (such as eastern Indonesia), and tax deductions are allowed for expenditures on training, R&D and environmental protection;

iii) the tax base was widened somewhat by, *inter alia*: imposing a 15% tax on off-shore deposits placed through Indonesian or foreign banks operating in Indonesia; levying a 5% capital gains tax on certain land transactions; and by imposing a 0.1% tax on the sale of shares and other certificates in stock market transactions (founder shareholders of listed companies are subject to an additional 5% tax);

iv) a 10% luxury tax is to be imposed on the selling price of luxury residences (excluding land).[7] The applicable range of the luxury tax was increased from 10-35% to 10-50%;

vi) a property tax exemption (formerly of Rp.7 million, and applicable only to buildings) was raised to Rp.8 million, but coverage was widened to apply to both buildings and land; and

v) important administrative steps were taken to increase compliance. For example, fines were increased for non/late-filing of VAT and direct tax returns, and certain Tax Regulations were replaced by MOF Decrees, which broadened the Tax Authority's power to audit for *compliance*, and not just for *assessment*. Also, a new Tax Court will be established (no date has been specified), and there will be no right of appeal to the Administrative Court.

1.55 **Assessment of the Tax Package.** As announced by the Government, the tax package was intended to make Indonesia's tax rates competitive vis-a-vis other countries in the region and to promote investment and growth in the more remote regions of the country. These are worthwhile goals (however, see the following two paragraphs). Also on the positive side, there are several specific measures that can be praised in this package. Most of the steps to broaden the tax base are useful, as they seem likely improve the economy's tax yield without much additional administrative cost. Also, the 5% capital gains tax on some land transactions as well as the 10% tax on luxury residences are welcome as they may help to keep the booming real estate sector under control. Furthermore, the administrative improvements are an important step forward, especially the provisions for broadening the Tax Authority's powers to audit.

1.56 However, the tax package also raises larger issues. Most importantly, the cuts to direct taxes are large (the changes to tax rates and deductions are estimated at more than 1/2% of GDP) and their expansionary impact comes at a time when the economy is already booming. In addition, Indonesia's economic successes since the tax reform of 1986 suggest that higher tax rates and the absence of tax incentives have not been a significant impediment to new investment; other policies, such as further deregulation, could sustain economic growth, at no financial cost to the Government.

1.57 As specifically concerns tax incentives, these are generally an ineffective instrument of regional economic policy, as their track record is highly questionable (see Boadway and Shah, and World Bank 1994a). In addition, they involve serious definitional problems and open the door to abuse.

Table 1.6: Indonesia: Summary of Central Government Fiscal Operations [a]
(in trillions of rupiah)

	1992/93	1993/94		1994/95		1995/96
		Budget	Actual	Budget	Estimate	Budget
Revenue & Grants	45.5	54.8	54.2	60.2	60.1	65.5
Oil/LNG taxes	15.3	15.1	12.8	12.9	13.4	13.3
Non-oil taxes	27.4	33.8	34.2	40.1	40.7	45.0
Non-tax revenues	2.3	5.4	6.7	6.8	5.5	6.7
Grants [b]	0.6	0.5	0.5	0.5	0.5	0.5
Current Expenditures [c]	28.5	31.5	33.3	35.2	35.5	40.3
External interest	5.5	6.1	6.3	7.1	6.7	7.2
Subsidies [d]	1.2	1.8	1.7	0.2	0.5	0.1
Other, of which:	21.8	23.7	25.2	28.0	28.4	33.0
Personnel [e]	14.4	16.5	18.2	19.7	19.8	23.3
Capital Expenditure	20.6 [f]	22.1	23.0 [f]	24.0	24.4 [f]	26.9
Total Expenditure	49.1	53.6	56.3	59.2	60.0	67.2
Overall Fiscal Balance	-3.6	1.2	-2.0	1.0	0.2	-1.7
Financing	3.6	-1.2	2.0	-1.0	-0.2	1.7
External (net)	1.3	-1.2	1.8	-1.0	0.2	0.5
Disbursements	11.2	9.1	12.6	9.5	12.1	11.2
Amortizations	9.9	10.3	10.8	10.5	11.9	10.7
Domestic (net financial drawdown)	2.3	0.0	0.3	0.0	-2.1	1.2 [g]
Exceptional: privatization receipts	0.0	0.0	0.0	0.0	1.7	0.0
			(as % of GDP) [h]			
Revenue & Grants	16.1	16.6	16.4	16.0	15.9	15.4
Current Expenditures	10.1	9.6	10.1	9.3	9.4	9.5
Capital Expenditure	7.3 [a]	6.7	7.0 [a]	6.4	6.5 [a]	6.3
Total Expenditure	17.4	16.3	17.1	15.7	15.9	15.8
Government Savings	6.0	7.1	6.4	6.6	6.5	5.9
Overall Fiscal Balance	-1.3	0.4	-0.6	0.3	0.0	-0.4

[a] This table presents Central Government fiscal accounts in the standard format used by the IMF's *Government Financial Statistics*, which differs from the format used in the Government of Indonesia's Budget. Tables in Section 5 of the Statistical Annex present the fiscal accounts in the Government's format.
[b] Estimated grant component of external financing.
[c] Includes spending of a current nature classified as development expenditure in the Government's Budget (fertilizer subsidy, defence expenditure, O&M expenditure).
[d] Includes fertilizer and petroleum subsidies.
[e] Central Government's personnel spending plus transfers to regional governments for personnel expenditure.
[f] Derived as the sum of government savings (revenues less current expenditures) and net financing (external plus domestic). Derived residually in this manner, these estimates of capital expenditure include net off-budget transactions.
[g] Drawdown of off-budget government deposits (reforestation funds).
[h] Based on new National Accounts (see Annex I).

Source: Ministry of Finance and World Bank Staff estimates.

1.58 **The Budget for FY1995/96.** In framing the Budget for FY1995/96, the Government faced difficult decisions. On the one side of the coin, it was aware that the economy might be giving off early signs of overheating. But, on the flip side of this coin, the Government had already announced the tax cuts described above, and pressures were building for increased spending—for example, a sizable across-the-board wage increase for the civil service. With little flexibility left on the side of income tax rates (and deductions), the Government acted to limit the expansionary effect, emphasizing: additional measures in the area of non-tax revenues; improved administration to boost collections of property, excise and value added taxes; better efficiency and absorption to accelerate disbursements of foreign aid; and prioritization of development spending in favor of infrastructure, especially in the least-developed regions of the country. The general salary increase to civil servants was limited to 10%.[8]

1.59 The FY1995/96 Budget (which was finalized before the large cross-currency movements of early 1995) is summarized in World Bank/IMF format in Table 1.6. The overall fiscal position is budgeted to be in deficit amounting to 0.4% of GDP in FY1995/96 compared to a small surplus (equivalent to 0.3% of GDP) that was budgeted for FY1994/95 and an estimated outturn of a very modest surplus for that year.[9] The FY1995/96 deficit would be financed by net external borrowing of Rp.0.5 trillion and a budgeted drawdown of off-budget government deposits (re-forestation funds) in the amount of Rp.1.2 trillion.

1.60 Budgeted revenues would drop sharply in relation to GDP, reflecting the secular decline in Oil/LNG revenues and the impact of the September cuts to direct taxes. At the same time, current expenditures would rise a little in relation to GDP owing to higher personnel costs and material purchases. The higher personnel costs stem from the 10% general pay increase and another 8% for growth in the civil service, promotions, grade-inflation, etc. As noted in past Bank Reports, an increase of 8% per annum in personnel costs that is not visibly linked to productivity or incentives seems excessive, and underscores the need for the Government to undertake a wide-ranging program of civil service reform. By contrast, budgeted development spending (measured in relation to GDP) would be down marginally from actual spending in FY1994/95. (See the further discussion of issues related to fiscal policy in Section F).

External Debt Management

1.61 At end-1993, Indonesia's external debt was the fourth largest in the developing world, after Mexico, Brazil and India (*World Debt Tables, 1994-95*), and it now totals about US$100 billion. This debt burden represents a major on-going constraint upon the flexibility of development policy in Indonesia (see Sections D and E). Nonetheless, an unblemished debt-servicing record has been one of the hallmarks of Indonesian macro-economic policy since the 1970s.

1.62 At the end of 1993, Indonesia's total external debt was estimated at US$89.5 billion (*World Bank Debt Tables, 1994-95*), of which US$52.5 billion was public and publicly guaranteed. Medium- and long-term debt of the private sector at end-1993 was estimated at US$16.4 billion; debt of short-term maturity was put at another US$20.7 billion. During 1994, there was some additional net external borrowing. More importantly, the appreciation of the yen and European currencies have significantly raised the dollar value of Indonesia's external obligations, to around US$100 billion. Indicators of Indonesia's indebtedness (Table 1.7) show a notable shift in the composition of debt towards more private debt and less public debt. This change is particularly important as techniques to

Table 1.7: Indonesia: Medium- and Long-Term (MLT) Debt Indicators 1990-1998
(% at year-end)

	1990	*1994* Estimated	*1995* Projected	*1998* Projected
Debt Outst. & Disb.(MLT DOD)/GNP [a]	53.6	45.0	45.2	40.9
Public	44.2	34.7	35.2	30.6
Private	9.4	10.3	10.0	10.3
MLT DOD/Exports [b]	185.2	153.2	152.1	124.7
Public	152.7	118.1	118.6	93.2
Private	32.6	35.1	33.5	31.5
MLT Debt Service/Exports [b]	29.3	29.3	27.9	22.5
Public	23.5	19.0	16.9	12.8
Private	5.8	10.3	11.0	9.7
MLT Interest/Exports [b]	10.8	8.6	8.6	6.5
Public	8.9	6.5	6.1	4.3
Private	1.9	2.1	2.5	2.2

Includes non-recourse debt.
[a] GDP is based on new National Accounts (see Annex I).
[b] Denominator is gross exports of goods and services.

Source: Bank Indonesia and World Bank staff estimates

manage private debt are markedly different from those appropriate for public debt, which has been one of Indonesia's fortes in the past. In addition, a higher proportion of private debt implies higher interest costs and a shortening maturity structure.

1.63 Sustaining its track record on external debt management, Indonesia took another significant step in the second half of 1994 when the Government appropriately used its share of the capital proceeds from privatization of Indosat to pre-pay expensive foreign debt. In total, the Government pre-paid about US$ 3/4 billion of debt to the Asian Development Bank and the World Bank, which dated from the early 1980s and carried high, fixed interest rates. Even allowing for the pre-payment fee, this was a significant cost-saving move by the Government. However, the outstanding amount of Indonesia's debt remains very large, as the operation paid-off only about 1 1/4% of Indonesia's total outstanding official debt, and about 3/4 of 1% of total debt.

D. External Risks

1.64 Despite strong fundamentals and the progress of the past several years, Indonesia remains vulnerable to a wide range of potential external disturbances. In particular, international financial markets remain turbulent as the Mexico crisis has been followed by the depreciation of the US dollar against the yen and the DM. These developments leave the Indonesian authorities with significantly less room for maneuver in policy-making. As discussed below, the risks they face may be conveniently grouped into those originating in

the country's large external debt, or a sudden drop in international commodity prices, especially oil.

1.65 **Risks Associated With Debt.** As mentioned, Indonesia's total external debt is estimated to be about US$100 billion. Nearly half is private and one-quarter is short-term. Of the public debt, roughly 50% is denominated in yen or linked to the yen in multiple currency loans. These characteristics leave Indonesia exposed to risk from several directions, most notably:

- loss of confidence, causing inability to roll over the short-term credits;
- rising international interest rates, which push up debt servicing costs in both the fiscal and balance of payments accounts;
- further depreciation of the US dollar, relative to the yen, which pushes up debt servicing costs in dollars (which is the currency of denomination of virtually all Indonesia's exports); and,
- external shocks could trigger a switch from domestic financial assets into foreign exchange.

1.66 The Government is aware of these possibilities and is prepared to take quick action, as demonstrated in early 1995.

1.67 Much of Indonesia's debt taken on in the 1980s was at variable interest rates. For example, in the early 1990s, some 30% of public debt was at variable rates. Also, roughly 40% of public debt is denominated in yen and another 10% is linked to the yen, mainly through multiple currency loans from the ADB and World Bank. Although these yen-denominated loans have relatively low interest rates, Indonesia carries the associated exchange rate risk, which has proved costly as the yen has strengthened. It is currently estimated that a 10% depreciation of the US dollar relative to the yen (close to the actual change during 1994 and substantially less than that which occurred during the first few months of 1995), adds approximately US$1/2 billion per year to Indonesia's debt servicing costs. Of this amount, roughly 40% is interest payments, and 60% is amortization.

1.68 **Risks From the Side of Commodity Prices.** Indonesia is still a large exporter of primary commodities, and many of their prices were on the upswing in 1994. But, these prices are subject to a great deal of volatility, and they could turn downwards unexpectedly. By far the most important commodities to Indonesia are oil and LNG/LPG, which still contribute roughly 20-25% to Indonesia's fiscal and external accounts. As rules of thumb in this regard, each dollar decline in oil prices causes a net deterioration of around $330 million in the balance of payments, and of $280 million in the Government's fiscal balance (assuming a constant domestic price). The impact of other commodity prices is more difficult to quantify. As one rough measure, non-oil commodity exports (comprising mineral and agricultural products, including plywood) still account for almost 30% of non-oil exports. A downturn in the prices of these commodities, would have a proportionate first-round impact on the balance of payments, as evidenced by the effect of the decline in plywood and textile & garment prices in early 1994 (see Box 1.3).

1.69 **Policy Implications.** To protect against these risks, Indonesia needs—above all—to continue its sound economic fundamentals and to focus on the key policy issues discussed in Section F. However, certain other policy implications also bear mention. First, the Government needs to adjust to the higher servicing costs of external debt that were brought on by recent currency re-alignments, by tightening fiscal policy accordingly. Second, a strong international

reserve position is the first line of defense against many of the risks mentioned above. The Government fully recognizes this, and has built up official reserves to a prudent level; but, this level will need to be increased further, at least in line with rapidly-growing imports. Windfall revenues (for example, accruing from privatization or from a temporary surge in oil prices) could be set aside to assist in building international reserves; they could also be used to pre-pay further amounts of expensive external debt.

1.70 In the event of a sustained drop-off in oil (or other) commodity prices, the Government will need to act decisively to maintain the confidence of lenders, especially as regards monetary and fiscal policy. Appropriately rapid action would avoid sparking a secondary round of capital flight and further speculation against the rupiah.

1.71 Under almost any scenario, it would be undesirable for Indonesia to undertake a sustained increase in external commercial borrowing; there is simply not enough room for maneuver in this quarter, given the existing debt burden.

E. Medium-Term Prospects and Policies

1.72 Indonesia has excellent prospects for sustained medium-term economic growth, given prudent policies (summarized in Section F) and adept handling of the risks outlined above. Per capita income should reach US$1000 before the turn of the century. This will generate the rapid employment growth that is necessary to absorb the expanding labor force at higher levels of earnings and to reduce poverty.

1.73 **Summary of Macro Prospects.** Medium-term projections, which are consistent with the effective policy actions of Section F, are summarized in Table 1.8. Growth is projected to rise in 1995 to around 7.5%, before slowing over the medium-term to a more sustainable 7% or so. Growth will continue to be driven by the non-oil, non-agricultural sector,[10] which would expand by over 8% per annum during the coming decade. The leading sectors would be (non-oil) manufacturing, mining, and electricity generation, which would all grow by an average of around 10% per annum. In the case of manufacturing, this pace would be a little below the 12% recorded during the past decade or so. The pace of expansion of construction would also come down, but more sharply, from some 12% per annum in the early 1990s to 8% per annum over the medium-term. The Oil/LNG sector would be virtually stagnant; any real growth in the Oil/LNG sector would stem from LNG.

1.74 The rise in direct foreign investment and private infrastructure development is projected to raise imports, which would widen the current account deficit in 1995/96 to about 2.6% of GDP, from 1.9% in 1994/95 (Table 1.8). This investment-led rise in imports would be partly offset by an assumed, policy-induced slowdown in the imports to contain the impact of the current economic boom. In the medium-term, with tighter monetary and fiscal policies, the current account deficit is projected to decline to 2% of GDP or so. Throughout the period, the current account deficit remains modest by international standards—for example, it is always much less than half the size of deficits in Malaysia and Thailand at the present time—reflecting the need for prudence given Indonesia's large external debt.

1.75 Under this projection, non-oil exports are projected to continue rising at over 16% per year with non-oil imports averaging a bit less, roughly 15% per year. Direct foreign

investment is projected to rise about 20% per annum, and other private medium- and long-term borrowing also expands rapidly, as would be expected. Public external borrowing rises in 1995/96, but it drops-off fairly markedly in subsequent years (see also Table 1.10). This pattern reflects tightening in the public sector, in part to offset the rise in debt service caused by the recent cross currency movements. The economy would accumulate a prudent volume of reserves over the projection period as the private sector finances its imports of investment equipment with direct investment and private borrowing.

1.76 Two points should be especially noted about these projections. First, the projections do not include any receipts from privatization; it is assumed that these would be used to reduce public external debt. Second, if private foreign finance is more buoyant than assumed, then investment could be larger than projected and the current account deficit could temporarily widen more than indicated. However, the Government should avoid financing any additional widening of the current account deficit by larger public borrowing or reserve losses; the private sector should provide its own financing.

1.77 **Projections of Savings and Investment Balances.** These balance of payments projections are echoed in the projected savings and investment balances.

Table 1.8: Indonesia: Projections of Key Macroeconomic Indicators

	Estimated	*Projected*			
	1994	*1995*	*1996*	*1997*	*1998*
Average real growth rates (% p.a.)					
GDP	7.3	7.4	7.1	7.3	7.4
Non-oil GDP	7.8	8.0	8.0	8.0	8.0
Gross Fixed Investment	12.6	10.5	7.5	7.0	7.3
Prices					
Oil (US$/bbl, average OPEC price)	14.3	15.6	16.1	16.6	17.1
Non-oil Terms of Trade (1983/84=100)	102.2	103.6	103.5	103.1	102.9
Balance of Payments (in billions of US$)			*Fiscal Years*		
Merchandise Exports (fob)	42.0	46.0	51.8	59.2	67.1
of which Non-oil	31.7	36.8	42.8	50.0	57.7
Merchandise Imports (cif)	-38.2	-43.0	-49.1	-56.1	-63.6
of which Non-oil	-34.0	-39.4	-45.6	-52.4	-59.7
Interest Payments (MLT)	-4.2	-4.7	-4.7	-4.9	-5.1
Current Account Balance	-3.5	-5.0	-5.9	-5.7	-5.6
Public MLT Loans (net)	0.8 [a]	1.7	1.2	0.7	0.5
Direct Foreign Investment	2.5	3.0	3.6	4.3	5.2
Other Capital (net)	-1.2 [a]	2.1	3.7	4.2	5.1
Use of Foreign Assets (- = increase)	1.4	-1.8	-2.6	-3.5	-5.2
Memo Items:					
Net Official Reserves (in billions of US$)	13.3	16.1	21.3	24.3	29.1
- Months of Imports	4.2	4.5	5.2	5.2	5.5
Current Account/GDP (%) [b]	-1.9	-2.6	-2.8	-2.5	-2.2
Non-interest Current Account/GNP (%) [b]	1.2	0.7	0.3	0.5	0.6

[a] Includes debt prepayment/offshore receipts from Indosat privatization.
[b] Based on new National Accounts (See Annex I).

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

Table 1.9: Indonesia: Savings-Investment Balances, 1993-1998 [a]
(% of GDP at current prices)

	1993	1994	1995	1996	1998
Gross investment	27.8	29.1	29.9	30.0	29.9
Fixed investment	26.3	27.6	28.4	28.5	28.4
Change in stocks	1.5	1.5	1.5	1.5	1.5
Gross national savings	26.0	27.2	27.4	27.2	27.6
Savings-investment gap [b]	-1.8	-1.9	-2.4	-2.7	-2.3
Public Sector					
Gross investment	9.7	9.5	9.5	9.6	9.6
Public savings	8.5	8.7	8.4	8.6	9.1
Savings-investment gap	-1.2	-0.8	-1.1	-1.0	-0.5
Private Sector					
Gross investment	18.1	19.6	20.4	20.4	20.3
Fixed investment	16.6	18.1	18.9	18.9	18.8
Change in stocks	1.5	1.5	1.5	1.5	1.5
Savings	17.5	18.5	19.0	18.6	18.5
Savings-investment gap	-0.6	-1.1	-1.3	-1.7	-1.8

[a] All data converted to calendar-year basis. As a result, the data on the current account deficit and the public sector deficit differ slightly from other tables. GDP data are based on the new National Accounts (see Annex I).
[b] The deficit on current account of the balance of payments expressed in calendar years.

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

Gross domestic investment is projected to rise a little in relation to GDP (Table 1.9). The rise would originate in the private sector, probably incorporating a shift in composition away from residential construction in favor of plant and equipment. Prudent financing of this investment spending implies reduced reliance upon foreign savings (from around 2.7% of GDP in 1996 to a target of about 2% within a few years), owing to large, existing levels of external debt. Consequently, national savings need to grow faster than GDP to replace foreign savings. Strong capital market development and new savings instruments would help raise private saving rates. However, the main policy action needs to take place on the side of public saving and investment. Specifically, the gap between public investment and public savings needs to narrow substantially. Such action will be needed to make room for the large, envisaged rise in private investment while reducing the external current account deficit.

1.78 **Projections of External Financing and the Role of Foreign Assistance.** No unusual difficulties are anticipated in meeting Indonesia's external financing needs over the medium-term (see Table 1.10), provided certain key steps are taken on a timely basis—for instance, ensuring that: growth of aggregate demand is held within prudent bounds; private projects are sound and efficient (see Chapter 2); and, an improved framework for infrastructure investment increases services while lowering costs (see Chapter 3). However, gross financing needs will increase temporarily, owing to: rapid expansion of investment by the private sector (which increases the current account deficit); rising

Table 1.10: Indonesia: Projected External Financing
(in billions of US$)

	Actual	*Estimated*	*Projected*		
	1993/94	*1994/95*	*1995/96*	*1996/97*	*1997/98*
Uses of Financing	12.3	12.3	17.3	19.4	21.1
Current account deficit	2.9	3.5	5.0	5.9	5.7
(of which, MLT interest payments)	(4.1)	(4.2)	(4.7)	(4.7)	(4.9)
Principal repayments	9.1	10.2 [b]	10.5	10.9	11.9
Increase in net foreign assets	0.3	-1.4	1.8	2.6	3.5
Sources of Financing	12.3	12.3	17.3	19.4	21.1
Direct foreign investment (net)	2.0	2.5	3.0	3.6	4.3
Private MLT loans	3.6	4.9	5.5	6.9	7.5
Other (net)	-0.1	-2.0 [b]	1.2	1.9	2.1
Public MLT loans	6.8	6.9	7.6	7.0	7.2
CGI assistance [a]	(3.5)	(3.7)	(3.9)	(3.9)	(3.9)
Other, incl. non-concessional	(3.3)	(3.2)	(3.7)	(3.1)	(3.3)

[a] Excludes grants, which are included in transfers in the current account, following standard methodology.
[b] Includes debt prepayment/offshore receipts from Indosat privatization.

Source: Bank Indonesia and World Bank Staff estimates.

debt service due to cross currency movements; and the need to build-up official reserves, particularly in the light of the recent volatility in international currency markets.

1.79 Looking further ahead, the current account would tend to narrow (reflecting steps to avoid overheating), but repayment of debt would increase and official international reserves would be accumulated at a faster pace. Consequently, total financing needs would continue to rise, by around US$2 billion per year. This rising financing need would be met entirely by the private sector—foreign direct investment, private lending, and moderate growth of short-term capital. Disbursements of official loan assistance would remain approximately unchanged, while public borrowing from private sources would increase from current levels, through REPELITA VI and beyond.

1.80 Despite the rising importance of the private sector in Indonesia's external financing, official assistance will continue to play several strategic roles. First, official assistance is the concrete means by which foreign governments and external agencies signal their support for Indonesia's development policies. Second, the availability of adequate amounts of assistance ensures an orderly transition to more diversified sources of financing. Third, it ensures adequate provision of financing for those areas of development that are not of interest to the private sector, for example, human resource development and some areas of public infrastructure. Finally, the term and risk diversification associated with official assistance improves the structure of external assistance; it also helps to maintain Indonesia's access to international capital markets and improves the country's attractiveness as a destination for foreign direct investment.

1.81 On the basis of the projections presented in the previous Sub-Sections, disbursements of financing assistance from Indonesia's Consultative Group (CGI) would need to exceed US$4 billion (including grants) in 1995/96. After allowance for the existing

pipeline of assistance and considering the availability of sound projects, achieving this goal would imply a level of new commitments (loans and grants) from the Consultative Group for Indonesia similar to last year's US$5.2 billion. The remainder of the rise in financing needs in FY1995/96 would be met by disbursements from other sources.

1.82 As recognized from both the Indonesian and donors' sides of the CGI Meeting of July 1994, Indonesia's priority needs to favor a composition of this assistance that emphasizes human resource development, poverty reduction and the provision of physical infrastructure that eliminates bottlenecks to private sector. Developments since last year's CGI Meeting have underscored the interest of the private sector in significantly increasing its financing of development of Indonesia's infrastructure (see Chapter 3). Accordingly, the priority areas for new assistance are human resource development, poverty reduction, protection of the environment, and the provision of infrastructure complementary to activities of the private sector (see Chapters 3 and 4).

F. The Priority Macroeconomic Policy Agenda

1.83 Achieving the medium-term prospects of Section E requires that three important, overlapping policy issues be addressed i) avoiding the danger of overheating; ii) maintaining control over Indonesia's external debt; and, iii) sustaining external confidence, especially in regard to the soundness of the financial system.

Avoiding Overheating

1.84 As noted at the outset of this Chapter, the Government is aware of the need to maintain macroeconomic stability as a precondition of further economic and social progress. At the present time, the main danger to Indonesia's financial stability seems to arise from the possibility of overheating, bearing in mind that the impact of the Mexico crisis may slow economic activity somewhat. If present trends continue following the Mexico crisis and the yen appreciation, a more contractionary balance of financial policies is likely to be needed to reduce the danger of overheating.

1.85 **Fiscal Policy.** The thrust of fiscal policy during the coming year will largely be determined by the Budget for FY1995/95, which was less contractionary than the previous year's. As such, it will not contribute much to any cool-down of the economy, nor will it help to generate the savings that are needed to finance rising private and public investment. This step taken, the containment of off-budget spending is one of the remaining policy levers for countering overheating and for meeting the additional debt service costs occasioned by cross-currency movements since the Budget was finalized. To this end, strict control needs to be exercised over off-budget spending, and the aim should be to bring such spending on-budget to contain slippages. The commercial lines of credit should not be used to finance such spending, but be maintained effectively as additional official reserves. Also, the Government should aggressively pursue those revenue items in the Budget that are targeted for increased collections: non-tax revenues; improved administration; and taxes on land and real estate transactions. Moreover, there is much more room for increased revenues from forestry (IHH), luxury, property and excise taxes, including on gasoline.

1.86 Over the medium-term, the ratio of tax collections to GDP, which is low in Indonesia by standards of lower middle-income countries, needs to be substantially increased, mainly by improved administration and broadening the tax base. Such domestic resource mobilization

efforts will be vital in maintaining macroeconomic stability and in funding needed investments in infrastructure and human resource development. Other useful steps include: improved tax administration; raising forestry revenues (IHH) and bringing them on-budget; raising urban property taxes and assessments; and better pricing of public infrastructure services (including congestion taxes). Fiscal policy also needs to be more "contra-cyclical". In Indonesia's balanced budget setting, this would mean running small overall surpluses at time of cyclical upturns and strictly earmarking these "surpluses" to underfunded long-term liabilities, such as the civil servants pension funds or debt prepayments.

1.87 **Monetary Policy.** With the direction of fiscal policy essentially determined for the time being, a sizable part of the burden of any cool-down will fall on monetary policy. During the past year or so, international interest rates have been on the rise, and aligning domestic rates with international rates has slowed monetary and credit aggregates somewhat. If international rates continue to rise and if Indonesia continues to maintain close alignment between domestic and international interest rates, it will be relatively easy to achieve Bank Indonesia's targets for monetary and credit expansion during the coming fiscal year. However, tighter policy and commensurately higher interest rates would be needed to contribute in a significant way to any necessary cooling-off, which will require courage, especially if international rates decline.

1.88 The conduct of monetary policy during the coming year is likely to be complicated by two additional considerations. First, Indonesia is vulnerable to contagion effects from events such as the end-1994 Mexico crisis and the early-1995 dollar depreciation, which could make it difficult for Indonesia to rollover short-term credits (see Maintaining Confidence below). The second complicating consideration concerns the state of Indonesia's banking sector; in some quarters there are doubts as to the capacity of some of Indonesia's banks to withstand a significant, extended tightening of monetary policy. These two complicating factors point towards the need for more balance in the use of monetary and fiscal policies to cool-down the economy. Also, they underscore the importance of institutional policies to improve the depth and health of Indonesia's financial system (see Chapter 2).

1.89 **Other Policies To Avoid Overheating.** As discussed in Chapter 2, deregulation has an important role to play in spurring growth in Indonesia. However, deregulation policies can also contribute to a cool-down of the economy. For example, in the near term, opening more sectors to imports and lowering tariffs on key commodities would take some immediate pressure off consumer prices. Similarly, greater private sector involvement in rice trading would help to dampen fluctuations in rice prices. Furthermore, more deregulation of the agricultural sector would lower the consumer price of key commodities, such as noodles, which are a substitute for rice.

1.90 Over the medium-term, implementation of the deregulation program will increase the supply responsiveness of the economy, resulting in less inflation in the face of supply- or demand-side shocks to the economy. Also over the medium-term, other policies can be used to increase the supply capacity of the economy; for instance, public expenditure policy that removes key infrastructural bottlenecks (see Chapter 3).

1.91 Caution is also needed as concerns the Government's policy of rapid increases in legislated minimum wages. To ensure continued strong employment growth, it will be important not to set minimum wages at levels that approach average wages in many sectors. Also, the pace of increase in such wages

should not exceed the capacity of other policies (e.g., deregulation, de-bureaucratization, productivity growth, and nominal exchange rate policy) to offset the cost impact of higher minimum wages.

Managing External Debt

1.92 Notwithstanding the prepayments of debt in 1994, Indonesia's external debt remains a heavy burden on the nation's economic development. To maintain control over this critical element of Indonesia's financial stability, the Government's own external financing needs must be strictly contained. But some further steps would also be important. For instance, the Commercial Offshore Loan Team, COLT, should be strengthened and ceilings should limit public or quasi-public external borrowing to prudent levels over the next few years, including off-balance sheet liabilities, such as guarantees. Also, commercial lines of credit should be set aside to protect against external shocks, and not used for off-budget financing. In addition, public enterprise borrowing on the domestic capital market needs closer surveillance (see Chapter 3). Moreover, the scope for pre-payment of expensive debt has not been exhausted, and there seems to be room for cost-saving through re-financing.

1.93 In a related area, more attention needs to be given to the implications for Indonesia's debt burden of the mega-projects underway in the area of infrastructure. Many of these projects will be highly leveraged and much of the debt component will be counted against Indonesian debt ceilings (see Chapter 3). Moreover, the Government needs to re-assert—at every opportunity—that it firmly maintains a clear distinction between private debt and publicly-guaranteed debt. Finally, the key to managing Indonesia's debt burden continues to lie in efficient use of borrowed funds (public and private, including those associated with foreign direct investment) to sustain the growth of non-oil exports. If borrowed funds are not used effectively, they will add to the country's already large debt burden, without contributing to the nation's repayment capacity. The best means to ensure effective use of borrowed funds is to undertake further trade policy deregulation measures, which expose the economy to international competitive pressures, and to use a clear competitive framework for allocating infrastructure concessions.

Maintaining Confidence

1.94 The most important ingredient to maintaining investor confidence is the visible maintenance of policies that emphasize strong fundamentals. However, these policies alone might not be sufficient to insulate Indonesia from a sudden, unexpected shift in investor sentiment, perhaps brought on by developments unrelated to Indonesia's own policies (for example, further rapid depreciation of the US dollar). In the face of uncertainty, portfolio managers rationally flee to safe havens at very short notice; economic fundamentals can take a back seat for a time. In addition, the potential for such effects is likely to increase in the future as rupiah-denominated assets become a better-known investment among off-shore portfolio managers.

1.95 As a strategic matter in this regard, it should be borne in mind that the capital flight of early 1995 was small relative to the total amount of money that could flee the country should a serious crisis of confidence develop. In such an event, some re-enforcement of Indonesia's strong fundamentals would likely be needed, in the form of: a stronger official reserves position; a forceful tightening of monetary policy; and significant fiscal action. Accelerated delivery of a strong deregulation package might also be useful. Even then, additional support from the aid donor community might prove necessary.

1.96 As on-going insurance against major loss of confidence, Indonesia should be prepared to demonstrate—in a highly visible and convincing way—that it will continue to manage its economic affairs prudently. In addition to maintaining strong fundamentals, the country can demonstrate its commitment in this regard by continuing to address those issues that many observers believe are hurdles to Indonesia's long-term development, such as deregulation. It will also be important to follow policies that strengthen the structure of the economy; in this area, the financial sector is widely regarded as the most critical.

Technical Annex I to Chapter 1
Indonesia's Revised National Accounts

1A.1 In early 1995 the Indonesian Central Bureau of Statistics (BPS) released new national accounts statistics for 1993 and 1994. These incorporate three significant changes: i) estimates of real output were re-based from 1983 to 1993 prices; ii) estimates of 1993 nominal output (Gross Domestic Product, GDP) and expenditure were revised upwards by some 9.2% as a result of improved estimation procedures; and, iii) sectors were re-classified and some sub-sectors were made more detailed.

1A.2 **Re-Basing to 1993 Prices.** Re-basing of the national accounts is a statistical exercise that countries undertake periodically to reflect a more up-to-date structure of the economy, in this case 1993 versus 1983. Effectively, it means deriving estimates of national output by using the prices and sectoral outputs in a more recent year as the basis for weighting growth rates of real output in sub-sectors and sectors. As a general rule, the re-based data yield higher estimates of growth because faster-growing sectors have a larger weight in the re-based estimates. For example, the 1994 GDP growth measured in 1993 prices was 7.3%; in 1983 prices, it was 6.8%.

1A.3 **Historical Revisions to Nominal GDP**. The level of nominal GDP in 1993 was revised upwards based on the results of the latest (1990) Input-Output Table, which was up-dated to 1993. The revisions also encompassed improvements in BPS's methodology. For instance, in some rapidly-growing sectors assumptions were replaced by new information on certain products. Examples in this regard would include: cashews in Agriculture; non-bank financial services and new forms of entertainment (e.g., karaoke) in Services; private short-courses (e.g., for language training) in Education; and telecommunications, private electricity companies and geo-thermal power generation in different types of Utilities. In other sectors, BPS improved estimates of activity, for example in Construction (where more detailed information suggests under-reporting in previous years), Forestry (where data on manufacturing input is now being used, rather than output data recorded by other government agencies), and Manufacturing. At present, these revised data are publicly available only back to 1993.

1A.4 **Sectoral Reclassifications.** The revised national accounts incorporate a new sectoral classification that totals twenty-six sub-sectors (nine major sectors) compared with twenty-one sub-sectors (eleven major) previously. In Agriculture, a new sub-sectoral classification stresses the distinction between food and non-food crops. A few simple forms of processing of agricultural crops (e.g., sun-dried coffee and fish), were transferred from Agriculture to Manufacturing.

1A.5 **Implications for Per Capita Income.** The new national accounts raise the Government's estimate of per capita income in Indonesia by about 9% in 1993 (see below).

	GDP (Rp., trillions)	GNP (Rp., trillions)	GDP per capita ($US)	GNP per capita ($US)
1993 Nominal, 1983 Base	302.3	285.8	746	705
1993 Nominal (& Real), 1993 Base	329.8	317.2	814	782
1994 Nominal, 1993 Base	377.5	363.0	919	884
1994 Real, 1993 Base	354.0	341.5	...	...

Source: BPS

Endnotes

1. In conjunction with the revised National Accounts (see Annex I), the Indonesian Bureau of Statistics (BPS) released its estimate of income per capita for 1994, which was US$884. The official World Bank estimate will not be available until August 1995.

2. Data on country-of-origin should be treated with a degree of caution as there appears to be a certain amount of arbitrariness in the choice of country designations and there is a large residual, "joint" category.

3. Mortgage loans to cover this expansion may be for 90% (or more) of the purchase value of the property (the proportion for existing housing loans tends to be lower, say 70%) with a long maturity structure, of 5-15 years; interest rates may be fixed or variable. There is no secondary mortgage market in Indonesia.

4. These problems are of less concern as regards banks' business loans, which comprise the bulk of loan portfolios, because these are predominantly short-term working capital credits. Of course, banks remain exposed to normal credit-risk on the business loan side of their business, which would be heightened by any sharp, lasting rise in interest rates.

5. The term "off-budget" applies to both revenues and expenditures. This concept is aimed at capturing fiscal transactions outside the framework of the annual Budget. For example, on the side of revenues, this concept captures reforestation funds, which accrue directly to the Forestry Ministry and are not recorded as a revenue in the Budget. On the expenditure side, the concept encompasses extra-budgetary spending financed out of the Government's financial accounts. Limits of the concept should also be noted—such transactions can only be estimated indirectly on a net basis; little is known about the size of the underlaying gross revenues and expenditures.

6. Rates were cut from 15%, 25% and 35% to 10%, 15% and 30%, and the ranges were changed from Rp.0-10 million, 10-50 million and over 50 million, to Rp.0-25 million, 25-50 million and over 50 million.

7. Alternatively, the tax is 10% of half of the sales price of the house and the land.

8. The pay increase was phased, with lower echelons of the civil service receiving the increase with effect from January 1995. Upper levels received the increase effective April 1995.

9. On a Government of Indonesia (GOI) basis, the budget is balanced (that is, a zero deficit), as always. The difference between the GOI accounting framework and the budgeted deficits noted in the text, is strictly presentational. As mentioned in the main text, in 1994 the deficit measured in a World Bank/IMF basis stems from two components: i) foreign borrowing from the aid donor community (in the amount of Rp.0.5 trillion, or 0.1% of GDP), which is counted as a development revenue in GOI format; and, ii) domestic financing from government forestry accounts (in the amount of Rp.1.2 trillion, or 0.3% of GDP), which is counted as a Non-Tax Revenue in GOI format.

10. A key swing sector in the medium-term outlook will be agriculture, most notably production of rice. Production of this commodity has grown less than long-term trends for the past 4 years, and output has suffered an outright decline each of the past 2 years. Weather conditions have played a key role in the past 2 years. But they are not the whole story: gains from technological improvements (higher-yielding strains, better irrigation, pesticides, etc.) have fallen-off; agricultural land has been converted to other, more productive uses; and, prior to 1994 (when producer prices jumped because of the drought), relative prices to producers were on the decline. On the economic policy side, pricing will be the key decision in the next few years. It will be an important factor in determining whether Indonesia follows the high-priced, domestically-oriented route of Japan, or the outward-looking, growth-generating policies of Thailand.

2
THE GOVERNMENT'S ROLE IN COMPETITIVE MARKETS

A. Overview

2.1 The private sector's increasing role in the Indonesian economy requires changes in the Government's role to maximize efficiency. This chapter analyzes some of the key changes that will be needed. The overarching need is to rely more on markets and deregulation to promote efficiency. But markets must be as competitive as possible if the economy is to rely on them to allocate resources efficiently and improve consumer welfare. This means that the Government must emphasize its regulatory role and eliminate the barriers to competition, including trade barriers, while reducing its directly productive role.

2.2 The first area of change is trade deregulation. Beginning in 1985, significant trade reforms improved the profitability of exports and reversed the period of inefficient, inward-oriented growth (World Bank 1994a). In 1991-1994, piecemeal trade reform had some success in making the structure of protection less distortionary. In May 1995 Indonesia took a large step in further deregulating trade. The nearly 25% cut in the average tariff, to 15% (roughly Malaysia's level), is the most significant since 1990. Moreover, the preannounced tariff cuts will reduce the average tariff to 7% by 2003. Strong pro-competitive forces should flow from this initiative, which is discussed further in Section B.

2.3 The significant steps taken in the May package highlight the need to deregulate the parts of the economy that remain insulated from competitive pressure by restrictions on trade. The remaining restrictions will exert a growing drag on the economy. Elimination of nontariff barriers that provide high protection to a few producers at the expense of consumers is a deregulation priority. The deregulation agenda includes also eliminating restrictions on exports. Over half of nonoil exports are subject to some form of export restriction. Export restrictions run counter to the objective of promoting nonoil exports. They serve various objectives including promoting domestic processing activities and improving average export quality but for the most part they are inappropriate instruments for these objectives. Section B also elaborates the remaining trade reform agenda.

2.4 Increasing domestic competition is also of major importance. Indonesia's previous, inward-oriented development strategy involved a plethora of domestic regulations and restrictions on entry. Subsequent deregulation of investment, however, introduced significant competition. Still, a significant Government presence remains in the production and distribution of "essential commodities" in competitive sectors, which reduce efficiency and offer no special protection for consumers. There also have been cases of re-regulation since the opening-up reforms began. Marketing of cloves, soybean meal and citrus in East Kalimantan are examples. The easing of restrictions on international trade will free up domestic competition in markets for many goods and services. But domestic trade restrictions remain large in number and form, and diverse in objectives. For this reason a rules-based approach to deregulating domestic competition also is warranted. This recommendation is elaborated in section C.

2.5 With the emergence of a dynamic private sector there is little rationale for maintaining the Government's presence as a producer in the competitive sectors of the economy. Thus, another change in the Government's role is to privatize public

enterprises operating in the competitive sectors of the economy and concentrate scarce financial and managerial resources where they are most needed. In Indonesia as in other countries the evidence is solid that, where they compete, the private sector outperforms the public sector. This evidence is reviewed in section D.

2.6 A competitive climate for business includes rules of the game to ensure that legal contracts will be enforced. Where these rules are absent other institutions such as negotiating and deal making evolve to facilitate business. Mark-ups and invisible costs are the price of negotiating and deal making and the lack of a clear framework for enforcing contracts. Section E analyzes reforms of the commercial law system aimed at creating a transparent and predictable environment for business.

2.7 The Government also has a regulatory role in some markets arising because of externalities or asymmetries of information. Government regulation of the financial sector is needed because the market may be slow to develop mechanisms for providing accurate, reliable and timely information to the public on the riskiness of investments. In addition, because of the high leverage of financial institutions and their role in managing the payments system, Government regulation can help prevent problems in one bank from spilling over into a systemic problem. Regulation of financial institutions can be improved by information disclosure and Government-mandated reporting requirements. Government regulation of exposure and capital—higher capital requirements—also discourages bank owners from risking depositors' funds by investing unwisely. There also is a direct role for Government as an owner of commercial banks in collecting more forcefully overdue loans. These issues are discussed in more detail in section E. The section also touches on the need for regulation in the increasingly important non-bank financial sector to reduce its vulnerability, ensure that resources are used productively and the Government is not left with unfunded pension obligations.

2.8 The Government's regulatory role also extends to protecting the environment because private firms do not bear the environmental costs of their actions and, thus, may overpollute or underinvest in environmental protection. The Government's role requires both the creation of a regulatory framework to encourage sustainable exploitation of the environment as well as forceful implementation of these rules. It also calls for investments in pollution control. These tasks also are described in section E.

B. Trade Reform

2.9 There are many good reasons to increase competition by deregulating international trade. First, Indonesia will grow faster. Indonesia's GDP growth accelerated after the trade liberalization reforms began in 1985. Second, progress in multilateral trade negotiations argues for pressing ahead with reforms to open up the economy. The momentum following the recent successful multilateral and regional trade liberalization initiatives—the Uruguay Round of GATT negotiations, the APEC leaders' Bogor summit, and the progress toward the ASEAN free trade area—will be lost without concrete steps toward opening markets. Third, heightened global competition—Indonesia's competitors have accelerated the pace of liberalization—needs to be met in kind. Fourth, deregulation of international trade will improve equity. Trade restrictions raise costs, including the domestic prices of food items, which disproportionately taxes the poor. The restrictions also cost jobs by insulating less efficient activities from competitive pressure. By lowering domestic prices of protected items, trade deregulation raises real wages and enhances competitiveness and growth.

2.10 The May 1995 deregulation package resulted in a significant reduction in the average tariff, the first since 1991 and the largest since 1990. The package marks a departure from the previous piecemeal approach to reform. The authorities also issued a schedule for future tariff reductions to 2003. In essence the authorities unilaterally extended the tariff cuts scheduled under the ASEAN Free Trade Area (AFTA) Common Effective Preferential Tariff (CEPT) scheme on a most-favored nation basis. Adherence to this trade reform schedule would result in more improvement in the structure of protection by 2003 than has occurred since the opening-up reforms began.

2.11 The May package also is significant as a response to an enhanced pace of deregulation in competitor countries. Malaysia, for example, cut tariffs on over 2,600 items in 1994. Thailand's deregulation, announced in 1994, will cut the average tariff by half over two years, replace nontariff barriers with tariffs on 22 agricultural products in advance of Thailand's GATT commitments, and deregulate foreign investment. In 1994 India reduced its maximum tariff by two-thirds, lowered tariffs on capital goods to 25%, cut nontariff barriers, and introduced measures to stimulate textile and garment exports. The May package was needed to keep from falling behind the competition.

2.12 With the May package Indonesia also helps sustain the momentum of multilateral trade reform. 1994 saw important steps taken toward a more open world trading system. There was the successful completion of the Uruguay Round of GATT negotiations, Indonesia's hosting of the APEC leaders' Bogor meeting with its commitment to free trade and the ASEAN Economic Ministers' endorsement of acceleration of the time-frame for the realization of the AFTA CEPT to ten years from 15 years. Continued multilateral lowering of trade barriers will benefit the entire world.

2.13 By lowering tariffs on over 6,000 items, the May package will put downward pressure on prices. The average 5% tariff cut will lower the consumer price index by an estimated one percentage point by the end of 1995. This is a welcome development in view of the nearly 5% rise in the consumer price index in the first four months of 1995 (Chapter 1). Restraining inflation is important because inflation adversely affects the poor especially.

The May 1995 Package

2.14 The main trade reforms in the May package include a five percentage point (ten percentage points for tariffs of 40%) nearly across-the-board reduction in import duties. Thus, tariffs on 4,500 items were reduced by five percentage points, tariffs on 1,050 items by ten percentage points, and tariffs on 500 items by 15-35 percentage points. According to the schedule for future tariff reform, tariffs below 20% will be reduced to 5% by 2000 and tariffs in excess of 20% will be reduced to 20% by 1998 and to 10% by 2003.

2.15 There are some exceptions to the across-the-board cuts. In the automotive vehicles sector very high tariffs are being reduced according to a separate timetable in which greater percentage point reductions correspond to smaller proportional reductions. Tariffs on chemical and metal products are being reduced according to a separate schedule that will bring tariffs to a maximum of 10% by 2003. Finally, tariffs on alcoholic beverages are not being reduced. On the other hand tariffs on some items were reduced by more than five percentage points and tariffs on 249 items were eliminated. The items include paper, cooking oil, wood and wood products, tiles and ceramics and glass and glassware.

2.16 In addition to tariff cuts, the May package includes the "tariffication" of nontariff barriers on 69 items—mostly high carbon steel strips—by replacing restrictive import licenses with tariff surcharges of 5% or 10%. Tariff

surcharges on 45 items were abolished and another 50 surcharges were reduced.

2.17 The immediate effect of the May package reforms is to reduce the average tariff plus tariff surcharge to 15% (Table 2.1), about the same as Malaysia. This is a cut of over four percentage points or nearly 25%, the first significant drop since 1991. The production- and import-weighted averages also fell by one-fifth and one-quarter respectively (Table 2.1). The dispersion of tariff protection dropped to 17% from 20%. High dispersion, a persistent feature of the Indonesian system of protection, is bad because is allows inefficient, high cost but protected activities to survive and compete with internationally competitive but unprotected activities for resources.

Table 2.1: The Average Tariff plus Surcharge
(percent)

	Pre-1985	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Unweighted	37	22	20	20.0	19.7	19.5	15.0
Weighted by:							
import value [a]	22	11	11	11.9	13.7	12.5	9.5
1987 production	29	17	15	11.8	10.9	10.4	8.2

[a] 1991 import weights for 1990 and 1991 and 1992 import weights thereafter.

Source: World Bank staff estimates.

2.18 The May package also altered the negative investment list. Ten sectors were dropped from the list and five were added. Thus, a total of 34 sectors remain on the negative investment list (Table 2.2). The main changes included the addition of a new category, "Sectors closed to 100% foreign ownership." Eight sectors are included in this category: operation of ports; production, transmission and distribution of electricity to the public; provision of public telecommunication services; shipping; provision of drinking water; public railways; nuclear power; and advertising.

Table 2.2: The Negative Investment List

	Category	*Number of Sectors*
I.	Sectors closed unless certain requirements are met	9
II.	Sectors closed to foreign investment	6
III.	Sectors closed to 100% foreign investment	8
IV.	Sectors absolutely closed	11
	TOTAL	34

2.19 The May 1994 investment deregulation opened the first seven of these, which are classified as "important to the country," to foreign investment provided that Indonesian partners owned 5% of the entire paid-up capital of the company. The May 1995 package relaxes the requirement that 5% of the capital be owned by Indonesians, stipulating only that foreigners may not own 100% of the capital.

2.20 Ten sectors were dropped from the negative foreign investment list for the stated purposes of increasing business opportunities, domestic supplies of the affected products, value added and technology transfer. The sectors affected are: cooking oil; block board; unfinished and semi-finished rattan; utility boilers; motor vehicles; machines for producing white cigarettes; disposable gas lighters; prescription medicines; aircraft repair; and advertising (though 100% foreign ownership is prohibited—see above). Finally, for environmental protection reasons, five sectors were added to the list of sectors closed totally to investment: manufacture of finished or semi-finished mangrove wood; cyclamate and saccharine; sulfite-based pulp production; chloro-alkali industries using mercury processes; and chloro-fluorocarbon industries.

Unfinished Trade Reforms

2.21 Implementing the tariff cuts programmed in the May package would improve the structure of protection by more than has occurred since trade liberalization reforms began. The implementation of the May package scheduled tariff reforms would reduce the average statutory tariff to 7% and lower its standard deviation to 4%.

2.22 As the structure of tariffs improves the losses from the remaining distortions will grow over time. Elimination of nontariff barriers on imports and export restrictions are the principal unfinished elements in Indonesia's program of trade reform.

2.23 The May package made little progress in reducing the production coverage of nontariff barriers (Table 2.3). Restrictive import licensing requirements continue to protect large shares of agriculture and nonoil manufacturing production. The restrictions on trade in the important commodities regulated by Bulog, the state logistics agency—rice, sugar, wheat, wheat flour, soybeans and soybean meal—were not touched and the authorities stated that they will be deregulated in line with Indonesia's commitments under the Uruguay Round of the GATT/WTO. However, Indonesia's commitments under the Uruguay Round do not require much action to be taken before 1998 (Box 2.1). The most likely channel for deregulating the trade restrictions on the Bulog commodities is through unilateral trade liberalization, just as occurred in the May package.

Table 2.3: Coverage of Nontariff Barriers
(percent of 1987 production protected by restrictive import licensing)

Sector	*1986*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Agriculture (excl. Forestry, Hunting and Fishing)	69	39.1	35.5	35.5	35.5	35.5	35.5
Manufacturing (excl. Oil refining)	46	31.7	31.1	31.4	31.2	30.6	30.3

Source: World Bank staff estimates.

2.24 Nontariff barriers keep domestic sugar prices too high. Domestic sugar prices are controlled and Bulog has the monopoly right to import sugar. A restricted number of traders are eligible to purchase sugar directly from Bulog. The gap between the domestic price of sugar and the price of competing imports fluctuated with world prices between 40% and 80% in the 1980s (Nelson and Panggabean 1991) and a quality-adjusted price differential of 37% was observed for sugar in 1992/93. A sharp rise in world prices beginning in the second half of 1994 more than offset a small increase in the local price to growers—the

"provenue" price—and reduced the price differential to 17% in 1994.

2.25 High domestic sugar prices are like an indirect tax. Such taxes are passed on to consumers. When food items are taxed the burden for the poor, who spend a larger fraction of their income on food, is higher. Sugar accounts for approximately 3.3% of total expenditures by the poor in Indonesia. The 17% fall in sugar prices that would result from deregulating trade in sugar would lead to a 0.6% increase in real expenditures on other goods and services by the poor.

Box 2.1: Indonesia's GATT and APEC Commitments Require Little Action Now

Indonesia's Uruguay Round commitments do not require any trade taxes to be reduced or NTBs to be eliminated immediately. Indonesia offered to increase tariff bindings—commitments to keep tariffs below the bound maximum rates—to 95% of tariff items from under 10% now. But the offer did not include any tariff line with a tariff higher than the ceiling tariff level. Most notable among the excluded items are motor vehicles and parts, which are protected by tariffs of up to 125%. Thus, the increase in tariff bindings is a commitment not to raise tariffs in the future, rather than a commitment to lower them (now or later).

Indonesia also agreed to eliminate import surcharges—another name for import taxes—on bound items within ten years. But, again, this requires no action since all combined tariffs and surcharges on items covered by this commitment already are below the ceiling bindings. Thus, Indonesia could replace the surcharges that are to be eliminated with higher tariffs and meet its commitment without lowering total taxes on imports.

Indonesia's commitment to abolishing NTBs on bound items over ten years covers 98 manufacturing tariff lines (half of all manufacturing lines protected by NTBs but excluding motor vehicles and iron and steel products). The June 1994 deregulation package reduced this number by nine.

In agriculture, the tariff binding agreement covers all tariff lines, but no agriculture tariffs must be reduced because all bindings exceed existing tariffs. The only NTBs that the Indonesian Government will have to abolish are the local content schemes protecting soybean cake used in animal feed (over three years) and dairy products (over ten years). Bulog (the State Logistics agency) monopoly import licenses are unaffected by the commitment since, under GATT rules, these are not regarded as NTBs but rather as legitimate practices that state trading enterprises may perform.

Indonesia, as host to the 1994 APEC summit at Bogor, has been a prominent supporter of APEC. The APEC leaders made a commitment to free trade at Bogor. That commitment is ambiguous as to whether APEC would become a vast free trade area with barriers to trade with outsiders or, alternatively, an agreement based on "open regionalism" in which APEC members would abolish their barriers to trade with each other and with non-APEC countries.

Drawn from *Trade Policy Review Indonesia 1995* General Agreement on Tariffs and Trade, Geneva (February 1995) and the APEC Economic Leaders' Declaration of Common Resolve.

2.26 The May package also left untouched the nontariff barrier protecting domestic wheat flour production. Since 1987 the only things that have changed are the domestic transfer prices, which the Ministry of Finance sets, and world prices. Bulog has the sole right to import wheat—none is grown in Indonesia. The wheat is transferred to the wheat flour millers—there are only three, two huge mills owned by a single private company and a small state-owned mill—which process the wheat in exchange for a processing fee. The flour subsequently is transferred back to Bulog. The miller retains the bran by-product of milling, which it sells to feed producers.

2.27 Although high domestic wheat flour prices are not as much of a problem as in the case of sugar—higher world prices reduced the gap between the domestic wheat flour price over the estimated world price to only 4% in 1994—restrictive dealing arrangement between Bulog and the flour millers has adverse consequences for downstream users of wheat flour. Lack of competition in flour milling and the fixed price structure limit incentives to produce a wider variety of flours, including higher qualities. Bakery needs for specialized flours are not reflected in market signals. The baking industry complains about the quality of Indonesian flour and its inconsistent baking characteristics. This is especially a problem for small and medium industries that lack testing equipment and must rely on trial runs. If a product turns out poorly, they incur additional costs by having to hire technical help to analyze the flour. Deregulation of wheat and wheat flour trade would give a boost to Indonesia's bakery industry and to small and medium industries.

2.28 Restrictions on soybean and soybean meal trade raise the domestic price of soymeal above the import-competing price, inhibit the development of small and medium industries and reduce exports. Soybean processing has been re-regulated since the onset of the opening-up reforms. With the opening of a large domestic soybean crushing plant in 1988 private imports of soybeans were banned and, to protect the crusher, imports of soymeal were restricted by a licensing requirement. The Government introduced a qualitatively identical scheme to the arrangement between Bulog and the wheat flour miller for milling wheat into flour and bran. The main structural difference from the wheat flour scheme is that the soybean crusher is not a monopsony buyer of soybeans. Manufacturers of soybean cake and soysauce, primarily small industries, and producers of fermented soybeans, primarily small cooperative factories, account for two-thirds of soybean purchases.

2.29 The restrictions on soybean imports permit the domestic price of soybeans to exceed the landed price of competing imports. In 1994 the margin was 40%. This disadvantages small soybean cake producers that purchase soybeans on the open market. The cooperatives are less disadvantaged because Bulog sets the soybean price for them below the domestic open market price. In 1994 it was 5% above the landed import price. The producers of soybean cake and fermented soybeans are squeezed by the high price of domestically-grown soybeans.

2.30 The soybean crusher is not disadvantage by a high soybean price. Bulog sets its price below the landed import price for soybeans. In 1994 the subsidy was 23%. In addition, and unlike the case of wheat flour, Bulog sets its soymeal purchase price above the landed import price of soymeal. Although higher world prices resulted in a margin of 5% in 1994, it has been measured as high as 50% since the control of soybean and soymeal trade began in 1988.

2.31 High-priced soymeal disadvantages downstream users, particularly feed mills. Their response has been to substitute less desirable sources of protein such as corn meal for soymeal, which has impeded the development of an efficient poultry industry. The Government has responded to the problems of the feedmillers and the poultry producers by relaxing the restrictions on soybean and soymeal trade. And, as noted above (Box 2.1), under Indonesia's Uruguay Round commitments to the GATT, the local content restrictions protecting the soymeal producer will be phased out by 1998. An acceleration of that date, accompanied by the elimination of restrictions on the import of soybeans, would stimulate the poultry industry in which Indonesia has a comparative advantage. Soybean deregulation also would reduce the domestic price of soybean cake and fermented soybeans, important sources of protein in the Indonesian diet.

2.32 In addition to Bulog's sole right to import the above items, other agricultural goods that are subject to restrictive import licensing include milk and dairy products, onions, garlic and cloves. In industry the main items protected by restrictive import licensing include alcoholic beverages, salt, including iodized salt, fertilizers, propylene copolymers, printed matter, iron and steel tubes, hand tools, motor vehicles and motorcycles and keyboard instruments in a completely knocked-down condition.

2.33 The rationale for protecting some of these items is transparent. Attempts to develop the domestic automobile industry through local content schemes and high tariff and nontariff barriers extend back to the 1970s. A measure of their lack of success is that prior to the May package parts of the automobile sector were protected by taxes on imports of up to 275%; the sector remains a high-cost enclave. In the May package the highest tax was reduced to 200% and it is scheduled to decline to 90% by 2003.

2.34 The rationale for other nontariff barriers is less transparent. Iodine deficiency is a problem in some parts of Indonesia. Although it is not clear that liberalizing iodized salt imports would solve the public health problem, the restriction is questionable. The rationale for restricting imports of hand tools also is unclear. These nontariff barriers keep domestic prices above the price of competing imports. For example, the domestic wholesale price of a hand pump was 164% higher than the comparable price in Singapore in 1993. There appears to be an inconsistency between policies that raise the domestic price of hand tools and the objective of promoting small and medium industry.

2.35 Nontariff barriers are a significant source of high costs in the Indonesian economy and one that has yet to be attacked in a concerted way. An across-the-board elimination of nontariff barriers is warranted. Where necessary the protection afforded by the nontariff barriers could be replaced by temporary import surcharges.

Removing Export Restrictions

2.36 Indonesian exports remain subject to considerable regulation and control. Export restrictions cover half of total non-oil exports. The export restrictions take four forms: Export Bans (72 products), Regulated Exports, which can only be exported by exporters approved by the Ministry of Trade (1,827 products), Supervised Exports, which require approval by the Ministry of Trade (105 products), and Export Taxes (80 products). Most of these restrictions are directed toward agricultural exports. By value, nearly two-thirds of agricultural exports, including all the large cash crops—rubber, palm oil, coffee, and copra—are subject to some form of export restriction. Trade associations also affect the marketing of some, primarily agricultural, commodities.

2.37 Five reasons are officially cited for using export restrictions: (i) to deal with quotas imposed by importing nations; (ii) to conserve natural resources and endangered species; (iii) to promote higher value added downstream industries; (iv) to raise the quality of the exported products; and (v) to regulate domestic supplies. Export restrictions with competitive bidding for quota rights are an appropriate instrument for controlling exports subject to quotas in importing countries. Export restrictions also are appropriate in some instances to protect endangered species. However, they are not appropriate instruments for the other objectives. They have negative side effects, encouraging smuggling and, most importantly, depressing nonoil exports.

2.38 Export restrictions on inputs are an inappropriate means of promoting downstream industries. They lead to resource misallocation from under-production of the input and over-production of the processed good. For

example, export restrictions on logs and low log royalties have contributed to an unsustainable pace of logging and a lack of efficiency in the wood processing industry.

2.39 Qualitatively identical restrictions to those on logs are imposed on raw rattan. In 1988 the Government banned the export of raw rattan (the bans were replaced by prohibitive export taxes in 1992). After the ban the price of rattan logs fell. This provided an initial stimulus to the rattan furniture industry, at the expense of rattan cutters. Over time rattan cutters have left the industry to pursue more lucrative opportunities—in Sulawesi, a main source of rattan, many rattan cutters reportedly switched to cultivating cocoa, which is much less regulated—and raw rattan supplies dropped. As a result raw rattan prices have risen, though they remain 50% below the smuggling price (which in turn is below the price that would prevail in the absence of restrictions). Rattan furniture exporters cannot pass higher raw materials prices on to buyers in the highly competitive furniture export market and profitability in the domestic furniture industry has declined. The number of rattan furniture makers has shrunk and further consolidation appears likely. In January 1995 an interministerial team (*Tim Koordinasi Industri Hasil Hutan*) was formed to guarantee adequate supplies of raw rattan for the furniture industry. However, the surest way to do this is to allow raw rattan cutters a reasonable price by eliminating the export taxes on raw rattan. Efficient processors may need time to adjust to higher raw rattan prices. This could be accommodated by replacing the specific export taxes on raw rattan with an *ad valorem* export tax that would be phased out over a limited, pre-announced period.

2.40 In competitive markets, export restrictions are unnecessary for regulating domestic supply. The Minister of Trade supervises the export of some commodities—salt, cement, fertilizer, pulp and paper, crude palm oil—in order to ensure sufficient domestic availability. For example, in September 1994 the Government, through a Ministry of Trade decree, imposed an export tax on crude palm oil to keep the domestic price of cooking oil down. This taxes CPO producers to the benefit of consumers. However, this kind of intervention reduces the expected profitability of investing in the CPO industry, which, over time, will cause exports of CPO to be lower than in the absence of Government intervention. Export restrictions on cement, fertilizer, salt, and pulp and paper are only one part of a regulatory framework whose aim is to ensure adequate supplies of these "essential commodities" for the domestic market. Indonesia's greater openness has made these regulations unnecessary.

2.41 An across-the-board elimination of export restrictions is warranted for virtually all commodities subject to export restrictions except those on textiles, which are justified while they remain subject to Multi-Fiber Arrangement quotas, and the export bans on endangered species. Where the restrictions have encouraged large investments in processing activities, their progressive elimination over a limited time period could be considered.

C. Promoting Domestic Competition

2.42 Deregulation of restrictions on international trade will expose many of the most highly protected activities in the economy to competition. But restrictions on domestic competition take many forms, including cartels, price controls, entry and exit controls, exclusive licensing, public sector dominance, and *ad hoc* interventions by Government in favor of specific firms and sectors. Some restrictions are imposed by the national Government, others by sub-national Governments, and still others by trade and

business associations (often with official sanction). Some of the restrictions on domestic trade are summarized in Table 2.4. A rules-based approach to deregulating barriers to domestic competition is needed.

Table 2.4: Restrictions on Domestic Competition in Indonesia

Type of Restriction	*Sectors in Which Prevalent*
Cartels	Cement; Plywood; Paper; Fertilizer
Price Controls	Cement; Sugar; Rice
Entry and Exit Controls	Plywood; Retail Trade
Exclusive Licensing	Clove Marketing; Wheat Flour Milling; Soymeal
Public Sector Dominance	Steel; Fertilizer; Refined Oil Products

2.43 The myriad restrictions on domestic competition reflect myriad objectives. Some commodities are termed "essential" and it is said that their distribution is too important to be left to the market (for example, cement, fertilizer). In the cement and fertilizer industries regulation of domestic distribution is accompanied by a significant state presence in production. For other products restrictions on domestic competition are used along with restrictions on international trade to promote infant industries or promote value added in processing activities (for example, wheat flour, soymeal). For still other products, the restrictions are instruments for exploiting Indonesia's power in world markets (plywood). In other cases, restrictions on domestic competition are second-, third- or fourth-best policies for correcting problems that have arisen due to existing distortions (rattan). Finally, local revenue raising is another objective behind some controls on domestic competition.

2.44 Some Indonesian industries are organized as cartels with controls on prices, outputs, entry and exit enforced through trade associations (often with Government sanction). Most such industries are characterized by a sharp dichotomy with relatively efficient firms at one extreme and inefficient, high cost firms at the other. The two are able to co-exist because the cartel rules prevent price competition within the sector from driving the inefficient firms into bankruptcy. This is the case, for example, in the cement and paper and pulp industries. The cost of supporting inefficient firms is passed on to consumers in the form of higher average prices for the goods produced by the relevant industry. Often, Government supports the cartel arrangements because they protect high-cost state-owned enterprises in the sector.

2.45 Exclusive dealing arrangements restrict marketing of a variety of products. Continuing the example of wheat flour, Bulog's agent, a large, well-connected wheat flour miller, undertakes the importing of wheat on behalf of Bulog and, in exchange for a fee, processes the wheat into wheat flour. Although restrictions on investments in the wheat flour industry were lifted in 1993, new investors still would have to buy wheat from Bulog—in practice, through the agent—and export 65% of their output, which have depressed interest in the sector.

2.46 Fertilizer is an "essential" commodity whose distribution is controlled by a state-sanctioned monopoly. One of the state-owned fertilizer producers has the monopoly right to distribute and market all subsidized fertilizers in Indonesia. A set of allowed distribution charges for the company are negotiated each

year with the Ministry of Finance. The allowed charges compensate the company for costs incurred but do not provide any pressure for efficiency improvement. The lack of competition or pressure for greater efficiency raises distribution costs. The potential for cost savings has been estimated at 15-50% of current cost levels, which translates into savings of up to $100 million annually (World Bank 1995b).

2.47 Cement is another essential commodity whose distribution is tightly regulated. Distribution quotas are established monthly for each cement producer at meetings involving officials from the Ministry of Trade, Ministry of Industry, Ministry of Transportation and the Cement Producers Association of Indonesia. Each producer is assigned delivery quotas to particular regions based on plant location and the cement market situation in each of the 27 provinces. An objective of the distribution of quotas is to ensure that each market is serviced by two or more producers.

2.48 The cement industry is characterized by periodic, annual shortages and there is widespread dissatisfaction with it on the part of consumers and producers. The distribution regulations are largely to blame. At times producers must service distant markets whose reference price is based on transport costs from a nearer plant. Excessive freight absorption reduces cement industry profitability, and its capacity for financing investments (Plunkett and Pasinringi 1995). Although BKPM has approved 30 new cement plant investments in the past three years, realization of these investments has been poor and in October 1994 BKPM announced it planned to revoke 23 of the licenses.

2.49 Deregulation of distribution controls along with privatization of publicly-owned plants (see section D), would increase competitive pressure in the cement and fertilizer industries. For this to occur the Government would have to abandon the idea that intervention is necessary to protect consumers of these commodities. The development of a national market with competitive private traders allows the Government to rely on the private sector for their production and distribution.

2.50 Not all marketing monopolies affect essential commodities as the continued existence of the clove marketing monopoly attests. In the latest development with this troubled monopoly, new regulations were promulgated in 1994 requiring clove cigarette manufacturers to increase the clove stocks in their warehouses to help the clove marketing monopoly run down its clove stocks. Although the monopoly announced publicly that it was returning farmers' compulsory savings, it simultaneously introduced administrative procedures defining farmers' eligibility to obtain their money that in practice limit withdrawals. The clove marketing monopoly serves neither the smallholder clove farmers, the *kretek* cigarette manufacturers, nor the taxpayers at large. It should be wound up.

2.51 The recent (January 1995) resuscitation of the idea of granting monopoly rights to distribute rattan in Java is a more recent example of an exclusive dealing arrangement for a non-essential commodity. This privilege would be conferred by the members of the Indonesian Furniture and Handicraft Industry Association, the main buyers of semi-processed rattan. Its objective is to increase the supply of rattan to processing plants located in Java. Further administrative restrictions on rattan trade are not the solution to the structural problems in the rattan industry. A more advisable course would be to eliminate completely all restrictions on domestic and international trade in rattan. Since the domestic price of cut rattan likely would double (to the smuggling price) some relief in the form of a temporary, declining *ad valorem* export tax on raw rattan could help efficient processors adjust. It seems likely that the tangled knot of interventions in rattan

marketing—central Government restrictions, provincial Government restrictions (see below)—will only be cut by strong action from the central Government.

2.52 Sub-national Governments also restrict trade in various ways. Strictly speaking, sub-national Governments are prohibited from imposing commodity taxes without prior approval from the central Government. However, "user charges" (*retribusi*) can be implemented with approval of only the provincial Government and these are used to tax trade. The province of Central Sulawesi bans the export of raw rattan to other provinces, which has created the anomalous situation whereby exports of raw rattan from Central Sulawesi to foreign countries are permitted (in principle; they are subject to prohibitive export taxes) but exports to Java are banned. In South Sulawesi, a provincial Government decree forces rattan traders to purchase cut rattan only from the local cooperatives (KUDs), which levy a fee on purchases by traders. The difficulties posed by local road use fees for shrimp traders in South Sulawesi are described in Box 2.2. The motivations for these levies and controls vary and include raising revenue and promoting cooperatives.

Box 2.2: Local Levies Crimp Shrimp Exporters in South Sulawesi

Locally-levied transport fees are holding back the development of the shrimp and prawn industry in South Sulawesi. Shrimps and prawns are an important new crop in South Sulawesi. Most production comes from small farmers on the eastern coast of the province, a nearly ideal location for their production. The coast faces a large sea with little shipping traffic, and is largely covered by mangrove swamps that naturally provide proper salinity levels required for shrimp production and protect the coast from wave activity. Exporters buy shrimp from farmers on a regular basis, and must transport the product to Ujung Pandang quickly, as all cold storage facilities are located there and the product is highly perishable.

Local administrative "fees" reportedly are not much of a problem—exporters negotiate stable fee levels with local officials for transporting local product out of the *kabupaten*. However, problems arise when they try to transport the product back to Ujung Pandang and have to pay informal road use fees. It is common practice in the province for local Governments to raise money by charging vehicle fees. The fees are supposed to pay for the upkeep of the road, but in fact go into a general fund for local use. Any level of Government can charge these fees. All they have to do is station two people on the road, often with some sort of barriers to stop passing traffic. Fees are usually higher for commercial vehicles than for private cars, although tourist buses seem to be exempt.

The problem is not the existence of the fees, but their unpredictability and variability. When exporters send a truck back to Ujung Pandang, they cannot predict how many times the truck will be stopped. Separate negotiations consume valuable time as the product deteriorates on its ice bed in the back. The bottom line is that costs vary from week to week. The uncertainty in transit costs and time has held back the fish and shrimp farm development on the east coast.

Source: Trade Implementation and Policy Project, Ministry of Trade.

2.53 Trade taxes appear to be attractive vehicles for raising revenue. This is a false perception. Although they appear to tax "someone else" (consumers in other provinces or countries), the most common result is that those consumers have substitutes and the main impact of trade taxes is to depress local producer incomes. Despite central Government efforts to dissuade sub-national level Governments from taxing trade, such interventions are pervasive.

2.54 *Ad hoc* interventions by Government in favor of large or otherwise influential business

groups also occur in Indonesia. Such interventions take the form of Government equity participation in large commercial projects with one favored group or another, favoritism in the procurement practices of public enterprises, or the outright grant of exclusive licenses to produce, import, and sell in certain regions. Often, the stated justification for such interventions is the need to build a strong domestic private sector that can compete internationally. Unfortunately, such interventions typically have the opposite effect. By decreasing domestic competition they promote inefficient firms. By providing large benefits to a few, they generate rent-seeking behavior in the private sector.

2.55 There also are many examples of non-transparent transactions between Government and elements of the private sector. In the textile and paper industries, private groups have been allowed to buy public enterprise assets at low prices without an open and transparent divestiture process. The converse also has happened: the public sector has purchased private assets at significantly inflated prices (relative to the market).

2.56 Cartels, exclusive licensing, entry and exit controls, and non-transparent transactions between the public and private sectors have resulted in significant pockets of monopoly and oligopoly in the Indonesian economy. While it is difficult to document this empirically for the economy as a whole or for all the major sectors, it is possible to do so for the manufacturing sector.

2.57 The average level of concentration in Indonesian manufacturing is high. Concentration is lower than 25% in only two subsectors (textiles/footwear and wood products). The weighted average of 47% is high by international standards, very high compared with developed countries (22% in the United Kingdom and 36% in the United States). Indonesia's ratio is even higher than that of Malaysia (45% in 1990).

2.58 When the data are disaggregated to the 3 digit level, the most concentrated subsectors are: measuring instruments, transport equipment, electrical machinery, iron and steel, structural clay, cement, glass, porcelain, industrial chemicals, paper, tobacco and beverages. This accords broadly with popular perceptions.

2.59 Theory suggests that the lack of competition results in lower economic efficiency. It is difficult to demonstrate empirically this link because accurate sectoral efficiency data (such as total factor productivity measures) are not available for Indonesia. However, an indirect method may be employed. This is to examine the correlation between export orientation and concentration by sector. Export orientation provides a defensible measure of efficiency since exporters have to compete in unfettered international markets. Those who succeed are likely to be those who are most efficient and keep close to international best practice in their product and process technologies. Table 2.5 below shows that there is a broad negative correlation between export orientation and concentration. Sectors with above-average concentration tend not to be heavily engaged in exporting. Conversely, subsectors with low concentration ratios are among those with the highest export orientation.[1] Regression analysis confirms this pattern in a statistically more rigorous fashion: the higher the concentration level, the lower the export orientation (at the 5 digit level).

2.60 In view of the number and variety of restrictions on domestic competition and their myriad objectives, a rules-based approach to deregulation is warranted. This approach would dissolve Government-sponsored or sanctioned monopolies controlling marketing and distribution of "essential" and other commodities and open the distribution (retail and wholesale trade) sector to foreign investment. The rules-based approach would include legislation ensuring that an ordinary business license or SIUP (*Surat Izin Usaha*

Perdagangan) be the only permit required for exporting and/or engaging in domestic trade and that membership in commodity or trade associations be voluntary, not a condition for engaging in these activities. It also would include repealing and outlawing commodity-specific taxes and *retribusi*. In localities where revenues from such taxes are important, consideration would need to be given to the development of new ways of mobilizing revenue. To ensure a strong supply response, domestic trade deregulation should be done in tandem with measures to open the economy to international trade—reduction of nontariff barriers and elimination of export restrictions.

Table 2.5: Concentration and Export Orientation

	High Export Orientation	*Low Export Orientation*
High Concentration		Food (15,62) Paper (15,50) Chemicals (19,50) Non-metallic Minerals (11,58) Basic Metals (24,72) Machinery (18,57)
Low Concentration	Textiles/Footwear (34,24) Wood Products (55,16)	

Note: Numbers in parentheses refer to the ratio of exports to total output in 1992 and the four-firm concentration ratio in 1991, respectively, both expressed in percent. High concentration refers to cases where the concentration ratio is greater than the overall weighted average of 47%. High export orientation refers to cases where the share of exports in total output is greater than 25%.

D. Privatizing Public Enterprises

2.61 The Indonesian constitution requires the economy to be overseen (*dikuasai*) by the Government. The emergence of a dynamic private sector in the competitive sectors of the economy means that the oversight role can be fulfilled by ensuring a level playing field for business through the establishment of transparent, enforceable rules of the game. The Government need no longer devote its limited financial and managerial resources to the production of goods and services in the competitive sectors of the economy.

2.62 Privatization of Government enterprises operating in the competitive sector would free up scarce Government resources for use in higher priority activities. In addition to raising efficiency, privatization also could be used to spread the ownership of productive assets among a larger number of Indonesians.

2.63 In Indonesia the evidence is clear that, where the two compete, private sector enterprises outperform their public sector counterparts. One reason is that it is extremely difficult for the Government to be an effective owner. Businesses need wide latitude if they are to innovate. Government employees who try to be innovative in overseeing public enterprises are likely to be thwarted. For this reason, Government enterprises will rarely be as effectively overseen as privately owned

enterprises and privatization should not be delayed by trying to set up better "governance" procedures.[2]

2.64 Another reason is that public sector enterprises have multiple objectives that interfere with providing good service to consumers at the lowest cost. In Indonesia these social objectives include promoting small and medium industries, promoting cooperatives, and providing employment to the greatest number. Too often a by-product of using enterprises in the productive sectors to pursue non-commercial objectives is low efficiency and poor financial performance.

2.65 The public enterprise sector in Indonesia consists of some 180 enterprises across all economic sectors, including industry (38), agriculture (35), finance (30), public works (19), transportation (17), and ten other sectors (41). These figures represent enterprises in which the State has a direct majority ownership, including joint-ventures. They exclude subsidiaries of PEs and enterprises owned by local governments. Their production represents an estimated 15% of GDP, the book value of their total assets is about Rp.295 trillion ($140 billion in 1994) and they employ 1.14 million (1.4% of the labor force). While the number of public enterprises has remained roughly stable, their share in the economy has declined as a result of strong private sector growth.

2.66 Progress in privatizing public enterprises has been slow. Based on a Presidential Decree in 1988, an assessment was made of the financial soundness of each public enterprise, and a program developed for their restructuring. The restructuring programs introduced in 1989 were ambitious, but implementation has been slow and well below expectations. The shortfall in privatizing public enterprises is especially large. The plan was for 52 public share issues but by end-1994 only two had been realized (including the much-publicized partial privatization of PT Indosat). Although seven public enterprises were sold fully or in major part to the private sector or to public enterprise employees during 1989-93, twelve new public enterprises were formed. Progress in winding up loss-making public enterprises also has been slow. Only four public enterprises have been fully liquidated; other liquidations took the form of mergers.

2.67 The financial performance of Indonesian public enterprises generally is inferior to the private sector's. The average return on public enterprise assets is, not surprisingly, considerably lower than the average return on assets in the private sector. The pre-tax return on public enterprise assets (excluding the state banks and Pertamina) fell to 4.1% in 1994 from 5.6% in 1989, and return on equity to 7.8% from 10.4% (Table 2.6). In comparison, the **after tax** return on equity of private enterprises—proxied by those listed on the Jakarta Stock Exchange—was 8.8% in January-September 1994.

2.68 The poor and declining performance of public enterprises is borne out by Ministry of Finance calculations. The Ministry of Finance classifies public enterprises by their level of financial and operational soundness based on an assessment of profitability (profits before tax/operating assets at book value), liquidity (current assets/current liabilities), solvency (total assets/total liabilities), and of technical indicators specific to subsectors in which public enterprises operate. According to this assessment, the share of "less sound" (*kurang sehat*) and "unsound" (*tidak sehat*) public enterprises increased from 46% to 54% during 1990-94 (see Figure 2.1). At the same time, the share of "very sound" (*sehat sekali*) firms dropped from 32% to 22%.

2.69 The problems of overseeing public enterprises and the underperformance of public enterprises compared with private sector competitors is seen in examples from different

sectors. In the financial sector, for example, the lack of effective oversight permitted serious abuse in the state banks. Although they account for less than half of outstanding credit, state banks have 75% of classified loans (Box 1.5 in Chapter 1).

Table 2.6: Overview of Public Enterprise Financial Performance, 1989-94

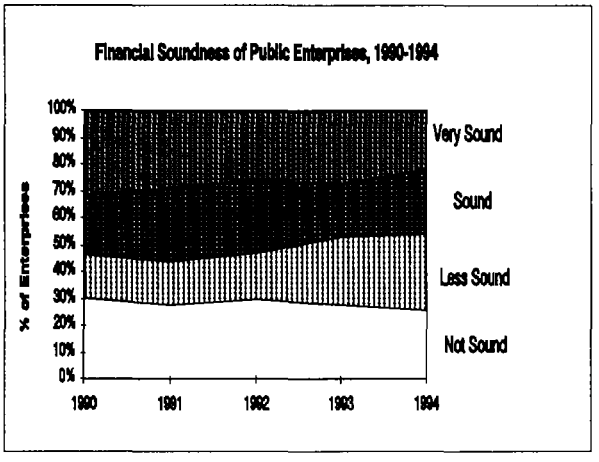
	1989 [a]	*1990* [b]	*1991* [b]	*1992* [a]	*1993* [c]	*1994* [d]
All Public Enterprises						
1. Number of Enterprises	187	188	187	186	186	182
2. Total Assets (Rp.trillion)	144.5	177.7	200.5	236.5	268.8	285.9
3. Pre-tax Profit/Assets (%)	4.6%	4.5%	3.7%	3.1%	2.8%	2.8%
4. Pre-tax Profit/Sales (%)	13.9%	12.8%	10.8%	9.6%	9.2%	9.3%
5. Pre-tax Profit/Equity (%)	16.2%	18.1%	14.0%	11.5%	10.6%	9.5%
6. Total Losses/Total Assets	-0.12%	-0.17%	-0.25%	-0.25%	-0.11%	-0.14%
7. Number of Loss Maker	28	28	29	33	30	23
8. Total Debt/Total Assets	71.7%	75.1%	73.7%	73.2%	73.9%	70.8%
Excl. Banks & Pertamina						
1. Total Assets (Rp.trillion)	51.6	59.4	69.9	87.1	102.2	113.4
2. Pre-tax Profit/Assets (%)	5.6%	5.4%	5.2%	4.2%	4.0%	4.1%
3. Pre-tax Profit/Sales (%)	12.6%	12.9%	12.4%	11.0%	10.6%	11.3%
4. Pre-tax Profit/Equity (%)	10.4%	10.7%	9.7%	9.9%	8.0%	7.8%
5. Total Debt/Total Assets	49.4%	49.8%	46.8%	47.0%	49.7%	46.6%
Public Estates (PTPs)						
1. Total Assets (Rp. trillion)	5.1	5.5	5.8	6.2	6.3	6.2
2. Pre-Tax Profit/Total Assets (%)	5.9%	5.5%	5.2%	8.1%	6.3%	8.1%
3. Pre-Tax Profit/Sales (%)	15.0%	13.0%	12.0%	15.6%	11.8%	13.5%
4. Pre-Tax Profit/Equity (%)	11.2%	10.3%	9.4%	14.7%	11.1%	13.2%
5. Total Debts/Total Assets	46.9%	47.3%	44.8%	45.2%	42.9%	38.7%

[a] 98% audited
[b] 99% audited
[c] 85% audited
[d] 5% audited

Source: Ministry of Finance

2.70 The Government estate companies or PTPs are another case in point.[3] Like public enterprises as a group, PTPs' financial performance is inferior to that of private estates. Declining commodity prices in the 1980s explain part of the worsening financial performance. More significant is the ill-conceived expansion of traditional estates, whose area nearly doubled between 1980 and 1992. The capital expenditure requirements of this expansion were excessively debt-financed. The average PTP debt-total assets ratio shown in Table 2.6 masks dangerously high debt levels in tree crop PTPs, which are offset by a low ratio for sugar PTPs. Debt management is a serious financial problem for some PTPs.

Figure 2.1



2.71 The operational performance of PTPs also lags that of the private sector (World Bank 1994g). For example, the costs of oil palm development in PTPs are from one-quarter to one-third higher than those of private estates and the cost of a PTP crude palm oil mill is 40% higher than a private mill. Comparative analyses based on Best Demonstrated Practices showed significant performance gaps between the public and private estates in terms of production per hectare, unit production costs and gross margins. The private sector consistently outperformed the public sector in oil palm and rubber productivity. Crop yields of the PTPs have been stagnant compared with the improvements in average productivity of smallholders and private estates. Crop technology in PTPs lags that of Malaysia by five to ten years, in particular on selection of planting materials and fertilizer application.

2.72 Repeated Government interventions to try and resolve PTPs' financial problems generally have taken the form of mergers, management changes, debt write-offs and reschedulings and the occasional liquidation. The latest reform was the 1994 reorganization of 32 state plantation companies, including the PTPs, into nine groups. The objective of this consolidation was to enhance economies of scale and integrate better the plantations with processing units.

2.73 Consolidating loss-making and profitable PTPs is unlikely to raise their overall efficiency to that of the private sector. The consolidation fails to address the fundamental problems plaguing the PTPs, and may reduce the efficiency of the profitable PTPs. Consolidation only forestalls the need for further budgetary support from the Ministry of Finance as long as intra-group profits are sufficient to cover losses. However, the "reform-financial distress-reform" cycle will not be broken until the PTPs are privatized.

2.74 Merging state-owned enterprises in the fertilizer and cement industries into holding companies is explicitly aimed at enhancing their performance. But poor performance in some of these companies cannot be traced to problems that consolidation will correct. In fertilizer, for example, triple super-phosphate and ammonium sulfate production is not efficient—urea production is—and costs are considerably above import equivalent prices. However, this is due to outdated technology and high-cost raw materials. Consolidation will not solve these problems. Failure to privatize the fertilizer producers also hampers Indonesia's nonoil export drive. Urea production is efficient and there exists significant export potential. However, exploiting this potential will require significant investment to maintain competitiveness and expand capacity. The policy of phasing out capital support to public enterprises means that the capital expansion plans will require significant private financing. The Government would be better advised to accelerate the privatization of the fertilizer industry rather than consolidate production units.

2.75 Consolidation of units and changes in the legal status of public enterprises are unlikely to produce meaningful improvement in performance unless accompanied by a change in their ownership. This is not to say that Government should not try to oversee its public enterprises better—clearly it should. There are several measures that could be implemented:

Increase professionalism of oversight arrangements by: (i) consolidating public enterprise supervision in the Ministry of Finance or a separate agency with professional management, and phasing-out the supervisory role of the various sector ministries, which would eliminate conflicts of interest; (ii) focus the boards of commissioners on strategic rather than control functions; (iii) improving the management compensation and public enterprise performance evaluation systems to increase the motivation of managers to perform to highest industry standards; and (iv) improving the quality and application of public enterprise corporate plans and work programs. The regulations that apply to public enterprise operations should be reviewed to determine what improvements can be made to enhance management autonomy and flexibility of decision making. Consideration should be given to applying the principles of regulation no. 55/1990, which free publicly listed public enterprises from special Government regulations, to all public enterprises. To the extent possible public enterprises also should be relieved of their non-commercial objectives to place them on an equal footing with private firms.

2.76 In addition to trying to improve oversight of public enterprise the Government can help raise efficiency in state owned firms through supply side deregulation—as discussed in sections B and C—to reduce costs and create a supportive economic climate. Further deregulation of markets for public enterprise products and services would make it easier to assess the performance of public enterprises by pushing domestic prices toward border prices, the standard for efficiency. The practice of providing below-market interest rate financing to public enterprises has largely been discontinued. That process should be continued and all public enterprise financing should be at market rates.

2.77 At the same time, greater emphasis on quickly privatizing public enterprises is warranted. Developing a comprehensive strategy for privatizing public enterprises could help. This would be in line with the diminished role of public enterprises as agents of development, the demonstrated ability of private firms to outperform public enterprises, and the need for Government to phase-out funding of future upgrading and expansion of public enterprises. In addition to improving their efficiency, privatization of public enterprises would free Government resources—particularly scarce capital and management talent—for priority areas such as education and primary health care. The Government's role would need to switch from direct management of public enterprise activities to providing an appropriate policy and regulatory framework, as discussed in the following section.

2.78 The strategy for privatizing public enterprises could start by developing a public enterprise policy reform framework. The current case-by-case approach followed by the various sector ministries risks creating uncertainty and delays and, potentially, could lead to conflicts. Public enterprise reform should try to attract managerial expertise and capital for future upgrading and expansion. The development of such a reform agenda should be directed by a central agency. Privatization could be accelerated by classifying public enterprises along different criteria such as: the nature of public enterprise markets (natural monopoly, potentially competitive, currently competitive); enterprise size and financial condition; the "strategic" nature of the public enterprise, based on a clear justification for any special status; and the potential for breaking-up ("unbundling," see Chapter 3) larger public enterprises into viable and non-viable units, competitive and non-

competitive activities, including divesting "non-core" assets as separate concerns. Public enterprises in commercial markets (for example: those in industry, the PTPs and other agricultural public enterprises) could be privatized early.

2.79 There also is a need to broaden the approach to privatizing public enterprises. The Government has focused its efforts on public listings (initial public offerings) on domestic and overseas stock exchanges.[4] This method has the advantage of being fully transparent and promoting wider share ownership. But most public enterprises cannot meet the stringent listing requirements of minimum size or financial health and performance. Another drawback of IPOs is that they typically attract passive investors who collectively may have an interest in effective management oversight but individually may not—the free rider problem. Thus, the immediate impact of a public listing on improving enterprise management may be small. "Core" strategic investors are investors with a sufficient stake to overcome the free rider problem and who, because of in-depth sector knowledge, management expertise, and access to markets, can help improve enterprise management more directly. The Government could develop transparent procedures for attracting core investor(s), including through competitive private placements and joint-ventures.

E. Regulation and Rules of the Game

2.80 Although the Indonesian Government's role in direct production is too large and needs to shrink through privatization, it has considerable work to do in developing the rules of the game to promote sustainable, private sector-led growth. The Government has a role in the regulation of the **financial sector** because the market may be slow to develop mechanisms for providing accurate, reliable and timely information to the public on the riskiness of investments, and may have to extend credit to weak banks for various reasons. The Government also has a role to play in protecting the **environment** because the private sector may not perceive the broader environmental impact of its actions and, thus, may overpollute or underinvest in environmental protection. The Government also is responsible for introducing modern, enforceable **rules of the game for competitive enterprise**, including protecting consumers from the abuse of market power by firms operating in less than vigorously competitive markets.

1. Financial Sector Regulation

2.81 **The Banking Sector**. A main objective of regulation is to ensure soundness of the banking system. Despite last year's scandal at BAPINDO, progress was made in this regard in 1994 (see below). Nevertheless, the stock of bad loans remains high, which increases the sector's vulnerability to high interest rates.

2.82 Government regulation of the banking system has improved since the financial system deregulation of 1988. Prudential regulations, including licensing procedures, operational guidelines and bank rating criteria are tighter, the legal framework is more up to date (the Bank Act of 1992) and the human capital base has improved through manpower and institutional development programs at Bank Indonesia, the Central Bank. These include the formation of special Credit Supervision Teams (separately for the state and private banks, respectively) to monitor progress in settling problem debts. There also was an important re-organization of Bank Indonesia's bank supervisory departments in August 1994, and a further tightening of banking regulations in early 1995.[5]

2.83 The main task ahead is not simply one of adding more regulations. Rather, it is one

of continuing to manage problems in the banking system, particularly overseeing the orderly workout of the bad loan problem. The Government's strategy in this regard has three prongs.

i) Institutional development, including better prudential regulations, an improved legal framework and manpower/institutional development programs at Bank Indonesia.

ii) Strengthening the state banks with a view to eventual privatization. The particular case of BAPINDO required exceptional measures, including legal action against management and a borrower, and contracting an established international bank as management advisor. The sight of BAPINDO's top management being jailed on corruption charges has strengthened the incentive for better management in the rest of the state banks.

iii) Improved banking supervision to identify and resolve problems at private banks on a case-by-case basis, in accordance with Article 37 of the Banking Act of 1992. Issues related to the existing stock of bad debts are being addressed through a monitoring committee internal to Bank Indonesia, which is operating with a commitment from the Supreme Court to time-bound prosecution of cases. To avoid future bad loans, Bank Indonesia is attempting to improve banks' credit analysis procedures and to strengthen internal audit practices at private banks.

2.84 As mentioned in Chapter 1, the strategy has produced positive results. The state banks meet or are approaching Bank Indonesia's targeted legal lending limits. They also have made some progress in reducing classified assets in relation to risk weighted assets though, for the group, total capital adjusted for the shortfall in provisions against classified assets remains below the BIS standard (Box 1.5 in Chapter 1). There also are good prospects for at least one state bank to "go public" within the next year or so.

2.85 For the private banks, there has been no serious threat of crisis in the past year and there has been notable consolidation, generally facilitated by Bank Indonesia.

2.86 Looking ahead, the most pressing task is to build on the progress achieved so far. For the state banks this includes deciding what to do with BAPINDO. In addition, delinquent borrowers who are able but unwilling to pay need to be forced to repay their loans. Cost-cutting measures could also help make room for loan write-offs, for example: consolidating branches, activities and physical assets; reducing staff; and cutting managerial salaries. Also, merging or liquidating state banks should not be ruled out.

2.87 The arguments for privatizing the public enterprises operating in the competitive sectors of the economy apply with equal force in the commercial banking sector. There is little economic, social or financial justification for not privatizing the state banks.

2.88 For private banks, the most important issue is ensuring appropriate incentives for bank owners and managers, and providing depositors with some assurance regarding portfolio exposures. Adequate capital is needed to ensure that owners/managers are risking some of their own funds and to protect deposits somewhat. For these reasons, the Government needs to ensure provisioning to the Basle standard, on the envisaged schedule. Going beyond that, higher minimum capital requirements would help force mergers and reduce risk by allowing greater diversification. The Government also needs to continue to enforce exposure limits strictly through supervision, to reduce risk and non-arms-length

transactions. In this regard penalties for exceeding exposure limits should be reviewed with an eye to increasing them, if appropriate.

2.89 Another major issue for the private banks is improving mechanisms for taking over problem banks. Problem resolution at banks proceeds on a case-by-case basis, in accordance with legal provisions of the Bank Act of 1992. Bank Indonesia provides technical assistance, including by facilitating mergers with other banks or inviting new shareholders.[6] Other mechanisms for assisting troubled banks include providing liquidity through discounted commercial paper at Bank Indonesia and concerted interbank lending from other private banks.

2.90 This approach to problem private sector banks has worked. It has the advantage of being flexible; its disadvantage is that it makes large demands on Bank Indonesia's management. Procedures for liquidating problem banks in a way that protects the interests of depositors and the general public could reduce the burden on Bank Indonesia staff. Stronger exit procedures, especially to liquidate banks and recover collateral, would help progress toward a regulatory system that is less Government- and more market-driven. Some positive steps in this direction are current initiatives toward more public disclosure, fostering independent credit organizations and meeting prudent provisioning requirements.

2.91 Further improvement of bank supervision is another issue. Bank Indonesia has made progress in this area. Senior staff at Bank Indonesia are professional and aware of the need to follow-up supervision with consultation, with cease and desist orders and, in extreme cases, revoking licenses. However, the financial world continues to innovate and generate new products, such as derivatives, that pose difficult problems even for seasoned bank supervision teams. In training field examination staff, the greatest single challenge is to keep them conversant with on-going financial innovations, and to achieve a better understanding of current best practice in credit analysis.

2.92 The bank examination process is also too protracted.[7] The final review given to examined banks—a management review at Bank Indonesia headquarters—normally is not held until 9 to 12 months after completion of the exam, by which time the bank and peer data are likely to be stale. Shortening this time span is a high priority, and more work is needed for planning the deployment of human resources in examinations. Also, bank examiners need to move further away from their traditional "checklist" approach to examination. In particular, there needs to be greater willingness on the part of examiners to make qualitative judgements about the health of financial institutions. The adoption of the CAMEL system was an important step in this direction.

2.93 The re-organization of Bank Indonesia's banking supervision departments in August 1994 helped coordinate on- and off-site examinations. The new organizational structure facilitates communication between Bank Indonesia and the commercial banks. To avoid the examiners getting too close to the banks they supervise—so called regulatory capture—banks should be shifted periodically to different teams. Bank Indonesia's internal auditing staff need to be alert to the dangers of conspiracy, and statistical surveillance techniques should be developed to signal bank ratings that are inconsistent with basic data.

2.94 Bank Indonesia expects commercial banks to formalize in writing their strategic direction. It would be helpful if Bank Indonesia were to do the same. Such a statement should incorporate the view that the current system of regulation is too Government-directed. More reliance on market forces would be appropriate. A deposit insurance scheme with low coverage limits could be an element of a market-based approach to regulation (see also Box 2.3).

2.95 **The Non-bank Financial Sector.** Indonesia has a highly diverse non-bank financial sector that has developed over a short period of time (see Chapter 1). The capital markets are regulated by BAPEPAM, which has successfully developed institutional infrastructure needed by the market, such as rules, regulations and guidelines for disclosure of information. A new Capital Market Law is expected to be effective in 1996, and the Jakarta Stock Exchange shifted to computerized trading in May 1995. But there have been some delays in implementation and gaps remain, including tightening of regulations governing prospectus issue and listing requirements for securities issues; toughening controls against insider trading and illegal market practices, defaults and insolvencies; introduction of minimum capital standards for securities firms; and the introduction of bankruptcy procedures to protect securities holders.

Box 2.3: Self-Regulation Requires Information Disclosure To Be Effective

One of the most effective forms of supervision is market discipline, where reward or punishment is administered by the market in terms of credit lines, financing cost and share prices. This can only be effective if the market receives sufficient information on the activities of institutions to make a meaningful assessment. Transparency of financial risk entails meaningful disclosure of risks as well as management performance.

In the case of banks, better disclosure procedures, through frequent publication of higher-quality audited statements, could provide better information for large depositors. For securities, the Government has a role in educating investors about risks. Standardized accounting rules and clear disclosure requirements provide information needed by investors. The quality of issues traded in the market can be maintained through listing standards or by establishing objective guidelines (minimum criteria in terms of profits, revenues, assets or net worth) for new issues. Market forces can be relied on to price efficiently when these conditions are in place. Supervision of the market trading systems is needed to prevent market manipulation and to ensure that insiders do not use privileged information to the disadvantage of public investors.

Indonesia's commercial bank requirements include some disclosure, for example to publish financial information on a regular basis. Bank Indonesia has also been emphasizing the importance of banks' self-regulation and internal audit, while checking periodically on compliance.

2.96 BAPEPAM's extensive responsibilities already have stretched its resources to the limit. Its staff is fully occupied processing company registrations of securities to be floated and listed. Very little capacity is available for market surveillance, oversight of brokers and dealers and other sensitive activities. The stock exchange and other organizations are not yet effective as self-regulators, and unless they are made so, BAPEPAM will be overwhelmed.

2.97 A first priority for BAPEPAM is further staff development and training. If BAPEPAM were an autonomous agency of Government, it would be able to compensate better than the Government pay scale and compete more effectively with the private sector for skilled professionals. BAPEPAM needs to expand its staff training activities to develop the levels of skills required to dispatch its obligations.

2.98 To assist with the issue of over-stretched staff resources, BAPEPAM need not undertake a major increase in personnel. Rather, more reliance on self-regulatory mechanisms is needed. For example, if the new capital markets law were to require

associations of stockbrokers, underwriters and similar market professionals to be licensed by BAPEPAM, a basis for self-regulation would be established. BAPEPAM's role could be limited to ensuring public disclosure, approving associations rules and practices, and overseeing the associations' enforcement of their rules and practices.

2.99 Contractual savings institutions (CSIs) are another part of the non-bank financial sector. Raising their involvement in long-term financing depends upon a number of preconditions. These include an adequate and effective system of prudential regulation, supervision and enforcement and a system of investor protection which includes accounting and information disclosure to investors. In addition, operating efficiency and freedom from investment controls that use CSI's as captive sources for funding Government debt or politically motivated projects are essential. Growth in CSIs is also dependent on the growth, level and distribution of income.

2.100 Investments by CSIs, particularly pension and insurance companies, require regulation beyond ensuring timely and accurate disclosure of financial information. Chief among these are regulations defining fiduciary responsibility and limiting investment exposure to closely linked firms. In the case of JAMSOSTEK, the compulsory health insurance and pension scheme for workers, closer costing, managing, and supervision is warranted (see Chapter 1). Because of the potentially large Government liability, strong financial oversight of JAMSOSTEK should be exercised by the Ministry of Finance.

2.101 Another precondition for the realization of substantial development in long-term financing in Indonesia through growth in CSI's is adequate infrastructure for the smooth operation of financial arrangements in an environment of confidence on the part of investors. There are many components of such infrastructure, including communications, the availability of legal, accounting, actuarial and management skills, suitable systems for the regular receipt of payments and record keeping; and the soundness of community facilities for the maintenance of order and such things as fire fighting, these being crucial to the management of general insurance risks.

2. Managing the Environment

2.102 The environment—land, air, water, forests and energy sources—serves both as a source of natural resources, and as a "sink" for waste. Pressures on the environment are growing rapidly in Indonesia. There is a role for Government in managing these pressures. There is a complementarity between good economic policy and an effective strategy for environmentally sustainable growth. Moving to market prices for key natural resources like land, water, forests and energy, for example, will simultaneously reduce wasteful consumption, and improve macroeconomic efficiency (and hence competitiveness). However, this alone will not be enough. Many environmental problems are caused by the failure of markets to take into account "externalities." The Government needs to set an appropriate regulatory and incentive framework for environmentally responsible behavior and increase investment in environmental protection.

a. The Regulatory/Incentive Framework

2.103 It will not be possible for Indonesia to take on every environmental issue all at once. A World Bank study (World Bank, 1994d) identifies five priorities: (a) land management; (b) forest management; (c) water management; (d) urban pollution management; and (e) industrial pollution control—particularly on Java.

2.104 **Land Management**. Creating a more transparent land market and establishing transferable property rights is essential. Ensuring that land resources are sold, leased and taxed at market prices also would raise Government revenue. The following changes

are needed: (a) simplification and improvement of land laws and regulations; (b) acceleration of land titling and registration under the Government's announced 25-year program for land registration; and (c) greater public access to BPN's land information, which would promote land titling and fair sales prices. The extension of the national geodetic network by the National Mapping Agency and the public sale of those maps also would increase public information about land use and ownership.

2.105 Regulations increase the complexity and transactions costs of registering or selling land and distort land prices. Two permits are needed for land purchase: *izin prinsip* and *izin lokasi*. Both give private developers the indefinite monopsonistic right to purchase land they desire to develop. Land purchase regulations need to incorporate local environmental issues (Box 2.4). Formal sales prices of state land, *tanah negara*, often are less than one-quarter of the market price. Moving to market-based land transactions will require steps to eliminate barriers to market prices. A pilot project of public land auctions could be considered. Requiring a realistic resettlement plan to be developed as a part of the feasibility analysis/project preparation work, within the context of a national resettlement policy, would lessen social tensions and promote equity.

Box 2.4: Simpler Is Not Always Better—Land Acquisition, Location Permits, and *Pakto93*

After being approved by BKPM, the Investment Coordinating Board, to buy land, a developer still needs a location permit (*izin lokasi*), which gives a developer the exclusive right to purchase the land it covers. But in Indonesia, the land market is not well developed and property rights are poorly defined and enforced. Developers have been clumsy and even ruthless in evicting semi-legal residents. In other instances, where developers and landowners have been unable to agree, tracts of valuable land sit idle, still covered by a location permit.

To compound these problems, the October 1993 deregulation package (*Pakto93*) shifted authority for issuing the location permit from local Governments to district-level offices of BPN, the National Land Agency, which led to a rush on location permits. In Bandung Regency, for example, the pace of location permit issuance (in terms of average area covered per year) has increased nearly 35 times since *Pakto93*, to about 2,580 hectares during 1994. In Bekasi Regency, location permits covering about 7,700 hectares were issued during the ten months period between November 1993 and August 1994.

Permits are being issued in a rush, without taking account local plans for land use, environmental issues, or social concerns. But when most of the 3,344 hectares covered by 77 location permits recently issued in North Bandung was found to be situated in a protected watershed area (Decision of the Governor of West Java 181/1/1982), Parliament became involved. In this case, official debates were organized and experts from the Institute of Technology in Bandung were asked to investigate. Similar problems have arisen in East Java, notably in the Greater Surabaya area. East Java's Governor has therefore mobilized a special task force to develop appropriate land development controls and has protested the negative impact of Pakto93 to the central Government.

In centralizing the authority to grant location permits, *Pakto93* sought to streamline the investment approval process. But as the example in North Bandung demonstrates, local interests must be adequately addressed to make the permit issuing process effective as a regulatory tool. Local Governments need to review the environmental implications and service requirements of new industrial facilities before location permits are granted. Environmental impact assessment (AMDAL) requirements under PP51 of 1993 should be enforced. The Government may also wish to consider alternatives to the location permit system but the most obvious measure for improving the process—that is, developing the appropriate legal and institutional framework to regulate the land market—will take time.

2.106 Simple, focused land use planning would improve land management. In Indonesia, land use planning activities are scattered among different agencies at different levels of the Government. The Law for Spatial Development, which was passed by the Parliament in September 1992, was supposed to lead to such planning. The Law's provisions for local participation, disclosure of information and assessing environmental risks should be implemented.

2.107 **Forest Management**. Mispricing of forest resources is a major policy failing that leads to excessive use of logs in industry and wasteful logging practices on concessions, as noted earlier in this Chapter. In 1991, Indonesian plywood mills used 25% more logs—3 million cubic meters—than the most technically efficient factories in other countries. Although estimates vary, significant amounts of commercial wood are left damaged in the forest during logging operations.

2.108 **Water Management**. Like land and forests, water is substantially mispriced, leading to low prices and excessive use by some groups (chiefly farmers and middle and upper class urban householders) and high prices and scarcity for others (chiefly the urban poor). Chapter 3 outlines the need for pricing reform for water in the cities, especially where low charges for groundwater are leading to rapid exhaustion of deep aquifers and the associated low charges on piped water that preclude the maintenance of adequate service levels. Pricing reforms need to be supported with better institutions. Efforts to establish river basin management authorities, reorganize DGWRD and recodify the byzantine mass of laws, regulations and ordinances governing water into a new Water Code are fundamental.

2.109 **Urban Environmental Issues**. Protecting the urban environment will require a larger role for market forces and an appropriate regulatory framework. In addition, investments in urban services will need to grow rapidly over the coming decades, both to meet the existing backlog of demand and to cope with the rapidly expanding urban population and its environmental loads. Within the next two decades, well over half of Indonesia's GDP will be produced in cities. The pricing, cost-recovery, and institutional policies to ensure coordinated urban development are discussed in Chapter 3.

2.110 **Industrial Pollution**. There are two key issues of industrial pollution control facing Indonesia's policy makers: (a) what to do about the pollution from existing firms; and (b) how to "delink" future pollution loads—and the damage they may cause—from the rapid expansion of industrial output. A major issue in both cases is how to achieve the optimal level of pollution control at the least cost.

2.111 Reducing pollution from existing firms requires: (a) policies that encourage greater efficiency (increased domestic competition, market-based prices for natural resources, and "full-price" cost recovery for investments in supportive infrastructure—particularly urban services); (b) carefully targeted pollution control efforts—by area, by pollutant, and by industry—focusing on the worst polluters and most damaging pollutants in the most threatened areas; (c) strengthened institutional capacity for pollution monitoring and enforcement, especially at the provincial level; (d) encouragement of "clean technology," including "pollution prevention pays" campaigns and industry-specific technical assistance; and (e) extensive reliance on the power of publicly available information.

2.112 Reducing future industrial pollution is critical because by the year 2010 existing firms will account for only about 15% of total industrial output and, by the year 2020, less than 8%. The highest priority, therefore, should be given to minimizing pollution loads—and damage costs—from newly established and expanding firms. The obvious place to start is at the investment approval

stage. The suggested strategy involves three key elements: (a) use existing environmental impact assessment (AMDAL) procedures, but ensure professional and expeditious reviews, including through "contracting out" with experienced foreign firms; (b) expand the review to include issues of technology choice; and (c) for major or highly polluting projects, ensure local Government input on location issues, and encourage the location of medium- and larger-scale firms in industrial estates.

b. Investing in Environmental Protection

2.113 Incentives and regulations are the Governments' main instruments for promoting environmentally sustainable growth. But they won't be enough by themselves. Ensuring environmental protection also will require an increase in public expenditures. It should be possible to cover most of these costs through a combination of pricing and cost-recovery policies and increased fiscal revenue from the environment-related policy reforms, especially higher revenues from timber, land and domestic fuel sales. Pushing ahead the Polluter Pays Principle, embodied in Indonesia's 1984 Environmental Law, through the use of pollution charges, also would provide an important source of revenue for public expenditures on pollution abatement.[8]

2.114 **Public Expenditures for Environmental Protection**. Investments in urban water supply, sewerage and sanitation, solid waste management and urban transport will need to expand substantially (see Chapter 3) as will outlays for forestry management and biodiversity protection. Additional expenditures will be required for strengthening environmental institutions and improving existing information and management systems, but most of this increase (for example, for staffing and staff development) will involve recurrent budget expenditures.

2.115 **Private Sector Investments in Pollution Abatement**. The cost to existing firms of pollution abatement will depend on the level of abatement desired and the policies and instruments used to achieve it. The "unit costs" of abatement rise with the proportion of total pollution eliminated, increasing rapidly in the higher ranges. World Bank staff estimates of the aggregate abatement costs for existing firms in Indonesia indicate a range from $275 million to reduce pollution by 30%, to $1.5 billion for a 70% reduction, and $5.7 billion to reduce pollution by 90%. Abatement costs also vary by pollutant and by industry, and for firms within the same industry they depend on differences in scale, the age and type of technology, and its efficiency of use. Market-based instruments, such as a system of pollution charges and rebates, that encourage firms with lower abatement costs to generate most of the reduction, offer the potential for lower total costs—by one estimate, as much as 30% less—than a regulatory system that imposes the same abatement standard on all firms. Applying the goals of Indonesia's Clean Rivers Program, *Prokasih*, to all industrial polluters—a 50% reduction standard—would lead to total costs of about $700 million. Amortized over 10 years, this would be $70 million per year, or less than 0.04% of current GDP. Based on the experience of other countries, abatement costs borne by new or expanding firms would range from 2-5% of total investment, but this would be less than 0.5% of sales and about 1% of value added.

3. Setting the Rules of the Game

2.116 Firms and industries, and not nations, compete with one another. But Government-set national economic policies condition the business environment in which these firms and industries compete. The enterprise climate in Indonesia lacks supporting institutions for a modern business sector. This includes a well-functioning legal system to provide a level playing field for enterprise.

a. The Commercial Legal System

2.117 Investors need confidence that agreements are enforceable. The most modern laws are of little practical value unless there are adequate means of enforcing them.

2.118 **The Court System**. The Indonesian court system is widely perceived by investors and creditors to be inadequate. Procedures are slow with the result that cases often take too long to resolve. The courts are overburdened and understaffed; there is little specialization, with all types of cases going to general courts and judges; enforcement of credit, security and copyright interests is difficult; and there is a lack of confidence in the fairness of the trial process. The courts are governed by the Basic Law on the Judiciary, No.14 of 1970, which emphasizes the principle of independence and seeks to prohibit all outside interference in judicial matters. The administration of the court system is under the jurisdiction of the Ministry of Justice, which controls the budget, posting, transfer and promotion of judges. As in most civil law systems, judges are career civil service employees, beginning as clerks and working their way up to judges.

2.119 There is a clear need to strengthen the court system for commercial law. A basic step is to increase the technical competence of judges to handle complex, modern commercial cases, through a combination of training and improved compensation. In the short term, salary increases could be linked to the objectives of a just and speedy settlement. There could be targets set for courts to reach decisions reasonably quickly. Publishing court decisions would promote consistency in judicial decisions. Another short-term measure that would help raise confidence in the justice system would be for Indonesia to make it possible for its courts to enforce foreign courts' judgements. At present, while joint ventures can submit disputes to foreign courts, the awards are not legally binding in Indonesia.

2.120 Beyond the short term, Indonesia could consider establishing on a pilot basis a specialized court to handle commercial matters. Also, a panel group of judges could be regularly assigned to handle commercial cases so that they develop deeper knowledge in commercial law. The Central District Court in Jakarta and a few other District Courts in areas with a high concentration of commercial activity (such as Surabaya or Medan) deal with a larger number of—and more complex—commercial cases than other courts. The Government could initially concentrate its efforts on selection of personnel, training, and performance in these selected courts.

2.121 **Arbitration**. Arbitration provides an alternative to the court system. It has the advantage that a dispute can be settled quickly by specialists knowledgeable in the technical areas, rather than judges who are trained in general aspects of law. Arbitration also avoids the confrontational aspects of a court trial and encourages settlement. Under Indonesian law, all disputes of a commercial nature can be submitted to arbitration, including disputes with Government agencies and enterprises. Arbitration proceedings follow procedures similar to those found in the Civil Procedure Code, but they are not required to. The format of the arbitral award is simple, and it must be rendered within six months of submission. The enforcement of a domestic award in principle is not cumbersome and appeals are limited to certain matters. An arbitration board (Badan Arbitrase National Indonesia, "BANI") was established in Jakarta in 1977 by the Indonesian National Chamber of Commerce and Industry as a private arbitration institution. However, its services are neither frequently utilized nor highly publicized. Recently, it has handled only 5-10 cases a year. The failure to utilize BANI more fully despite the shortcomings of the formalized court system suggests the need for improvement in the existing arbitration framework.

2.122 Several steps could be considered to strengthen the arbitration process. First, the list of arbitrators should include specialists in different areas, with diverse technical skills and business experiences. At present, BANI's arbitrators, although competent individuals, are drawn mainly from the ranks of former judges and professors, in contrast to the much wider use of businessmen and professionals in other countries. Second, a few highly qualified and respected resident foreigners should be included in the list of arbitrators. This would give confidence to foreign investors that the Government and the local business community are serious about settling disputes in a manner perceived to be fair by all parties. The use of non-nationals as arbitrators in commercial cases is quite common throughout the world. Third, concerns about the enforceability of foreign arbitral awards in Indonesia need to be addressed. Until recently, Indonesian courts refused to recognize foreign awards in spite of treaty commitments to the contrary. The Supreme Court has issued a circular that sets out a procedure for applying to the Court for recognition of a foreign arbitral award. The contents of the circular and the procedure it requires still need to be publicized to the business community. Indonesia also could reaffirm its commitment to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards; while Indonesia is a party to this convention, there has not been a single successful enforcement of a foreign arbitral award in Indonesia.

2.123 **Regulating Anticompetitive Practices.** Competition Policy broadly consists of Government regulation of domestic and international trade and investment and competition and antitrust law, which affect industry structure and business behavior. Indonesia lacks a specific competition law aimed at anticompetitive practices by firms. The 1945 Constitution contains provisions that promote "economic democracy," create a "national economy with a high competitive power," and avoid "unsound competition... in various forms of monopoly and monopsony which is harmful to the society and in contradiction with the ideal of social justice." However, the Constitution does not prohibit monopoly. A monopoly may be permitted if it is for the general welfare of the people and/or is controlled by a state institution. A hallmark of the role of Government in modern market economies is a framework for competition policy that establishes legitimacy for competition, deters anti-competitive conduct, and protects consumer welfare.

2.124 Experts within the Government of Indonesia are developing a draft competition law. The principal objective of competition law should be to maintain and encourage competition as a vehicle to promote economic efficiency and maximize consumer welfare. A focal point of the law should be the actual and potential business conduct of firms in a given market and not on the absolute or relative size of firms. This requires that the authorities assess whether a firm (or firms) can exercise market power—the ability to raise price or otherwise affect the market so as to earn supra-competitive profits over a sustainable period of time. The draft competition law contains provisions relating to business activity and conduct to help assess these aspects of business behavior.

2.125 **Developing the Legal Profession.** In Indonesia, as in most countries, a substantial responsibility for interpreting laws in commercial areas falls on the private legal profession. While the State has the major role in criminal cases, the private sector litigants, lawyers, notaries and other specialists ease the burden in the commercial area. Properly trained legal professionals can assist a court or arbitration panel in reaching a reasoned, proper decision, which may avoid the need for the issue to reach the court. The Government, in cooperation with the private sector and universities, can help develop the legal profession through improving legal training, including in relevant subjects outside the law;

expanding opportunities for overseas training; improving the foreign language skills of the profession; and allowing entry of more foreign legal professionals, by easing the strict work permit system.

2.126 **Legal Information**. The Indonesian public's access to legal information is severely limited, posing a major barrier to the effective development and implementation of the commercial legal framework. There are two main problems. First, many laws, regulations, judicial decisions, procedures, and other legal information are unavailable or difficult to obtain. Second, although considerable effort goes into fashioning legal rules and procedures, the effort is undermined by the way they are presented to the public. A systematic official method of bringing regulations into existence within a reasonable time is lacking. Steps to disseminate legal information more effectively include: establishing a daily Gazette to notify new laws and regulations, and expanding the scope and size of the Berita Negara (State Reports); authorizing official translations of the Commercial Code; publishing court decisions; compiling and publishing rule-making and policy decisions systematically; and improving the sale and distribution of Government publications.

2.127 **The Law Reform Project**. The Government recognizes the need to develop the commercial legal framework. It initiated a major commercial law reform project in 1992, and the last State Policy Guidelines (GBHN) place strong emphasis on legal system development. Full implementation of the legal reform agenda will necessarily take time; however, the steps recently taken by the Government—the establishment of an Administrative Court, the promulgation of new laws in the financial sector and the new company law—attest to the urgency and seriousness with which the Government is now taking up this agenda. A welcome feature of the law reform project is the involvement of the legal profession and the private business community.

Endnotes

1. Wood products may be an exception. Although it is an export-oriented sector, its largest subsector, plywood is dominated by a cartel that controls entry and prices both in domestic and international markets. All sales to the international market, for example, must be made through the cartel. The sector is not characterized by competition despite its low concentration ratio (0.13 at the 5 digit level).

2. The necessary oversight need not come from equity holders alone. In developed countries creditors also can provide monitoring. But not all creditors have the incentive to monitor borrowers. State banks suffer the same problem as state enterprises and cannot oversee enterprises well. Even ostensibly private banks would not have strong incentives unless their private owners bear the risk, which may not be the case if portfolio losses, even unrecognized, exceed the bank's equity and/or deposits are insured. Care is needed before relying on creditor monitoring.

3. There are 27 PTPs supervised by the Ministry of Agriculture. Roughly half of total public enterprise employees work in PTPs.

4. In infrastructure, Government also has used build-own-operate (BOO), build-own-transfer (BOT), and joint ventures schemes to introduce private sector participation (see Chapter 3).

5. In January 1995 Bank Indonesia (BI) issued four new regulations specifying supervision policy, the broad guidelines of which were set in February 1991. The new regulations are intended to strengthen commercial bank management (by providing character guidelines for ownership, management and membership on banks' Boards of Directors and by extending BI's supervisory authority to include banks' credit analysis and corporate strategies); to improve the quality of credit information; and to standardize certain accounting systems.

6. The tax reform measures (see the discussion of Fiscal Policy in Chapter 1) include a provision to encourage bank mergers. The new law allows banks to pay lower taxes when merging due to wide differences between the market price and the book value of assets.

7. The lead examiner gives an oral report of findings to the examined bank's management on the final day of an on-site exam.

8. The Polluter Pays Principle was first adopted by OECD countries in the 1970s as a basis for the formulation of environmental policies. The principle holds that polluters should bear the full costs of the goods they produce, including the social costs that they impose on the public in using land, water and air as a sink for wastes. By forcing these costs back onto the polluter better decisions on the use of scarce natural resources will result.

3
MANAGING INFRASTRUCTURE

A. Overview

3.1 Rapid industrial growth and associated urbanization are beginning to overload Indonesia's infrastructure. Although capacity has increased substantially since 1970, further improvements in infrastructure are needed to sustain rising living standards and international competitiveness and to improve equity. Macroeconomic prudence limits the rise in investment that can be made. Thus, Indonesia needs more ***efficiency in infrastructure investment and operation***, to reduce costs while improving service.

3.2 Greater private sector investment and participation can improve efficiency, and is targeted in REPELITA VI. The Government will nonetheless continue to have a major role in infrastructure. ***That new role will focus less on direct investment and service provision and more on improved management of the private and public investment program (and related debt), and of the regulatory framework and public infrastructure, to improve services and access.***

3.3 The main recommendations are:

- **Rationalize Investment and Improve Capacity Utilization**. The infrastructure program's size and sectoral allocations are issues. Proposed investments are about 50% larger (as a percentage of GDP) than in REPELITA V; they probably would widen the current account deficit by 2% of GDP if carried out. However, actual investment may be less, due to slowdowns in external finance and domestic saving growth, and to implementation difficulties. Thus, the Government needs to tread a narrow path between avoiding excessive imports/debt and ensuring sufficient capacity growth. Public investment should focus on areas of low private interest, e.g., Eastern Islands, urban and feeder roads. Power is a major issue: too much new generation would add to the large existing over-capacity: better transmission & distribution would permit about 15% more sales from existing generation capacity.

- **Develop a clear, competitive regulatory framework to maximize the benefits of private finance and increase efficiency**. A large, steady flow of private investment, at reasonable cost, will depend on a switch from the negotiated deal-by-deal approach to a clear, competitive regulatory framework. The first step is to define concessions clearly, up-front and award them through transparent, competitive bidding. (Specific conditions would depend on the sector.) This approach has lowered power costs in the Philippines and in Indonesia itself. The framework for contracts also needs to manage risk prudently, by i) developing contracts that allocate risks to parties most competent to manage them and that ensure private sector efficiency gains are passed on to consumers, and ii) managing prudently and appropriately pricing scarce public sector credit, guarantees and contingent liabilities.

- **Encourage private sector participation by splitting-up ("unbundling") public sector functions; use a market-based, competitive approach and sectoral regulatory frameworks to increase efficiency gains and pass them on to consumers, including the poor.** An easy first step that would reduce costs would be to encourage public firms to contract-out maintenance, billing, management, construction, and other non-core services competitively. A more complicated, but in many cases desirable, step to improve efficiency would be to unbundle production, transmission and distribution in power, gas and water. This would open up possibilities for efficiency gains through direct competition of multiple firms in a market (e.g. generation), in

addition to indirect, bidding competition for concessions. Unbundling also would permit firms to deal directly with users (e.g. "wheeling" of power or gas through grids), which would reduce the government's role in transactions and encourage the private sector to take more of the commercial risks of capacity creation. Thus, service contracts, leases, and concessions can be used raise efficiency through increased private sector participation, with or without ownership. Finally, arrangements for sectoral regulatory frameworks will be needed where it is difficult to introduce competition. The regulatory function should be taken out of the public enterprises to prevent conflicts of interest.

- **Improve infrastructure pricing to recover costs, finance investment, manage demand and encourage efficiency**. Adequate pricing is critical to private participation and improved public sector performance. Key elements are smaller, better targeted subsidies in power, water, rail and public buses; higher average water charges; fees for road use and congestion; and competition to lower power generation and telecommunications prices. Poor cost recovery largely subsidizes the better-off, because the poor lack access to services. The public, including the poor, are willing to pay for better access to quality services. Greater resources would finance capacity expansion, including greater access by the poor. However, mechanical reliance on cost-plus pricing will reduce efficiency and international competitiveness. The basic aim is to emulate pricing in a competitive market.

- **Rationalize sector management, reduce institutional complexity and assign responsibilities better** by clarifying roles, functions and authorities. The fragmentation and overlap of investment, operational and regulatory responsibilities leads to poor policy definition, inefficient investment, capacity imbalances, unclear assignment of responsibility and accountability, and difficulties in private participation. In addition to separating the regulatory role from other public functions, the central government should shed implementation to lower tiers of government, public enterprises, and private operators, except as warranted by prudent management of public borrowing. The central government should focus on establishing national policies and sectoral regulatory frameworks, developing technical and financial standards and procedures, and giving technical assistance and guidance to lower tiers of government.

- **Make public services more business-like and responsive to consumers**. Public institutions need fewer goals, which are more focussed on service provision; more managerial autonomy and accountability; and more reliance on the private sector (see above) to improve performance. Decentralization would improve efficiency in many cases, since most infrastructure yields largely local benefits. For example, linking urban services more closely to revenues through user charges and higher property taxes/better assessments would improve accountability and service quality, as well as generate resources for service expansion. Where markets do not match service demands and costs effectively, because of externalities, governments need to involve users and stakeholders in the decision-making process to improve investment efficiency.

3.4 The rest of this Chapter discusses the management of infrastructure to increase efficiency in more detail. Section B provides an overview of the role of the Government in infrastructure and the worldwide shift to private services. Section C discusses the management of the investment program in the context of that shift and the need to maintain macroeconomic stability. The Chapter then turns to improving: the framework for private finance of infrastructure (Section D); pricing of infrastructure (Section E); and public sector services especially by unbundling to increase private participation

(Section F) and by decentralization (Section G). Summary discussions of the main infrastructure sectors are contained in Boxes. The annex at the at the end of this chapter discusses the cross sectoral issues of urban infrastructure.

B. The Role of Government in Infrastructure, Past and Present

3.5 The public sector has long been the main infrastructure supplier in developing countries. To some degree, this reflects efficiency considerations related to non-market spillovers and concerns about "natural monopolies". To a much greater extent, however, the public sector's large role reflects a response to political pressures. The need for infrastructure has been substantial, requiring considerable capital, entrepreneurship and advanced technology. The related contracts and operations were capable of generating large rents. Uncertain regulatory frameworks have inhibited/raised the cost of private investment. Also, for many years, finance through public borrowing seemed cheaper than private capital. Finally, the prevailing development philosophy provided intellectual backing for public supply by suggesting that government could succeed where markets appeared to fail and that foreign investment was exploitative. As a result, governments engaged in major infrastructure building programs funded with taxes and external loans, and often nationalized private infrastructure.

3.6 Indonesia, using the prevailing public sector model, expanded infrastructure at one of the world's most rapid rates in 1970-90. Power generation capacity increased twelve-fold, paved roads and phones increased five-fold, and irrigated acreage doubled. Water and sewerage expansion were, however, much less rapid.

3.7 Worldwide, despite its initial successes, the public sector model has generated growing dissatisfaction. Unmet demands and poor quality services are becoming bottlenecks to growth. The poor usually lack access to services. Infrastructure has been expensive and inefficient—high cost contracts, excess capacity, inadequate maintenance, and "lost" output. Users are forced to substitute high cost alternatives or go without. Natural monopoly arguments have lost intellectual acceptance and real world applicability in the context of poor public services and alternatives arising from technical change (in mid-20th century, trucks instead of railroads; more recently, cellular instead of conventional telephones).

3.8 To respond to these dissatisfactions and changed circumstances, governments are shifting to a more private sector/market- oriented approach to infrastructure, particularly in Latin America and East Asia. In addition to efficiency, finance has become a major consideration: governments can sell-off parts of public firms and fund new investment more easily, because of financiers' interest in "emerging markets".

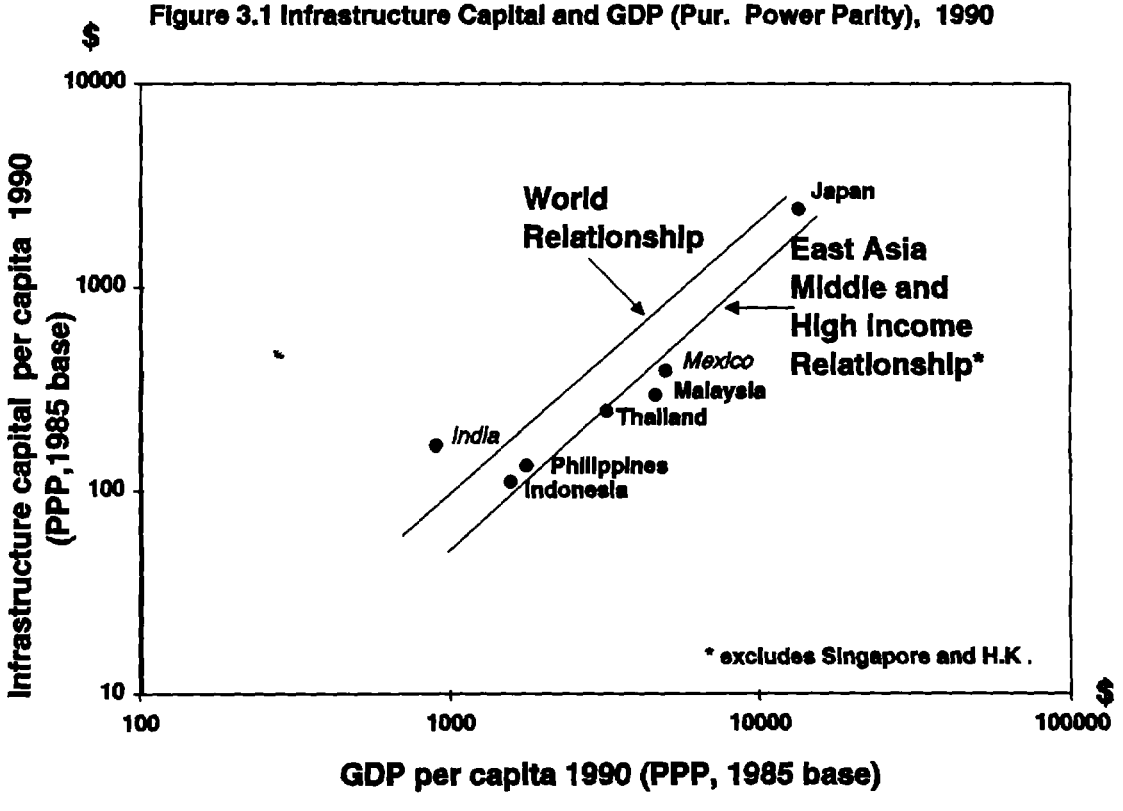
3.9 Indonesia is no exception to these new trends. However, to get the most out of the new model, Indonesia's Government must put greater emphasis on its role as manager of infrastructure to maximize efficiency. In this role, governments at all levels must manage the infrastructure program, concentrating on five key elements: (i) rationalization of the overall and sectoral investment program, with the public sector focussing on areas where there is low private interest and equity can be improved substantially; (ii) setting up a clear competitive framework for private finance and ownership; (iii) pricing; and improving public services through (iv) unbundling to permit greater competition and private participation and (v) greater decentralization and participation. If governments' management along these lines does not improve efficiency, and the potential benefits of private participation and ownership are dissipated in high prices and rents, then the new model is unlikely to be successful or long-lived.

C. Indonesia's Infrastructure and the Proposed Investment Program

3.10 **Capital Stock.** Indonesia's estimated infrastructure capital stock (in power, roads, telecoms, water, and irrigation) is about what might be expected in an East Asian country of its per capita income.[1] Indonesia's stock per capita is below Malaysia's and Thailand's, but proportionately so is Indonesia's per capita income. This suggests that Indonesia has been investing about the same percentage of GDP in infrastructure as the other East Asian economies (Indonesia has a higher share of irrigation than the others (Ingram and Fay) and its power figures neglect the large amount of private self-generation (See Box 3.1)). Compared to the worldwide relation between infrastructure and GDP, Indonesia's stock is somewhat lower than might be expected. However, the East Asian countries, including Indonesia, appear to have grown more rapidly than other regions with less infrastructure.

3.11 **Proposed infrastructure investments** total about $56 billion (about 6.8% of the new, upwardly revised GDP) in power, telecommunications, transport, water and irrigation during the rest of REPELITA VI (See Table 3.1).[2] Investments are concentrated in power (43%) and transport (33%), as is typical in developing countries (Ingram and Fay, Kondury). Indonesia needs large transport investments to serve the archipelago and encourage industrial decentralization to reduce the concentration in Jabotabek that is generating diseconomies. However, the proposed share of power investment appears to be high compared to other developing countries (Ingram and Fay).

Figure 3.1 Infrastructure Capital and GDP (Pur. Power Parity), 1990



Adapted from World Bank, World Development Report 1994, Fig. 1, p. 3.

Table 3.1: Indonesia: Major Infrastructure Sectors: Proposed Investment 1995-98 and Capacity Targets in REPELITA VI Compared to REPELITA V .

	Proposed Investment 1995-1998		*Selected Targets of Add. Capacity*	*Selected Indicators of Add. Capacity*
	(US$ bil. current)	*(%)*	*REPELITA VI (& Proposals)*	*REPELITA V*
Total	**56.3** [a]	**100.0%**		
(Private)	(18.4)	(32.9%)		
Power	24.1	42.8%		
Generation	17.0		9522 MW [d]	4600 MW [d]
Private	9.1 [b,d]		(2900 MW [b, d])	[d]
Public	7.9 [c]		(8700 MW [c])	4600 MW
Trans. & Dist.(Pub.)	7.1 [c]		30,000 MVA & 133,000 KMC	7,500 MVA & 55,000 KMC
Telecoms	6.8	10.9%	5 mil.lines	3 mil.lines
Private	3.1		2 mil.lines	-
Public	3.7		3 mil.lines	3 mil.lines
Roads & Rail roads	15.3	27.2%		
Private (Toll Rds.)	3.1	5.5%	310 KM	115 KM
Public	12.2	21.7%	Most spending for improvement	
Air & Sea	3.1 [e]	5.5%	Multiple Indicators	Multiple Indicators
Water	5.0 [f]	8.9%	30,000 l./s.	20,000 l./s.
Irrigation	2.0	3.6%	Multiple Indicators	Multiple Indicators

[a] Excludes urban sewerage, and drainage, and kampung improvement targets, estimated to cost $5 bill.; planes and ships estimated at $6-7 bill.; and mass transit.
[b] See PLN, RENSALITA (1995). The spending includes proposals for about 5600MW that, with further investment, is expected to be completed in REPELITA VII. Costs were estimated at $120 mill./100MW for coal, $80 mill./100MW for combined cycle plants, except where cost figures were available; recently prices have fallen.
[c] Based on PLN RENSALITA (1995); includes spending for capacity coming on line in REPELITA VII.
[d] Excludes private purchases of generators for self-generation.
[e] Excludes ships and planes estimated at $6-7 bill.
[f] Includes $2 bill. private investment. An alternative project list totals $7.8 bill. See Gov. of Indonesia 1994a.

Sources: Staff estimates, REPELITA VI, Gov. of Indonesia (1994a, FY1994/95 Budget), PLN RENSALITA 1995.

3.12 **Private infrastructure investment** is expected to account for over $18 billion (33%) of the proposed investment program in the main sectors in 1995/96-1998/99, according to Government projections. The Plan includes explicit reliance on substantial private infrastructure investment. Projected private investment is concentrated in power generation, telecoms, toll roads and water. The highest concentration is in power generation, where the proposed increase would account for 27% of capacity in REPELITA VI, plus starts on a roughly 5600 MW of capacity that would come on line in REPELITA VII. Toward the end of REPELITA VI, private generation investment is expected to become larger than PLN's. Also, the Government has announced plans to privatize partially major infrastructure enterprises (Section D). Nonetheless, most infrastructure is expected to remain public. Even in power, about 62% of investment will be public, including all transmission & distribution.

(Progress in privatization is discussed in Section D, and Boxes 3.1 (Power), 3.2 (Water), and 3.5 (Telecoms). The success and contribution of the privatization program will depend heavily on the establishment of a sound regulatory framework (Section D)).

3.13 **Rationalizing the Investment Program to Maintain Macroeconomic Stability.** If implemented, the proposed investment program would reduce bottlenecks and push Indonesia well above the East Asian trend line in Fig. 3.1. Proposed investment is about 50% higher than the estimated rate of investment during REPELITA V in the same sectors (World Bank 1994a, p. 52).[3] The proposed rate is also 40-70% higher than the rates in the same sectors in most East Asian countries—in China, Korea, and Thailand infrastructure investment was 4-5% of GDP in 1990-92—and the rates in a 25 country sample, in the same sectors (See Kondury and Ingram and Fay, p. 14). Finally, the proposed rate is about 10% higher than a recent World Bank estimate of the cost of meeting needs in the same sectors (World Bank 1992b). Building capacity too soon, as well as too late, is costly. The proposed investment program may exceed what is efficient intertemporally.

3.14 More importantly, the proposed investment implies a rise in investment that would be associated with an estimated $35 billion of imports and external borrowing, and likely lead to a rise in the current account of deficit of about 2% of GDP, and higher inflation. The widening of the current account and higher inflation could be avoided only if domestic saving rose or other investment demands fell by the same amount. Such a rise in the current account deficit is likely to be unsustainable in the current international environment (Chapter 1).

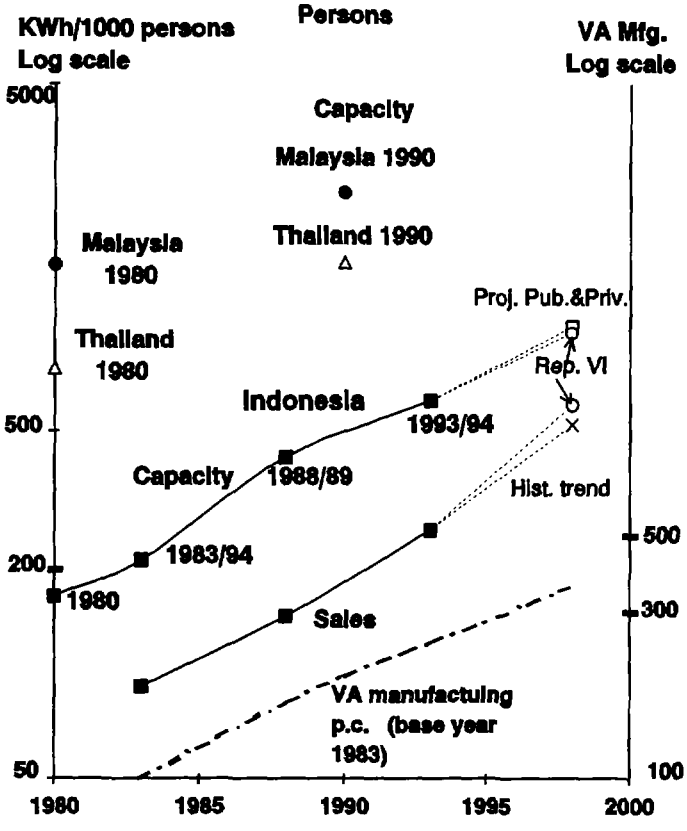
3.15 The proposed investment in these five sectors thus needs rationalization to what is financeable under current conditions without overheating—roughly 80% of the level shown in Table 3.1.[4] This would translate into the investment rates shown in Table 1.9. This investment should be financeable with higher domestic saving, based largely on better cost recovery, and the projected increase in foreign debt.

3.16 Some rationalization has occurred already—PLN has cut back its generation target 10% and private power start-ups have been delayed. More reductions may occur—financing issues could delay or even stop some investments, public and private. (Chapter 1). The deal-by-deal approach may delay projects and reduce investor interest. Institutional problems and implementation delays may continue to slow investment in the water sector. The Government will need to monitor the situation and make adjustments as needed in critical sectors. Should overheating develop, the Government will need to stretch-out the program or even cut it further. On the other hand, should lack of finance begin to cut-back infrastructure investment excessively, the Government will need to improve further the regulatory climate and make investments critical to international competitiveness, financed with higher public and private saving.

3.17 In making these adjustments, it is important to examine the efficiency of the sectoral/sub-sectoral investments. It is also important to examine the projected private sector investments—to what extent they are likely to receive financing, to what extent that financing will add to Indonesia's external debt, and to what extent they depend on Government guarantees, explicit or implicit, that may prove costly (See Section D). Finally, alternative programs will be needed, in case investments are deferred by lack of finance and growth of demand for services does prove strong.

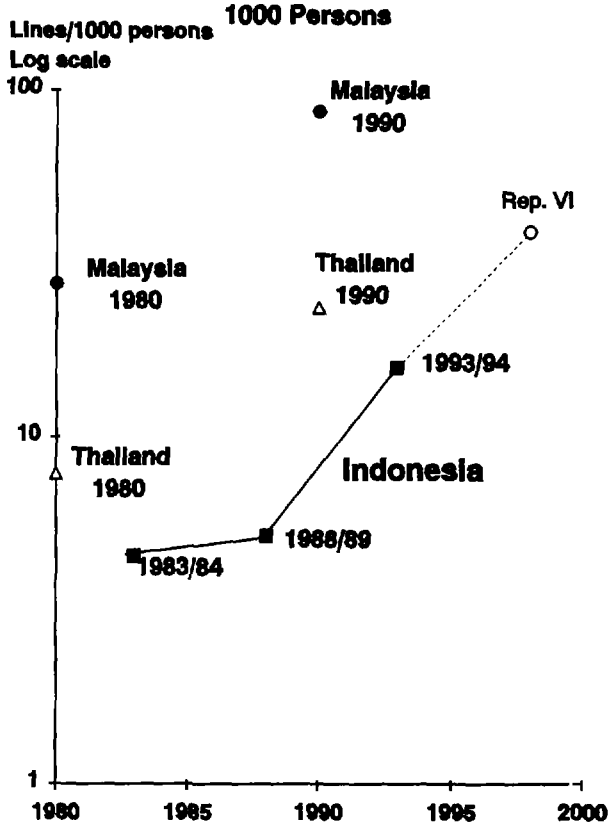
3.18 **Sectoral Issues.** Figures 3.2-3.5 show the rapid growth of the four types of infrastructure in the last two REPELITAS, the projected acceleration in REPELITA VI, and comparable data for Malaysia and Thailand. Note that Indonesia's power figures exclude

Figure 3.2 Power: Capacity & Sales per 1000 Persons



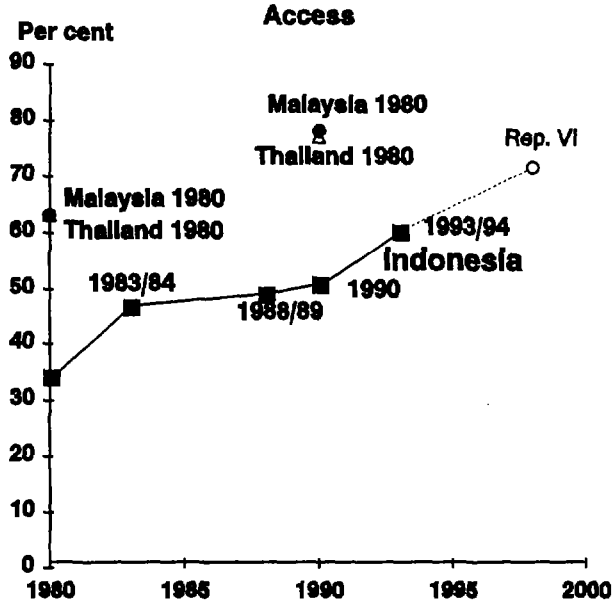
Source: Repelita VI, Statistik Indonesia, WDR 1994.

Figure 3.3 Telephones: Lines per 1000 Persons



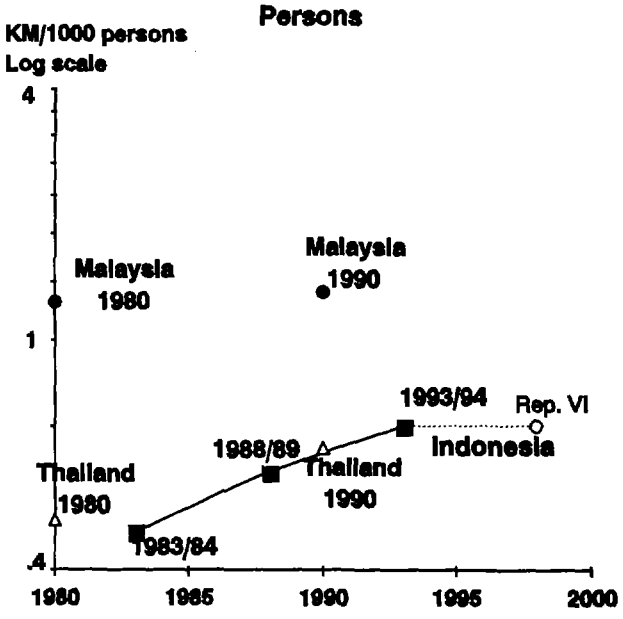
Source: Repelita VI, Statistik Indonesia, WDR 1994.

Figure 3.4 Safe Water: % Pop. with Access



Source: WDR 1994, Indon. calculated from 1990 base.

Figure 3.5 Paved Roads per 1000 Persons



Source: WDR 1994, Repelita VI, Statistik Indonesia.

full-time, private self-generation equivalent to about 50% of capacity at end-1992 and fill-in capacity equivalent to another 30% (Box 3.1) Factoring in this self-generation lifts Indonesia's power figures substantially. Indonesia's telecoms and power (including self-generation) are about 10 years behind Thailand and 15 years behind Malaysia; in water the gap is somewhat larger. Indonesia's roads per person (or per km of land area, not shown) are about the same as Thailand's but much less the Malaysia's. This comparison overstates Indonesia's transport network capacity; the vast archipelago requires air and sea connections, as well as roads on each island.

3.19 The **Power** sector will require substantial Government management. If the program materializes, then generation capacity would increase by a very large 96%. (The program also would form the basis for a further increase of about 16% in capacity early in REPELITA VII.) The proposed growth in generation is very high compared to past trends and planned growth, especially given the excess reserve margin of over 50% in the Java-Bali grid (versus 20-25% in efficient grids). The proposed increase also seems rapid relative to Malaysia and Thailand (Box 3.1) and Korea 1966-76 (World Bank 1979).

3.20 Indonesia's targets for transmission & distribution capacity are appropriately high—doubling or more. Slow growth of transmission & distribution has been a major bottleneck in the growth of demand and a major factor in Indonesia's frequent power outages. Demand growth cannot come close to projected levels unless transmission & distribution targets are fulfilled. Fulfillment will depend on increased efforts by PLN, relative to REPELITA V, and substantial funding for transmission & distribution investments.

3.21 The actual power sector investment is likely to be much less than the program, however. In the private sector, aside from the Paiton project, potential investors still have not finalized financing or are negotiating with the Government. In the current international markets, financing may take time to mobilize. Actual private investments thus may be 70% or less of the programmed total. Since most of the private sector projects are long-gestation coal plants, much of the private sector's generation capacity is unlikely to be in place before REPELITA VII. In the public sector, PLN faces resource constraints that may limit its real resources to levels similar to REPELITA V, when only about 1/2 of the REPELITA VI generation target was installed and transmission & distribution lagged. PLN's internal resource mobilization finances much less of investment than its 30% target. Development budget transfers and external borrowing are likely to grow slowly in real terms, because of the Government's appropriate prudency regarding spending and external debt. Some domestic borrowing is possible, but it is unlikely to be enough to allow PLN to meet all its targets, unless PLN's profitability increases. Moreover, domestic borrowing by PLN would entail a public guarantee, will be costly in terms of rates, and will crowd out other investments unless saving rises in response to capital market development (Section D).

3.22 In this context, the Government will need to guard against under- as well as over-investment in power, and manage carefully intra- and inter-sectoral issues. First, the Government should continue the policy of not enhancing PPAs with guarantees—additional guarantees should reduce the cost of a PPA and would lead other investors to ask for renegotiations, delaying the whole program. Second, the Government should encourage PLN to focus its limited resources on transmission & distribution. With better transmission & distribution, generation capacity could be utilized more fully. Increased utilization of generation capacity, from the current 80% of Malaysia's and Thai-land's to 90%, would allow 15% more sales, with an avoided cost of $2 billion in generation capacity. This should be feasible given Indonesia's large reserve margin.

Box 3.1: The Power Sector Page 1 of 2

Power generating capacity has grown rapidly since 1984 (12.1% p.a.). However, demand for power grew even faster, particularly with industry growing very rapidly after deregulation began. (According to the national accounts, value added in manufacturing grew 9.1% p.a. 1984-93, and recent BPS work suggests that growth actually was much faster). To help meet this growing demand, the Government authorized duty-free import of captive generation equipment. By end-1992/93, captive generating capacity was estimated at about 5500 MW and 3000 MW backup (World Bank 1994c), compared with PLN's capacity of 10,900 MW. In addition, in April 1990, the Government invited private participation in the sector. In February 1994, PLN initialled the first power purchase agreement (PPA) for the coal-fired Paiton I, BOO project, at a reported $0.083/kwh (levelized in 1998 prices), including common facilities for other plants and local procurement obligations.

Generation capacity currently is estimated to have a reserve margin more than 50% over peak load in Java-Bali, compared to 20-25% that would be possible with a system operated at efficiencies similar to Malaysia and Thailand. A 96% capacity increase is programmed for Repelita VI (See Table 3.1). PLN expects to build 8700 MW, almost twice the increase in Repelita V. With PLN in effect reserving most gas plants for itself, the private sector has been focussed on coal and geothermal plants—2900 MW by end-Repelita VI and another 5600 Repelita VII. Once the Government appeared ready to accept take-or-pay contracts of $0.075/kwh (levelized in 1998), with higher tariffs early in production. Private sector interest in the program grew rapidly and many companies submitted unsolicited proposals. The Government is now negotiating both the solicited and unsolicited proposals. The PPAs also have included fuel supply commitments—generally coal. The program's status is as follows: PLN completed about 1300 MW in 1994, and has 1770 MW in its Super Crash Program, aimed at fulfilling the National Electrification Plan (RUKN). PPAs have been signed for about 3500MW and negotiations are continuing on an additional 4300 MW, which is expected to come on-line early in Repelita VII. The Paiton I financing agreements were completed in April, with $680 million equity, and $1.82 billion borrowed, largely guaranteed by the Japanese Export-Import Bank ($900 million) and US EX-IM ($500 million) and the US OPIC providing a $200 million loan for construction. Other private operators are seeking financing.

Large transmission & distribution capacity increases (50-100%) are also part PLN's Repelita VI targets. Transmission and distribution have lagged generation, growing only 6-7% p.a. for most of Repelita V. New plants, such as Paiton and Tanjung Priok, are running much below capacity, because of inadequate transmission. Indonesia's has more frequent outages and brownouts than Malaysia and Thailand, despite a much higher reserve margin over peak load, mainly because of transmission & distribution problems.

Power tariffs are set by Presidential decree, with the objective of achieving an 8% rate of return for PLN. In 1994, the Government adopted an automatic tariff adjustment mechanism, with quarterly changes based on a formula that includes changes in fuel prices, power purchases, general prices and the Rp./$ exchange rate. Connection fees were reduced recently. There are 24 different tariff categories and the schedule is uniform across the country, despite considerable cost differences. Peak load tariffs are not an issue now, given excess capacity, but could be used to manage demand at a later date. Cross subsidies for residential consumers are considerable, estimated at about $250 million in 1992, with less than 10% reaching the poor (WB1992, p. 94). PLN's **Revenues** finance less than 30% of its investments, with the rest of investment funding coming from Government transfers (usually borrowed externally) and PLN's own borrowing. In the first two years of Repelita VI, PLN's annual financing has been similar to Repelita V, raising the question of whether it can double both its generation and transmission & distribution investment.

PLN's restructuring and partial divestiture are planned during Repelita VI. The Java-Bali grid, the largest sub-system, would be unbundled into generation, transmission, and distribution companies, with equity to be sold on stock markets or privately placed. The Government recognizes that restructuring requires a separation of PLN's commercial and social missions (e.g. rural electrification and the Eastern Islands), but has not yet decided on how to achieve it. The Government also recognizes the need for a clearer regulatory framework.

Concerns and Risks: If executed, the proposed investment program is likely to lead to substantially more overcapacity in generation early in Repelita VII. A 14% p.a. growth in generation would be very high by international or historic standards (see Table Box 3.1), even allowing for output growth somewhat higher than targeted. Self-generators are unlikely to be induced back into the grid unless (i) distribution improves, and (ii) power tariffs are below their operating costs, and (iii) connecting charges are low. The main bottleneck in the system continues to be transmission and distribution, not generation. PLN will need great efforts to meet the transmission and distribution targets and avoid worsening the bottlenecks. If demand growth is less than the high projected rates, then the take-or-pay contracts will force PLN to buy from the private plants while reducing generation from its lower cost hydroelectric and coal operations, as has occurred in the Philippines.

Box 3.1: Table Ratio of Power Growth to Output Growth in Selected E. Asian Countries.

	Ratio Capac. Growth to Growth in		Ratio Demand Growth to Growth in	
	GDP	GDP Mfgs.	GDP	GDP Mfgs.
Indonesia				
Repelita VI(proj.)	1.86	1.23	2.61	1.72
Pub. + Pvt.(proj.)	2.24	1.47		
Repelita V (actual)	1.30	0.9	2.29	1.55
Malaysia				
1980-90	1.28	1.06	1.57	1.16
1970-80	1.27	n.a.	1.41	n.a.
Thailand				
1980-90	1.13	0.92	1.44	1.17
1970-80	1.63	1.22	1.80	1.34

Source: WDR 1994.

Some take-or-pay PPAs also appear to be high and front loaded, compared to recent agreements in the Philippines and Thailand (Gunaratne 1995), although exact comparisons are difficult because of differences in plant type, tax concessions, fuel costs, local content requirements, etc., and assumptions regarding load factors and site costs. The Government's *de facto* adoption of a $0.075/KWh (1998 prices) as a benchmark to speed up negotiations, led to a sharp upsurge in interest, including many unsolicited bids. In contrast, the recent, more competitive bidding for the Cilegon concession led to an estimated price of $0.061/KWh (1998 prices) and pushed down the benchmark for other bids.

Any increase in over-capacity and any PPAs above PLN's generation cost would translate into higher costs for PLN in the late 1990s. This, in turn, would require a politically unpopular jump in power tariffs, or a substantial Government subsidy to avoid the jump. Related concerns over PLN's obligations could complicate financing for the private projects and PLN's privatization. These problems would be worsened by the unbundling of the system, to the extent that industrial and commercial users, who currently pay the highest tariffs would be allowed to buy low cost power from third parties, and escape the burden of cross-subsidies. At the same time, PLN's tight financial situation may make it difficult for PLN to achieve its targets for new capacity in generation and transmission & distribution.

The proposed privatization will need a prior resolution of the issues of cross-subsidies and PLN's low rate of return, as well as obligations on existing and new bonds. In addition, the proceeds of the proposed privatization will be affected by the outstanding volume of PLN bonds and these bonds and the proposed privatization will compete with the financing of private power investments.

In sum, it would be desirable to re-examine the demand projections and the potential for both PLN and the private sector to carry out proposed investments, in light of financing conditions post-Mexico crisis. The Government should defer signing of any new PPAs or initiation of any new PLN plants until appropriate. The Government should avoid enhancing PPAs, especially government guarantees of private debt. No new plants should be reserved for PLN; all projects should be opened to private participation. The Government also should use a clearer, more competitive framework in allocating new private capacity, a procedure that has lowered costs in other countries and in Indonesia. It should encourage PLN to focus its limited resources on improving transmission & distribution and consider ways to rely more on the private sector for additional generating capacity. Finally, the Government should increase gas supplies to private power suppliers (Box 3.6), and encourage the private sector to sell into the grid and to large consumers through the grid ("wheeling") and to enter transmission (by unbundling the Java-Bali grid) and distribution. Existing excess capacity, on-going construction, and the ability to build gas plants fairly quickly, particularly if the private sector could access gas more easily, provide an insurance margin while a clear transparent framework for private investment is developed, even if demand were to grow rapidly.

Further increases in generating capacity, when needed, should not be considered reserved for PLN. The private sector should be allowed to bid on such increases, but the bidding procedures should be made more competitive (See Section D). The private sector's ability to carry out more of the revised generation program would be furthered by better access to gas supplies.

3.23 Figure 3.3 indicates a large, but reachable target in **telecoms**. Substantial private investment is part of the commitment of the five joint venture concessionaires, chosen from twelve pre-selected bidders. (Box 3.4) Substantial public funding through the budget also will be needed—the public sector's annual target for installations is about the same as the highest annual increase during REPELITA V. However, the ongoing process to privatize PT Telekom will generate capital revenues that will permit further retirement of high interest external debt.

3.24 **Transport** investments seem appropriate and reasonable, with the major issue being increasing their efficiency. **Roads** carry the bulk of traffic and, appropriately account for the bulk of public expenditure in transport. Figure 3.5 indicates additional road extension is low; much of the spending on roads will go to rehabilitate and upgrade local roads, and to increase the capacity and quality of roads and bridges, as is required. The program in **ports and airports** seems well under way and is urgently needed. Achieve-ment of the desired economic and social returns from these investments will depend on consolidating the many funding sources and channels, especially for roads, greater attention to feasibility studies, and improvements in criteria and procedures for allocating and disbursing funds. (See Box 3.2)

3.25 **Toll roads**, although small relative to the total, will improve the interurban network, and in Jakarta, the urban network. However, in some cases, traffic forecasts are low. Reaching the targets for toll roads will, of course, depend on the availability of private financing. A key element here, as well as in the productivity of the roads, will be their economic feasibility. Private financing also will depend on the development of a clear, transparent framework for bidding on the concessions and for operating the roads.

3.26 In the **water** sector, there is a risk of under-investment because of institutional undercapacity. The investment program is appropriately high, but is likely to prove optimistic unless strong implementation efforts are made. This critical sector has continually lagged Plan targets. About 40% of projected investment is assumed to be private. However, private interest is likely to be limited to a few projects, in high income areas, and more in production than distribution. This reflects the complicated regulatory framework in the sector, including the problems of dealing with numerous water distribution companies that are subject to local political interests and lack technical skills. In order to meet plan targets, the Government may need to finance more investment than planned, and rely on private participation to carry out and manage them. (See Box 3.3).

3.27 **Urban Infrastructure Investment** has been very low in Indonesia, about 0.4% of GDP or under $10 per urban resident during REPELITA V. The consensus is that Indonesia's urban water, sewerage, solid waste management and transport services have not kept pace with the most rapidly growing urban population in East Asia, especially on Java/Bali and in Jabotabek, now the world's fifth largest metropolitan area, in particular. Future growth and industrialization will depend on cities that work well internally. To provide the necessary infrastructure, it will be necessary to at least carry out the REPELITA VI investment program. This would represent over three times as much real investment per capita as during REPELITA V, when implementation was much below planned levels, in part because of limited local resources. In addition, implementation of the recently announced mass transit investments in Jakarta could add $2-3 billion to the

Box 3.2: The Transport Sector

Indonesia's transport sector faces major challenges: the country's vast geographic expanse, archipelagal structure, population distribution, and the structural change brought about by rapid growth. The transport network is the major factor in developing an efficient city system that will maintain Indonesia's international competitiveness. An efficient network will allow industry to decentralize away from Jakarta and Surabaya into medium and small cities with lower land and wage costs. Moreover, decentralization will mitigate congestion and pollution costs in Jakarta, that otherwise will approach Bangkok's levels.

Substantial capacity expansion is needed, particularly in the congested key transport corridors of North Java. The growth of export-oriented manufacturing, and rising living standards, place an increasing premium on the reliability of transport services and efficient integration of transport modes. Careful analysis and strategic planning are also needed to avoid creating environmental and social problems, and severe fiscal drains. It also is worth noting that the private sector owns a significant part of the sector's capital—cars, trucks, and ships and planes. Thus, pricing, policies, and the regulatory framework and its enforcement are critical in efficient transport development.

Road transport is dominant transport mode within Indonesia, and will remain so. In addition to upgrading the inter-city network of highways as planned, the Government will need to increase maintenance and develop incentive contracts with the private sector to take on this work (See Section F). Road use fees could be improved by linking them better to fuel consumption axle configuration, and vehicle weight, to recoup maintenance costs. In addition, overloading and safety restrictions need strict enforcement. Over the next 5-10 years, investment in capacity expansion will need to grow. A critical factor is the economic feasibility of the major investments, and the associated several year lead time to carry out the corridor studies, undertake land acquisition, and design measures to counter adverse environmental and social impacts. Institutional improvements, which would more clearly assign responsibilities and reduce the number of funding sources and criteria and improve disbursement patterns, would improve sectoral performance. Development of toll roads will be important to relieve congestion in some of the major corridors, but the success of the program will depend on the clarity of the regulatory framework under which these roads are developed. Requests to finance roads through the state banks should be resisted, to avoid a return to directed type credits; roads that are economically justified can find commercial financing.

Given the high population density and rapid growth on Java, rail has a future in selected corridors and freight commodities. Improvements in operational efficiency would be facilitated by Perumka's greater autonomy and clarification of institutional relationships with the Ministry of Communications. Interest in private participation is on the rise, including development of urban tracts, some passenger and cargo services, and building and maintenance of locomotives. While private participation holds the promise of improved efficiency and lower costs to consumers, translating that framework into reality will involve a substantial improvement in the regulatory framework for private participation. If privatization arrangements are not clear, and competitive, then the country runs the risk of turning over valuable assets at low cost, with no benefit to consumers. Regarding the rolling stock, needs must be carefully specified: Indonesia needs mostly light, high horsepower locomotives for its mainly passenger business, but current plans are for heavy freight locomotives, produced locally. These will be costly and unsuited for the traffic.

Sea and air transport are important for some inter-country commodities and the only means of inter-island and export/import trade. Additional port capacity is clearly needed to support the export boom. Achieving cost-effective results will depend on a clear strategy and an effective regulatory framework for private participation. Finally, given the goal of stimulating transport between the island, care should be taken in protecting local ship-building. Protected production will mean higher costs for ships, and correspondingly increase the cost of inter-island sea journeys.

Box 3.3: Urban Water

Indonesia's urban water problems are similar to most developing countries'—low coverage, large losses, institutional weaknesses and poor tariff policy. Lack of clean water is an important factor in the high incidence of water-borne disease and child mortality (Chapter 4). Most urban residents consider water pollution a serious problem, according to surveys. Moreover, urban plus agricultural demands for water are beginning to exceed supply during the dry season, indicating a need for water basin management.

Urban access to "clean water" (65%) is slightly less than in China or Thailand, and much less than the Philippines (93%) or Malaysia (100%) Wells and vendors account for almost 70% of access. Piped water is used by only about 35% of households, and about 10% of that comes from vendors who resell piped water. Access to piped water has improved only slightly since 1980, when it was 27%, because lower-than-planned spending during Repelita V barely kept up with urban growth. Piped water is often of poor quality because of treatment problems, and contamination of pipes, standpipes and transport. Limited access to piped water has led to a boom in wells, but a (small) survey suggests many shallow wells are contaminated (JICA).

"Unaccounted for water" (production that earned no revenue) is 35-50% of production in the largest cities. In Jakarta, losses reached 50% in 1993 when a new source came on line. If Jakarta were to cut that figure in half, to reach the efficiency attained in Seoul, nearly 50% more customers could be served (assuming adequate distribution capacity).

Local (level II) public enterprises, PDAMs, provide the piped water. They depend on the Public Works Ministry and provincial governments for projects and funding; they report to the Home Affairs Ministry and their board of directors is supervised buy local leaders, who have a say over tariffs. Moreover, PDAMs are required to share their revenues with local governments when cash flow is positive, according to a 1985 Ministerial decree. Local consultants and contractors are given preferential treatment in projects. Directors and staff are poorly paid, have poor career prospects, and turn over rapidly. Most PDAMs are unable to break-even financially, maintenance spending is 20-30% below necessary levels, and capital replacement is lacking (in part because of access to borrowing from the Government, the cost of which is deducted before distribution of cash surpluses to local governments).

Water tariffs are based on a standard national structure (1992) which is progressive by user category and consumption. The average tariff in 1990 was Rp. 277/m^3, with a range from Rp. 532/m^3 for industry, 341 Rp./m^3 for Government, Rp. 219/m^3 for households to Rp. 170m^3 for standpipes. This compares with Rp. 3000-5000/m^3 from vendors. However, tariffs vary substantially from the standard. Jakarta's PDAM charged about Rp. 2000/m^3 on average in 1993, more than many US cities, but households using less than 15 m^3 paid only Rp. 350/m^3. In addition to the tariffs, there are monthly charges of Rp. 800 for administration and meter rental, and an official connection fee of Rp. 81,000 (which is reported to be increased by over Rp. 100,000 unofficially).

Cross-subsidization of consumers by industry hurts competitiveness and encourages firms to use well water, which depletes aquifers and leads to salinization. The subsidy to consumers goes mainly to the better-off; more than 91% of the households with expenditures over Rp. 700,000/mo. had piped water connections versus only 10% of the households with expenditures below Rp. 100,000, according to 1992 data. Standpipe subsidies are often appropriated by custodians, who take advantage of water scarcity to charge Rp. 1000-1500/m^3.

In order to achieve the Government's economic and social objectives, and even come close to reaching the Repelita VI targets, a comprehensive revamping of the urban water supply and sanitation sector is needed. This would address investment, incentives, and institutional constraints. In investment, the balance has to shift to improving distribution and increasing connections for piped water. Reliability and quality of distributed water also needs improvement. The Government must take action now on waste-water disposal and sanitation (including sewerage in selected cities) in line with increased water supply, to reduce contamination.

...../2

Box 3.3 (Cont.) Page 2 of 2

To improve water supply and expand access to the poor, the PDAMs must be run more like service businesses. Among the most important recommendations along these lines are: (a) *tariffs*: raise the average tariff in most cases and reduce the number of rates to 4 or 5, lower tariffs to industry and remove of household subsidies above $10m^3$—as noted, most households with water connections have above-average incomes and actual standpipe charges are typically above official rates, set up a clear and transparent subsidy for low income consumers that could be paid by the Government; (b) *improve billing and collection*: establish more offices, employ private firms for meter reading and collection based on contracts with incentives for improved collections, publicize disconnections and penalties and the Government's low rate of payment; (c) *reduce water losses*: in addition to better billing and collections, raise spending on maintenance, ensure that businesses have reliable bulk water meters and connections, use more private contractors for pipe repairs and maintenance with incentive contracts for based on French and UK models; (d) *focus on improved water distribution*; (e) *improve the firms*: publish financial accounts, improve career prospects and employee training, encourage private sector participation through management; (f) *consider broad concessions to private sector firms in the major cities*, with carefully specified bidding rules and contracts, for example, in Jakarta.

On the institutional front, there are too many actors in the sector with unclear or overlapping responsibilities and without agreed understandings on policies. A clear assignment of responsibility at the national level is needed to develop appropriate policies, technical standards, and financial procedures; to provide technical assistance to water utilities, and to regulate the activities carried out by service enterprises, including private operators. At the level of individual firms, greater focus is needed on the basic objective of expanding access to safe water. Elimination of profit transfers to local governments and increased community involvement in planning water supply and managing standpipes would allow additional revenues to be use for capacity expansion and distribution improvement. Secondly, to enhance economic viability and water basin management, smaller water enterprises should be regrouped. One way would be to separate ownership from management, with municipal governments retaining ownership of assets, but companies managed by professional firms. In addition to increased efficiency, this would improve the transparency of finances and be an important ingredient for encouraging private participation in the sector.

investment program. A key area for increase is water supply, where the projected private sector investment may prove difficult to achieve in light of the prevailing regulatory framework and the low technical capacity of urban water companies, as noted. To carry out urban public investments will require a substantial increase in local revenues, from taxes and fees. In addition, substantial improvement in service delivery could be achieved through improved public sector performance, greater reliance on the private sector for service contracts, leases, and concessions under appropriate regulatory frameworks, and resolution of some institutional issues, the most pressing of which are land titling and traffic management. (Annex Chapter 3 discusses urban issues.)

D. Regulatory Frameworks to Maximize the Benefits of Private Infrastructure Finance

Overview

3.28 **A clear, competitive regulatory framework will increase the benefits from the increased availability of private finance for infrastructure, compared to the current deal-by-deal approach.** Such a framework would yield greater efficiency and lower costs to consumers, better management of risks and the country's direct and contingent liabilities, and a more stable, larger flow of finance. The cuts in the cost of power in the Philippines, and in Indonesia recently, demonstrate the benefits of competition among concessionaires for transparent contracts.

3.29 The increased availability of finance reflects international markets' higher demand for infrastructure investments in emerging markets. This demand is likely to remain high, although growth of demand had slowed even before the Mexico crisis. Infrastructure finance has gone

mainly to telecoms, power, gas and water, areas where contracts can be written to deal, imperfectly, with the risks from imperfect regulatory frameworks.

3.30 The Indonesian Government has raised capital revenues from (partial) divestiture and expects to raise more; it also hopes to use private finance to fund part of the proposed large increase in infrastructure. This finance will include some equity but mostly will be borrowing by the firm doing the project. Funding through equity and private debt, rather than public debt, are benefits given Indonesia's already-large public debt. Nonetheless, the project-based structure of finance will increase Indonesia's total external debt, public and private, unless the borrower is located offshore and has large off-shore assets. Moreover, the typical, take-or-pay contract creates a contingent liability (See para 3.60). Higher saving, including greater resource mobilization by infrastructure firms and governments and by domestic capital market development, is needed to reduce reliance on external funding.

3.31 In general, the framework to maximize the benefits of private finance will involve clear, up-front specification of the conditions, clear bidding procedures, and selection of the bidder offering the highest payment to or lowest cost to the Government. In addition it is desirable to separate regulatory functions from the public enterprise, to reduce conflicts of interest. Specific conditions would depend on the sectors. This framework would reduce post-contract renegotiations and charges of favoritism, and increase international interest; it also would yield direct benefits to the consumer and ensure international markets that the borrowing is being used efficiently.

3.32 The Government also needs a sound framework to manage the inflows to mega-projects and to allocate risk and liability efficiently between itself and investors. The size, efficiency and financing of the mega-projects affects the macroeconomy and external debt. Moreover, it should be recalled that some private off-shore borrowings often became public debts during the 1980s debt crisis. Finally, standard take-or-pay contracts effectively make many infrastructure projects quasi-public, through guaranteed sales to/purchases from the public sector, even if the project's debts are not publicly guaranteed explicitly. Such contingent liabilities are less onerous than an equal amount of debt, because even in the worst case they will involve only shut-downs of lower cost capacity. However, they do absolve private firms of the commercial risk of projecting demand and can lead to costly overcapacity if the public sector's demand projections prove too optimistic.

3.33 The framework for managing these risks and contingent liabilities prudently involves three parts: management of the increase in external debt and investment quality, discussed in Chapter 1; development of contracts that consciously take into account risks and risk pricing; and unbundling public sector activities to allow the private firms to deal directly with users and absorb more of the commercial risk of demand forecasting and capacity management.

3.34 Contracts need to allocate risks to parties most competent to manage them, take into account the costs of risk shifting and ensure that risk shifting does not reduce incentives for efficiency. For example, countries often take the risks of macro-economic policy. Investors may take exchange rate risk, and other macroeconomic risks, but this certainly increases the contract's cost. In some cases insurance is available against these risks, for a fee. Contracts that include guarantees of private external debt are not only equivalent to public debt in the market's view, they reduce the incentives for project evaluation and efficiency. Hence, great care must be taken before such contracts are extended, including careful evaluation of the benefits they might entail relative to alternatives such as private participation through incentive contracts for construction and operation. The Government's contracts need to rationing and price appropriately scarce public sector credit, guarantees, and contingent liabilities, bearing in mind that concessions to one investor usually

must be given to all. This process will be facilitated by careful up-front specification of contracts and bidding for the contracts.

3.35 A second important element involves unbundling public sector activities. For example, by separating—unbundling— production, transmission and distribution in power, water, and gas, it is possible to set up markets in which private firms compete to provide supplies at minimum costs, and distribute services to consumers, either directly or through transmission facilities (for a fee). Unbundling thus returns some of the commercial risk of forecasting demand to private producers and encourages them to provide low cost, high quality services through a market-based environment. Unbundling also permits greater reliance on the market to regulate sectors. However, in cases where markets are weak, a regulatory framework will need to be developed.

The Growth of Private Finance for Infrastructure

3.36 Private offshore finance for infrastructure in developing countries has grown sharply in recent years (Table 3.2 and WDT 1994), reflecting higher supply and demand. Supply has grown as international markets have recognized the potential returns in developing country infrastructure.[5] Demand also has grown as developing countries need infrastructure, and lack funding capacity because of inadequate cost recovery, limits on public borrowing capacity and aid flows, and, in some cases, macroeconomic problems.

3.37 In addition to traditional sources of private offshore finance such as direct foreign investors and international commercial and investment banks, funds for infrastructure have come from offshore bond and stock markets (often using new instruments such as depository rights—certificates issued by a depository bank that pay dividends based on shares held by a custodian bank in the home country), mutual funds, pension funds, and new institutions such as infrastructure investment funds (See Gunaratne 1994). The demand from these markets not only has funded new infrastructure, it has allowed Governments to sell-off part or all of existing firms. Moreover, the development of domestic capital markets also has mobilized resources, especially in Malaysia and, recently, India and Thailand. Of course, part of the funds raised in domestic markets typically come from off-shore investors.

3.38 In 1988-93, developing East Asian economies mobilized about $9 billion of private infrastructure finance, on- and off-shore. This is about one-half the total that went to Latin America. East Asia's higher saving rates and better fiscal performance translated into lower borrowing needs than Latin America. Moreover, Asian public infrastructure typically was better run than in Latin America. Finally, much of the recent flow to Latin America was associated with the country-specific regularizing of Argentina's and Mexico's large external debt-overhangs. In contrast to the Latin American approach of full divestiture of public firms, the East Asian approach typically has been partial privatization, mostly in telecoms.

3.39 In the last two years, the East Asian economies' growing needs for infrastructure investment and easier market conditions also have led to a growth in private projects finance. Most of the project investment in East Asia has gone into power plants (China, Malaysia, Thailand, and Philippines) and highways (Malaysia). Projects also exist in water & sewerage (Malaysia), and urban transport (Malaysia, Philippines and Thailand). About 150 projects worth over $100 billion were estimated to be under consideration at end-1994 (WDR 1994).

Table 3.2: Infrastructure Privatizations in Developing Countries and Offshore Bond and Equity Sales 1988-93

	Privatizations						*Bond & Equity*
	1988	*1989*	*1990*	*1991*	*1992*	*1993*	*1993*
Total ($ Billion)	0.4	2.3	4.3	6.3	8.3	3.8	5.2
				%			
By Region	100	100	100	100	100	100	100
Latin Amer.	100	9	79	95	74	38	44
East Asia	0	91	20	4	25	25	55
Other	0	0	1	1	1	37	1
By Sector	100	100	100	100	100	100	100
Telecoms	75	9	94	90	35	35	17
Power	25	91	0	5	36	46	58
Gas	0	0	0	0	23	2	11
Other	0	0	6	5	6	17	14

Note: Privatizations include sales in local markets, bonds & equity refer only to international markets. Excludes airlines, shipping, and road transport.

Source: WDR 1994, WDT 1994, Sader.

3.40 The project-linked finance typically is raised by a local entity, based on the project's potential revenues not provided by a parent, offshore corporation. Debt:equity ratios of 75:25, or higher, are typical. To the extent that the local entity borrows off-shore, its debt would be counted as part of the country's private sector external debt.

3.41 Indonesia has followed the East Asia pattern. The public toll road company, Jasa Marga, has jointly built and operated toll roads with private sector firms; local partners have included Humpuss and Citra Marga. In 1994, Indonesia partially privatized the public international telephone service, PT Indosat, and gave a franchise for international service to Satelindo, a joint venture of the PT Bima Graha Telekomindo consortium (60%), PT Telekom (30%), and Indosat (10%); it also is offering concessions to private firms that will include the obligation to supply 2 million new telephone lines. (Box 3.5) In power, in 1994, Indonesia signed purchase agreements for about 3500 MW of privately supplied power from two coal-fired two gas-fired, and four geothermal plants. The Government is actively negotiating with a number of potential power suppliers, that could supply an additional 4300MW. Finally the Government also announced its intention to privatize partially PT Telkom, PLN, Jasa Marga, and Garuda.

Developing a Clear, Competitive Framework for Concessions.

3.42 Indonesia can reduce the costs and increase the benefits of private infrastructure participation and investment by maintaining a stable macroeconomic environment and instituting an appropriate regulatory framework

Box 3.4: Indonesia's Telecoms Sector: Indosat and Beyond

A minority share in Indosat, Indonesia's public international telecommunications company was sold off in stock markets in October 1994. The Government sold 25% of its equity through the form of American Depository Rights (listed on the New York Stock Exchange), raising $830 million; the net proceeds were used to retire high interest rate ADB and World Bank loans. In addition, Indosat's equity was increased 10% by stock sales in the Jakarta and Surabaya markets, which raised the equivalent of $332 million; the net proceeds were retained by Indosat for investment. Merrill Lynch and P.T. (Persero) Danareksa coordinated the issues, the largest global equity offering in Asia up to that time.

PT Telkom (Persero), the public monopoly serving the domestic market is setting up seven regional companies. Five of these companies will enter into Build/Joint Operation/Transfer Schemes with five consortia (competitively chosen from among 12 pre-selected firms) that will manage the regional phone systems to specified quality targets and install 2 million new lines by 1999. PT Telkom will retain the other two companies, in the Jakarta and Surabaya regions, respectively, and install the new phone lines in those areas. PT Telkom also is slated for partial privatization during Repelita VI, with Goldman Sachs, Merrill Lynch, S. G. Warburg, and Lehman Brothers as the global co-coordinators. These changes are expected to improve service quality and speed-up connections. Reaching REPELITA VI's target of 5 million new lines will increase capacity 62% compared to end-REPELITA V.

The Government also has authorized new entrants into telecommunications. A franchise to provide additional international telecommunications service (through a separate access number) was given to PT Satelindo, a joint venture with 60% equity held by the PT Bima Graha Telekomindo consortium (60%) that in turn is linked to the Bimanatara and Artha Graha groups, 30% by PT Telkom and 10% by Indosat. In the cellular phone market, where service has lagged and prices are high, PT Telkom is facing competition from Satelindo (1993) and a subsidiary of Indosat (August 1994). PT Ratelindo also has been authorized to provide telecoms service. In February 1994, Satelindo sold 25% of its equity to Deutsche Telekom AG for $586 million; their participation should help improve service.

for concessions. The up-front issues are i) increasing the transparency and competitiveness of transactions in order to lower costs, and ii) dealing with risk: country, currency, sectoral and commercial/project risk.

3.43 **Increasing Transparency and Competition in Bidding and in Services** For any particular privatization transaction, benefits are likely to be greater/and costs lower, the clearer and more competitive the transaction. In addition, the benefits to the country/users also are directly related to the degree of competition implied in the concession—high prices can be obtained for a concession, to the detriment of users and efficiency, if the contract also provides the concessionaire shelter from competition through restrictions on other potential or actual suppliers.

3.44 Using financial markets to partial or fully privatize existing firms tends to be fairly transparent and maximize cash yields. Price is largely determined by a competitive market, although to a small degree (1-2%) it depends also on the management of the competition among underwriters for the issue. In order to divest through financial markets, particularly off-shore markets, firms need to have reasonably transparent books and disclose financial results, subsidies, tariffs, etc. In the case of Indonesia, PT Semen Gresik's preparation for its sale of shares on the domestic market is generally regarded as improving

accounting and performance. However, partial privatization and spreading share issues among a large number of small investors may not generate a large, sustained improvement in efficiency, although it can provide a counterweight to potential political interventions. In contrast, private placements, or bids for majority control, may improve management but they also may increase economic concentration and result in a lower sale price.

3.45 With capital revenues the main benefit of partial divestiture, the transaction's benefit depends on how these capital revenues are invested. If the partially privatized firm keeps the revenue it may not yield the highest net return for the country. Retirement of high interest rate debt, as Indonesia did with most of the Indosat revenues, appropriately matches reduction of public assets with reduction of public debt, and ensures a high payoff from partial divestiture.

3.46 Most privatization transactions in Indonesia are likely to involve project concessions, rather than market based divestiture, however. Indonesia has only a few firms that could be readied for market placement. Moreover its main strategy for private participation is for joint ventures (telecoms, toll roads) with investment commitments or individual projects.

3.47 Developing a clear, competitive framework for these project-related transactions would improve the benefits to the country, compared to the current deal-by-deal approach. (The same holds true for private participation without finance discussed in Section F).

3.48 It is occasionally suggested, incorrectly, that a carefully prepared and structured competitive process for inviting bids from the private sector is too costly in terms of time and money. It is sometimes said that a deal-by-deal approach or responding to unsolicited proposals by interested private sponsors is faster and cheaper. However, experience worldwide and in Indonesia itself (e.g. ports, power, toll roads, and water supply), belies this view. The absence of suitable benchmarks with which to evaluate the proposals adequately, and the difficulty of maintaining adequate transparency (which creates pressures for efficiency), tend to increase the costs of the deal-by-deal approach substantially. Moreover, without an up-front announcement of the parameters of the contract, Indonesia can be subjected to pressures to enhance the deal. Finally, experience has shown that poor preparation and the deal-by-deal approach tends to lead to protracted negotiation, negating one of the major benefits of private participation, rapid construction. An example is the expansion of the Tanjung Priok container port, where changes in the site and the concessionaire have delayed project completion and led to congestion in the port that has raised exporters' costs.

3.49 The World Bank's worldwide experience (World Bank 1992a) suggests that complicated contracts are likely to prolong negotiations. Complicated contracts and other lack of transparency also tend to reduce the number of bidders for a concession and raise costs, which can then lead to over-leveraging and markups in loan applications, all of which tends to reduce the benefits to the country from the sale of a concession and to increase costs that have to be passed on to the public. Finally, World Bank experience also suggests that perceptions of unfair dealing and favoritism can threaten the privatization process and even reform in general.

3.50 All this means the Government should be *more* transparent than other sellers in order to maximize the benefits of private finance. Experience suggests that competition among potential suppliers, on a very few, if possible one variable, and selection of the low bid, can lead to substantial benefits to the country. Bargaining with a sole source rather than competitive bidding is likely to raise costs of a given project. Although in almost all countries initial contracts have been negotiated

on a transactions basis, the examples of the Philippines (Gunaratne 1995) and Indonesia in power recently suggest that competition can reduce costs significantly.

3.51 To encourage transparency and competition, bidding documents must carefully define the main parameters of the project, for example service quality; investment if any; and pricing formulas. Introducing too many parameters/restraints can reduce the bidders' ability to provide service at the lowest costs. In particular, requirements on local content, such as often are included in Indonesian contracts, are undesirable because they raise the cost of services. The process should entail clear and simple selection criteria for winning bids; a clearly-defined, competitive bidding procedure; and disclosure of the winning bid.

3.52 The importance of careful preparation and specification of contracts in the bidding documents is illustrated by the Mexican toll roads case. The contracts failed to make the sponsors responsible for construction time and costs. Flexibility in the concession period allowed the sponsors to shift the costs onto road users or the Government. Creditors, mainly state banks, did not appraise and monitor the projects with sufficient diligence. Typical contract specifications for toll roads now remedy many of these problems.

Managing Risk Sharing

3.53 All projects' cost are affected by risks that raise the premium that investors require, over-and-above the international interest rate, to compensate them for risks. To minimize these costs, contracts should allocate risks to parties most competent to bear them at low cost. At the same time, the contracts need to avoid risk sharing that reduces incentives to efficient performance.

3.54 Country and currency risk reflect the risk of expropriation, or that an investor will not be paid or will be repaid in a blocked currency, or a depreciated one. Such risks can be reduced by maintaining a sound macroeconomic framework. Of course achieving a sound reputation takes time. In the case of Indonesia, a reasonably stable macroeconomic framework has been maintained for some time, the capital account has been open since 1970 and the last large devaluation was in September 1986. However, the large external debt overhang continues to concern investors.

3.55 Investors can insure against some risks of expropriation, blocked currencies and non-payment, for a fee with bilateral agencies and multilateral agencies (e.g. Multilateral Investment Guarantee Agency, affiliated with the World Bank). Recently bilateral agencies have begun to extend guarantees without a government counter-guarantee. Governments have attempted to reduce currency risk by offering concessions that include payment in foreign currency or its equivalent. Government guarantees of the investor's debt can reduce borrowing costs, but (a) this lower cost needs to be reflected fully in lower tariffs; (b) there no longer is any benefit to the country in terms of reduction in public external debt burden; and (c) incentives to evaluate the project and perform effectively are reduced.

3.56 Commercial risk is a major issue and private management of that risk often can represent a major saving for the economy. For example, commercial risk of constructing and operating projects often is assumed by private investors. This can save substantial amounts if private investors can construct facilities more quickly, which, with appropriate contracts, can reduce costs to service users. However, if contracts are based on cost of construction, the incentive to construct quickly, and at lowest cost, are reduced, as was the case with the Mexican toll roads. Similarly, restrictions requiring use of local, rather than lowest cost, inputs can substantially reduce the benefits of private management of commercial risk, as noted above. Private firms typically have lower staff costs that public firms. Private firms also have less "lost" output and unbilled services, although use of private contractors can reduce these problems in public firms (Section F).

3.57 The importance of risk and the approaches for dealing with it explain why private infrastructure investment has concentrated in three sectors: telecoms, power generation, and, to a lesser extent, toll roads. In the absence of well-defined overall "regulatory" framework, private investors view these sectors as being more stable and less subject to political intervention. Other sectors, such as urban transport and, recently, water have attracted investor attention, but risks remain. An example of the problems that can arise in these politically sensitive sectors is the Bangkok Expressway. A disagreement over revenue sharing delayed its opening, and then led to the public's "taking over" the road. Eventually, a consortium of Thai investors, led by a politically well-connected firm, bought-out the foreign investors and took over operations.

3.58 The private sector views power and telecoms favorably because sectoral conditions facilitate contracts that can mitigate investor risks. In telecoms, concessions can be awarded for certain areas, with well defined levels of services (interruptions, call connections, and installations) to be provided at well-defined prices, and with well-specified amounts of new investment to be made. A critical issue, given the rapidity of technological change in telecoms is the definition of prices. Fixed, cost-plus, or rate-of-return based prices tend to result in higher costs/inefficiencies to users, even if the Government recoups part of these losses through competitive bids for the contracts.

3.59 In power, take-or-pay power purchase agreements (PPAs), in some cases rate-of-return based, have been used to set prices (usually in foreign currency equivalent) for private plants to sell fixed volumes of electricity into the grid; sometimes these are accompanied by contracts for similarly fixed input prices. Toll roads can be more complicated but contracts can define the quality of road to be constructed and maintained, with well-defined tolls; in Mexico traffic volumes were also guaranteed, making the Mexican toll road contracts much like take-or-pay power contracts. The risks to the investor are the ability to meet these contractual obligations and the possibilities of non-fulfillment by the government, and inconvertibility of profits or nationalization of the concession, both of which can be covered by bilateral or multilateral insurance.

3.60 These contracts mitigate investor risk by transferring it back to the public sector; making the projects *quasi-public* because of the implicit guarantees that may end-up as costs to the public, even though the projects are privately owned and have no publicly guaranteed debt. For example, in the take-or-pay power contract, the investor takes only the technical risk of building and running a plant, and the risk that the public sector will not honor the contract. The private producers do not have to deal directly with consumers (in many cases the regulatory framework limits sales to consumers), nor worry about power tariffs; they are guaranteed sales at the agreed-upon price even if demand is lacking at that price.

3.61 The state power company or the Government thus takes two risks that would be the investor's responsibility in a different regulatory environment: forecasting demand and setting prices for the concession. Overestimating demand/building too much capacity and setting/accepting too high prices increases costs to the public, even if there is no explicit public guarantee of debt. In these case, even though the quasi-public projects may be technically efficient, they would be macroeconomically inefficient and reduce the

Box 3.5: World Bank Group Guarantees

Private sector participation in infrastructure projects often depends on the availability of long-term finance at reasonable rates. Private sector investment also often depends on contractual obligations from the Government or the public entities as regulator, supplier of inputs, or purchaser of output; while equity and debt investors may be willing to bear the commercial risk associated with projects, the risk of failure to fulfill these obligations can be a major constraint to mobilizing private financing on reasonable terms. World Bank group guarantees can be used to cover a portion of the financing—normally the longer end of the maturities beyond what the market is willing to provide—or to cover risks of failure to fulfill public sector obligations. Such guarantees can play a catalytic role in helping developing countries mobilize private participation in infrastructure, and help the borrower mobilize larger financing on better terms and conditions.

World Bank group guarantees are irrevocable commitments to third parties that have loaned funds to a borrower in a Bank member country that the guaranteed portion of the loan will be paid, if, under specified conditions, the borrower does not. The International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) can support private investments without a government guarantee, which means they remain the preferred sources of support for the private sector. In particular, MIGA offers insurance against broadly-categorized political risks such as currency convertibility and expropriation to investors in its member countries. World Bank guarantees require a government counter-guarantee and complement IFC and MIGA efforts in terms of covering different risks and addressing financial gaps that exceed their operational limitations. Since 1989 five guarantees were extended under the Bank's ECO program, including three in 1994 - China Yang-zhou Thermal Power ($350 million), the Philippines Leyte-Luzon Geothermal Power Project ($100 million), and the Jordan Telecommunications Project ($50 million). In September 1994, the Bank's Board approved a wider use of guarantees, which included broadening country eligibility; using guarantees to mobilize private finance for individual investment projects, expanding risk sharing with the private sector, allowing stand-alone and project-linked guarantees, modifying the fee structure, and streamlining procedures.

economy's overall competitiveness. And, they would burden the country with a large additional debt that would have to be paid, one way or another, by the public.

3.62 These risks are not hypothetical. In the Philippines, power shortages have quickly turned into over-capacity in some areas such as Mindanao, with the public being charged for plants operating at only part-capacity. In Malaysia last year, the public power utility also had to pay private generators for power it couldn't use. In the U.S., the state of California encouraged excess generating capacity when it required the grid to buy power at what it thought was long run marginal cost. In Mexico, the government was forced to adjust toll road contracts when hastily prepared forecasts of traffic volumes did not materialize in the face of high tariffs (WDR 1994, pp. 99), in part related to cost overruns in construction. In Indonesia, take-or-pay gas contracts have forced PLN to pay for gas it could not use, because lack of transmission & distribution facilities limited use of gas-fired, power generation capacity.

3.63 To rely more extensively on the private sector, while minimizing the risks of over-capacity, the Government of Indonesia needs to encourage private suppliers to deal with consumers directly. This is the case in the telephone network expansion, and could be done in power, water and gas, if procedures allowed private suppliers to deal directly with consumers, through distribution networks, and services were unbundled into generation, transmission, and distribution.

Unbundling Public Sector Services

3.64 **Splitting-up (unbundling) of services and introduction of more market-based competition, along with sectoral regulation as necessary** could improve Indonesia's infrastructure services further. In many cases public supply of infrastructure has been justified by "natural monopolies". However, the degree of natural monopoly differs greatly in many services. For example, in power, gas, and water, the services of generation, transmission and distribution differ greatly in their degree of natural monopoly. The three services could be supplied by different firms, and some of the services could be supplied by more than one firm, allowing competition to develop. Nor is it obvious that a single firm should supply all of Indonesia. Natural monopolies also have been reduced by technological change. For example, cellular phones can substitute for telephones; competition and service quality can be improved if different enterprises run the different services.

3.65 **Unbundling in power and gas** production, transmission, and distribution would produce three types of firms. First there would be suppliers of the basic service into the transmission system. These could include public and private firms and in the case of power, firms both dedicated to electricity production and self-generators with excess capacity. (In the UK, power is sold competitively into the national grid on a half-hourly basis). Competition between these firms will drive the costs down. Second, there would be transmission firms; usually there are few of these firms and competition may be difficult to establish—the Government may need to operate, or at least regulate these firms. Third, there would be firms that take supplies from the transmission firms and sell to users; there often can be competition, at least geographically, among these suppliers, which can reduce costs to users. Moreover, these distributors may enter directly into long term contracts with producers for supply through the grid (for a fee), in order to minimize variation in their costs. Competition for these contracts, and for the concessions when they are renewed, would reduces costs.

3.66 In Indonesia, plans are underway to unbundle power. Private generating firms are expected to come on stream toward the end of REPELITA VI. Plans are being made to split up PLN's generating plants into multiple, partially privatized firms. Improvements arrangements for sale into the grid by self-generators with excess power would increase use of the generators and improve their efficiency. Transmission is likely to remain in a few, public firms, but distribution could be opened up to competition. Allowing private producers to sell "directly" to users through the grid ("wheeling") for a fee, also would improve efficiency and reduce risks to the government. In gas, unbundling has not made much headway. Pertamina/PNG basically remains a monopoly producer and seller. Because Pertamina's main business is oil and LNG, not domestic gas sales, this sector has been neglected, particularly development of small fields and transmission and distribution to supply urban areas with cheap, clean power (Box 3.6).

3.67 Unbundling of services provides more competitive or contestable markets for some services. In these areas it is possible to rely more on market-based solutions and less on regulation to achieve efficiency. However, in other areas, e.g. transmission, a sound regulatory framework will be needed. As noted above, it will be desirable to separate the regulatory function from the provision of services, to avoid conflicts of interest.

Relying on Domestic Saving: Self Finance and Capital Markets

3.68 The Mexico crisis probably will worsen the slow-down in off-shore funding for investment that already was occurring in 1994

Box 3.6: The Gas Sector

Indonesia has substantial gas reserves in formations that are too small to support LNG exports. Development of these reserves would help meet the nation's energy needs in an environmentally friendly manner. It also would allow more oil output to be exported. However, gas provides only a small, and declining fraction of domestic energy use. Pertamina's tight regulation of gas concessions, pricing, and purchase/sale have stifled potential investment in gas exploration, production, transmission and distribution for the domestic market.

Deregulation and greater reliance on the private sector would stimulate a more dynamic, competitive domestic gas industry. Appropriate deregulation would lead to several sellers supplying the power sector, industrial users and gas distribution companies through an open access transmission grid. This structure has emerged as the most efficient in gas-producing countries such as Argentina, Chile, US, and UK. By liberalizing the sector and permitting the emergence of competition throughout the gas chain, only a light-handed approach to regulation would be required.

A more dynamic domestic gas industry depends on reducing Pertamina's role in deciding on the allocation of gas to consumers, which fields can be developed and at what price. The Government should encourage open, competitive bidding for concessions, liberalize gas prices and permit direction negotiation of prices/supply between producers and buyers. These measures would encourage exploration and production of gas for the domestic market. It also would improve the efficiency and environmental aspects of power generation (see Box 3.1).

Development of a national transmission and distribution grid also would be essential. Private participation in the ownership, management and financing of PGN should be encouraged to tap the financial strength and technical expertise of international gas utilities as partners in helping build the network. Private participation in PGN should be sought through a competitive, transparent selection process. And the roles of Pertamina and PGN need to be clarified. In addition, just as competition needs to be encouraged in gas exploration and production, investors also should be encouraged to enter and provide competition in gas trading and gas distribution, and perhaps transmission as well. Of course any such concessions should avoid any arrangements that would prevent evolution of an open-access transmission grid.

(WDT 1994). Even private borrowers for projects in fundamentally sound countries like Indonesia may encounter a temporary decline in funding. As an alternative, Indonesia's rapidly developing domestic capital market could well provide some infrastructure finance, but amounts are likely to be limited and the Government will have to manage the process closely, to avoid a number of pitfalls.

3.69 Investment finance through the domestic market faces a fundamental constraint —domestic saving. Infrastructure investment can get additional domestic resources only if it "crowds-out" other investment, or if domestic saving rises. Breaking this constraint was one of the attractions of offshore finance.

3.70 Domestic saving can, of course be increased, making more resources available for infrastructure investment. First, as noted in Chapter 1 and discussed in Section D of this chapter, better cost recovery, through appropriate pricing and efficiency improvements, would allow more self finance. Indonesia generally has a long way to go in this regard—although PT Telekom finances about one-half of its investment domestically, PLN typically has financed less than one-quarter of its investment internally.

3.71 Second, development of domestic capital markets can encourage more saving, and make more resources available, especially long-term resources. In the last three years, Indonesia's stock exchange has grown rapidly. New issues and warrants reached about Rp. 11.4 trillion (about $5.7 billion) in 1994. Bonds are much less common, as is typical in countries with inflation around 10% p.a.[6]; new issues in 1994 were about Rp. 900 billion (about $500 million). It is worth noting that much of the capital market growth came from external investors, whose withdrawal of funds has depressed East Asian markets (See Chapter 1).

3.72 Strengthening of the ongoing institutional and regulatory frameworks would further the growth of these markets, as would investment of pension and insurance funds under strong prudential regulation. Meanwhile, some funds could be mobilized in the domestic market, but not substantial amounts. The local placement of Indosat, $300 million, was one of the largest issues in 1994. PLN's 1993 bond issue, attractively prices at 2 percentage points above SBI rates, mobilized about $300 million at end of 1994, but this was only one of few issues in the year.

3.73 In mobilizing funds in the domestic capital market, the Government will need to pay close attention to a number of issues. First, as regulator of the capital market and ultimate guarantor of public enterprise borrowing, the Government will need to ensure that terms and conditions of new public enterprise issues are not out of line with the markets, that distribution of issues are competitive, and that the enterprises have the capacity to repay. This is particularly true since with Indonesia's open capital account, off-shore purchasers are important factors in the market. Second, new capital issues must be coordinated with the prospective partial privatizations of some of the companies, to avoid over-burdening markets with issues from particular companies. Finally, obligations on existing debt and arrangements for issues of new liabilities will need to be well-defined as part of the regulatory framework for privatizing firms.

E. Managing the Infrastructure Program: Adequate Pricing

3.74 Better pricing of services, to cover costs adequately, provide for greater self-financed investment, and encourage cost reduction, would improve Indonesia's infrastructure services. Adequate pricing is the basis of private sector participation, good quality public services and, most importantly, efficiency. The private sector will not provide services unless prices cover costs and yield a reasonable rate of return. For the public sector, adequate pricing is no less important. Reasonable, predictable revenues permit service expansion, quality improvement, and payment for private sector involvement. Revenues that are linked to usage through metering and collection improve accountability. Moreover, these revenues reduce the need for budgetary transfers. In turn, this reduces the likelihood that Government will impose additional objectives on firms and divert managers from the main goal of quality service supply. Pricing formulas should not be simply cost-plus; they need to replicate competition by putting pressures on producers to make and pass on cost savings; this is necessary to avoid simply passing on high costs to users. Finally, adequate pricing generates economic efficiency, by providing signals that encourage users to manage their demands in line with the true costs of producing the goods.

3.75 **Improving services by decentralizing revenues and user charges.** In the case of local public works, which provide mainly local benefits, services can be improved by linking them to funding from local revenues. This link encourages more efficiency in service delivery and accountability through the political process, as compared with centrally funded and provided services (See Section F and Oates, Tiebout). The link also is important for equity reasons,

since many of the benefits of many local services go to higher-income residents (See Box 3.2 and Annex to Chapter 3). The local revenues can be local taxes, "valorizations" that link charges to the properties that are expected to benefit (used effectively in Colombia but less so in Indonesia), and/or charges on developers that cover the cost of their demands on the infrastructure (Korea, US). In poorer areas, such as Eastern Indonesia, potential revenues may not cover costs fully. Nonetheless, the local areas can be encouraged to pay part of the costs of locally based infrastructure, or contribute labor, as occurs in many Indonesian villages and institutions such as the Mexican Solidarity Fund (WDR 1994 p. 74). The benefits, in terms of better service delivery and accountability are likely to be greater than any distribution benefits from larger central transfers.

3.76 **User charges** can link services to revenues even more closely. Charges linked to gasoline and road use often finance highway construction and maintenance (e.g., Latin America, US, Japan, Korea, Philippines). Bridge use charges are applied in many cities and urban road charges are beginning to be made possible by technological advances (cities such as Houston, Texas, and Singapore are using such systems and capability is developing in Hong Kong, the Netherlands, Scandinavia, and the U.S. See Hau). In devising such schemes, care must be taken to distinguish user charges from taxation or congestion charges, and to vary the user charge as returns on maintenance and new capacity decline. If fees can be closely related to use, for example tolls, then they can form the basis of private provision of the infrastructure.

3.77 **Connection fees** also are used by utilities to reflect both the actual cost of connection and any scarcity premium for access. Connection fees/charges need to be high enough to eliminate any demand for access that cannot be met quickly. Keeping fees low encourages excess demand for access and yields little real benefit to consumers; the firm's personnel are likely to appropriate the scarcity rent by charging additional fees themselves. To ease the burden of payment by the poor, the connection fee can be spread-out in monthly bills.

3.78 **Tariff Structures** also can be used to improve efficiency and manage demand. For example, rate structures that vary by time-of-use encourage efficiency. Peak-load charges force peak-load users to bear their share of the costs of capacity that will be idle most of the time. They also encourage rationalization of demand and, thereby reduce the need for additional capacity. Peak-load charges are desirable not only for power, but for urban roads. Such road congestion charges put a tax on road users for the extra costs they impose on other users at rush hour. This spreads out peak use on existing roads. It also helps avoid the usual problem of new roads' filling-up at rush hour and going empty at other times by penalizing drivers who switch their trips back into the rush hour. Such charges already are used in Singapore and technological advances are making them easier to apply (see Hau). However, in Jakarta, where traffic is heavy most of the day, peak load pricing may provide only limited relief.

3.79 **Tariffs to encourage cost savings** and pass them along to users are even better than tariffs that guarantee costs will be covered. Such formulas are particularly important in industries where rapid technological change is taking place, such as telecommunications. Competitive market structures tend to encourage such cost/price cutting. For this reason, it is desirable to introduce competition into as many infrastructure services as possible (See below). Government price setting in contracts should clearly be indicated as maximum prices, with no penalties for lower prices. Unfortunately, Government's setting of prices may encourage overcapacity—if the price is set too high, then cost recovery formulas pass on the costs of overcapacity to the consumer (See Box 3.1 and Section D). When competition is difficult to enforce, bidding to provide the services over a limited time frame, (with construction possibly provided by other suppliers) can recoup some of

the cost reductions. If possible, the proceeds of such bidding should be funneled back to the users.

3.80 Indonesia stacks up reasonably well on user charges, although some adjustments would be desirable for efficiency reasons and will become necessary as privatization proceeds. Indonesia's **telecoms** tariffs have recovered costs, including capital costs, reasonably well. As recent, rapid capacity growth has increased access, connection fees have been reduced. The tariff schedules for the privatized firms will need to incorporate downward adjustments to take into account technological improvements in the rapidly changing industry.

3.81 **Electricity** tariffs are similar, on average to Malaysia and Thailand. These tariffs covered PLN's operating costs but financed much less than the target of 30% of its investment during REPELITA V (WB1994a). Consumers and governments receive subsidies at the expense of industrial users, and consumers in the Eastern Islands are subsidized by the uniform national tariff. The issues of full cost recovery, including a much higher rate of return on capital, and cross subsidization, will need to be addressed as PLN is privatized. Pressures to reduce cross subsidization will increase if, as is efficient, power suppliers are allowed to sell directly to large users through the grid. Peak load pricing is not now an issue because of excess generating capacity.

3.82 In **transport**, charges relating to road transport raise a number of issues. The basic fuel prices were raised to international levels in 1993, increasing efficiency as well as raising revenue. Efficiency could be further served by two simple additional charges: (i) structuring road user charges to reflect the relative impacts of vehicles on the roads and (ii) adding charges reflecting the environmental impacts of the various vehicles and fuels. Regarding user charges, higher diesel prices could be used to reflect the impact of truck use on roads. Vehicle fees also should be differentiated to reflect vehicles impacts on roads. Regarding environmental fees, a surcharge should be put on diesel to reflect the substantial particulate pollution it generates. Similarly, surcharges on leaded fuel prices would reflect the increase in lead in the atmosphere. Finally, congestion charges are another issue in road pricing. Toll road charges are, if anything, too high to allow them to provide sufficient relief from urban congestion. Congestion charges are becoming increasingly feasible and should be considered over the longer-term (Box 3.7).

3.83 In other areas of transport, international port and airport service charges are reasonable, but domestic services need some adjustment to cover full costs more closely. Passenger and freight services are generally in line with costs. The exceptions are urban commuter railroads and public bus service. Charges for these services need to be adjusted more frequently. Although a subsidy may be retained for the basic service level, higher prices for the higher service levels would be desirable to improve cost recovery from the better-off.

3.84 In **water**, average tariffs cover less than operations and maintenance costs in many areas. Moreover, water is becoming scarce in the dry season. The poor quality of water and the attempt to provide a large cross subsidy to consumers, most of whom are better-off than average (Box 3.3), has led industrial

Box 3.7: Giving Urban Citizens a Smoother Ride

Efficient development of Jabotabek and the other major population and industrial centers will depend on development of an efficient interurban transport network, to encourage efficient decentralization, and on efficient, non-polluting transport within the cities, particularly Jabotabek. Otherwise congestion and pollution costs in Jabotabek will rise to Bangkok's levels. To improve urban transport, the Government could:

(a) Improve urban traffic management—spend more on traffic management, remodel one-way systems, install synchronized lights, provide/enforce bus lanes, and require parking in new developments.

(b) Introduce urban congestion tolls, and provide adequate parking at commercial rates, to reduce congestion on existing and new roads.

(c) Encourage the use of cleaner fuels, through higher prices of diesel fuels, increased supply of non-leaded gasoline and taxes on leaded fuels, establishment of stations for compressed natural gas, taxing/banning of new 2 cycle engines/vehicles, and enforcement of emission exhaust standards.

(d) Improve urban sidewalks and routes for non-motorized vehicles to improve traffic management and provide for pedestrians and bicycles, transport modes that are used heavily by the poor.

(e) Privatize public sector bus operations that now absorb large subsidies to do what is already done reasonably by private services. Increase the autonomy of urban railroads.

(f) Adjust bus and railroad tariffs more frequently, raise tariffs for higher quality services.

(g) Encourage development of private and joint venture toll roads through greater competition and transparency in bidding for contracts: better prequalification, clearly stated criteria for award of contracts, reduced constraints on bidders' supply sources, indication of government's contribution, and announcement of the winning bid.

(h) Develop an effective mass transit system in Jabotabek, based on careful examination of economic viability and fiscal aspects.

and other users to rely on deep wells. This in turn has generated negative externalities in terms of sinking of land salinization and overexploitation of aquifers. Fees for well use are low and not enforced. Improved water service typically will require higher average tariffs to consumers, with a subsidy retained only for a minimum, "lifeline" consumption, preferably financed by the Central Government. At the same time, charges to industry could be reduced, accompanied by collection of much higher fees on well use. Better metering of water use could reduce "unaccounted for water" and encourage conservation, as occurred in Bogor, with no apparent effects on health.

3.85 **Subsidies**. Less-than-full cost recovery are often justified as protection for the poor. However, study after study shows that the better-off are the main beneficiaries of low infrastructure tariffs—the poor generally are not connected to the subsidized services and are forced to use high cost/poor quality alternatives—for example, candles and kerosene rather than electricity and gas, public standpipes or water vendors rather than piped water. For this reason, the poor often are willing to pay much more than the going tariff for good service. A classic example is water in Indonesia. The better-off usually have household connections while the poor do not; the poor are forced to resort to higher cost

supplies from vendors or from shallow wells that may be contaminated (See Box 3.3).

3.86 Carefully targeted subsidies can indeed protect the poor. The critical issue is to ensure that the subsidies really benefit the poor, rather than the middle and upper class, or the providers of the goods. One approach is a low tariff for minimal use (lifeline tariffs), and a much higher tariff for anything above this minimum. Linking low tariffs only to the lowest use targets the poor more effectively than across-the board subsidies or multiple, gradually rising tariffs, such as used in Indonesia. Access could be improved by allowing low income users to pay connection charges over time, as part of monthly fees.

3.87 Subsidies are best funded by direct, transparent, budgetary grants. This ensures that the amount of subsidy is well-known. Using cross subsidies in tariffs to fund subsidies, as is done in many countries including Indonesia, is easier, but it is much less desirable. Cross subsidies have negative effects on transparency and economic efficiency. In particular, the distortion caused by raising tariffs above service cost contributes to inefficiency. For example, it encourages inefficient use of resources to create alternative supplies, such as the reliance on wells instead of the water distribution network.

F. Improving Public Infrastructure Services

3.88 Indonesia's Governments will continue to play a major role in infrastructure services for some time. In some areas, externalities are important. In many other areas, private capital will not be interested for some time, in part because of the lack of a clear regulatory framework and the time it will take to establish a regulatory reputation. Most importantly, the public sector's enormous presence will not disappear overnight. Governments therefore, must deliver higher quality public infrastructure services in order to ensure efficient growth and reduce poverty. Achieving this goal will depend on abandoning the standard public sector model of infrastructure provision. Governments at all levels must treat services as a commercial activity responsive to consumers, with revenues that cover costs and greater autonomy and accountability, not as a bureaucracy. Services can be further improved by greater reliance on the private sector and encouragement of competition, and by providing greater voice for stakeholders in cases where the market is ineffective (Section G).

3.89 **Indonesia's public sector performance** has been better than in many countries. Nonetheless it suffers from many problems that are common worldwide. Inefficiencies in power and water sectors mean that capacity utilization is low (Boxes 3.1 and 3.3). Over-staffing and lack of maintenance are common complaints. Delays in purchasing, related to the annual budget cycle/DIPs process, mean that construction often is undertaken during the rainy season, and quality suffers. Bidding processes are not transparent and low bids are not necessarily selected; bidding processes usually include local content restrictions that raise costs.

3.90 Responsiveness to users could be improved. Access is limited and service quality poor in power, telephones, and, especially, water. However, access is improving in power and telephones as a result of increased capacity, reduced connection charges, and public phones. Lack of access/poor quality, and attempts to provide cross subsidies, have led to dependence on more-expensive self-generation of power (Box 3.1) and water from wells and vendors (Box 3.2). In telecoms, the public sector has moved slowly to expand cellular and wireless alternatives, until recently. To some extent, the lack of access and poor quality reflect lack of resources, which in turn reflects prices that do not recover full costs and attempts to provide cross subsidies.

3.91 The poor suffer particularly from many of these problems. Low tariffs for household use of water and power reduce the companies' incentives to expand services to poor households, or to maintain connections. Lack of resources, as well as inefficiencies, limit the expansion and the quality of piped water, forcing poor households to rely on expensive vendors or shallow wells that often are contaminated. Lack of public phones limits the poor's access to phone service.

3.92 To reduce these problems and encourage the public sector to deliver high quality infrastructure services, more investment is not enough. Institutions and incentives must be changed. Four main recommendations have been identified (WDR 1994 p.2):

Treat infrastructure as a service business that responds to consumer demand on commercial principles; the great willingness to pay, as shown by reliance on high cost alternatives, means that even the poor are willing to pay higher prices if they receive reasonable quality service.

Encourage more competition and involve the private sector, to ensure users have low cost alternatives and put pressure on suppliers to reduce costs and employ best practices.

Give users and other stakeholders greater voice and responsibility, where externalities are important or the discipline of the market/the legal system does not ensure accountability, in the planning, operation, and regulation of infrastructure services.

Improve policy, regulatory, and legal frameworks to protect the public interest, the poor, and the environment and to coordinate cross-sectoral and sub-sectoral interactions, whether the services are public or private, with priority emphasis on areas where markets are weak.

3.93 Common reasons why government department and public sector firms perform poorly as service businesses are: i) numerous, vague objectives, which are sometimes inconsistent, rather than a few well defined objectives such as user coverage and quality of service; ii) limited autonomy over input and output costs and personnel that limits managers ability to respond to incentives; and iii) financial problems related to inefficiencies and politically motivated limits on tariff adjustments (Section E), according to World Bank studies. (WDR 1994, p.39). Thus, a first step to improve these entities' performance would be to focus them on few, well-defined and measurable objectives, related to service delivery; give them greater autonomy in setting prices, buying inputs, and deploying resources to achieve these objectives; and hold their managers responsible for achieving the objectives.

3.94 **Corporatization** of government departments, as was done in Indonesia and Malaysia with ports, represents a further step. As corporations, the entities' activities are subject to corporate, rather than civil service rules, and to more commercial accounting procedures. These changes can help reduce labor problems and improve managerial and labor performance, as well as provide a clearer picture of financial problems and the level and targeting of subsidies. However, these changes are far from cure-alls. Corporatization typically takes time as the Indonesian port case shows. Gains in efficiency have varied with Malaysia's ports showing one of the largest improvements (Galal et al). All government departments may not be easily "corporatized", although New Zealand has even corporatized highway spending.

3.95 **Performance agreements** could be used as a further step toward improving performance for entities that remain in the public sector. Performance agreements were first used in France and applied in the developing world in Korea, Brazil, Mexico and Africa. An information system generating quantitative indicators such as profitability, productivity, physical outputs and coverage must be developed. The system is then used to evaluate performance; the managers and workers in the

highest performing entities receive public recognition, bonuses and advancement, while poor performers can be terminated. Clearly, many of these rewards will depend on the firms being outside the civil service. Korea probably has achieved the most success with this approach. (WDR 1994, p. 43). In Indonesia, there are some examples of performance-based rewards that could be extended. In South Sulawesi, foremen are given responsibility for maintaining a fixed stretch of provincial road, and prizes are given annually for the best maintained. Indonesia's well-publicized competition for the cleanest city has had a noticeable success in encouraging local officials to keep the streets clean.

3.96 **Unbundling Public Enterprise Functions**. Public enterprises have taken on many activities that are not natural monopolies and are related only marginally to their basic business. For example, publishing, health care and recreation for employees, equipment supply, construction, etc., all could be supplied by private firms. Unbundling these services and allowing them to be supplied under more competition would improve efficiency. First, the public sector firm could then concentrate on basic functions, and not be distracted by peripheral activities. Second, while in some cases efficiencies may result from the combination of activities (economies of scope), generally speaking unbundling activities can increase competition in the unbundled sectors, which reduces costs to consumers and provides better quality services. Finally, unbundling can make transparent the cross subsidies that exist within the firm, allowing these cross subsidies to be evaluated better, and to be focussed more narrowly on the poor.

3.97 **Operations and maintenance contracts** are one way that many countries have used to unbundle services and improve quality at lower cost. This approach has been used in France, the Philippines and many African countries, for example, in water and sewerage (WDR 1994). The contracts usually base compensation on improvements in specified indicators. (Fixed fee arrangements are similar to consultancies and offer little incentive for improvements.) The contracts have been most successful where the manager has autonomy over a broad range of decisions and compensation; they often fail where autonomy is limited. Such contracts may serve as an interim to fuller reliance on private participation. Such contracts could be tried in Indonesian water and sewerage operations.

3.98 **Public Works by Private Contractors**. Indonesia has used private contractors for construction contracts for some time. Public firms compete for contracts with private firms. This represents a major improvement over construction by a public works monopoly. However, Indonesia's system could be improved further. Contracts sometimes are not offered to low bidders. The contracts could make better use of penalties for overruns and poor quality, and bonuses for early completion. The Government also could reduce costs by not requiring contractors to buy from particular suppliers. Public payments on contracts need to be more timely; a reputation for slow public payments will lead to higher bids (to compensate firms for their borrowing costs). Surveys suggest that the Government may pay more than the private sector for similar construction, in part because of its slow payment record.

3.99 **Greater use of leases/concessions of "natural monopolies" and other public services** is possible in Indonesia. With leases, the leaser bears the risks of operation, but not investment. The leaser is, however, required to return the capital in reasonable condition. With a concession, the concessionaire also could be obligated to make certain investments. Leases/concessions of one sort or another are now being used in thirty-seven countries (WDR 1994, p. 60). Ports, toll roads, and bus services are a common type of concession, in countries as diverse as Argentina, Hong Kong, Malaysia and Mexico. In the water sector, concessions and leases have been used in Africa and, recently, in Argentina; as well as service contracts for meter reading and billing (Chile) and management contracts (see above) (WDR

1994, p. 61). Concessions are being used in Indonesia for telecoms and leasing or concessions could be used in the water sector. The main issues are i) appropriate specification of performance levels and penalties for non-performance, ii) maintenance of the leased capital stock, and iii) competitive bidding for the lease/concession.

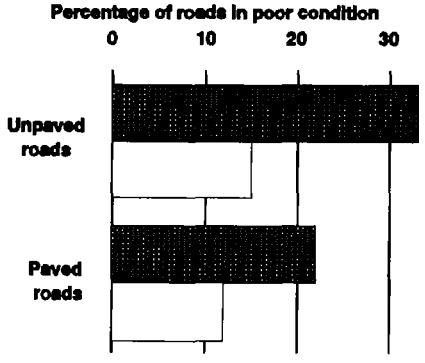
G. Giving Stakeholders a Voice: Decentralization and Participation

3.100 For most goods, markets provide a way of matching demands and costs efficiently. However, for some infrastructure goods, markets do not work well. Externalities like pollution are not reflected in market prices. Or it may be hard to charge (non-excludability) for the services. These classic "public goods", need group decision making on the amount/type of infrastructure, pricing, and operations and maintenance in order to ensure efficiency. Centralized public sector bureaucracies usually have not provided these goods efficiently. Services are too much or too little, too early or too late. Local conditions are neglected in design. And maintenance often is neglected. The closer the decisions to the main beneficiaries, the more likely the infrastructure will match consumer demands.

3.101 **Decentralization** often can improve provision of local infrastructure services, because it gives a greater voice to the users and stakeholders. Closer proximity to the main beneficiaries and closer links between costs and benefits, raise efficiency, improve service delivery and increase accountability. Experience in a number of countries—Bolivia, Ecuador, Philippines, Mexico—suggests that such decentralization can be effective. For example, Bank studies suggest that water cost are lowest when systems are decentralized under central coordination; a Bank review of road maintenance found that decentralized maintenance of local roads reduced backlogs and improved road conditions. In Mexico, the Solidaridad program executed projects locally at one-half to two-thirds the cost of state or federal projects (WDR 1994, p. 74).

3.102 Decentralization is not a cure-all, however, its benefits depend on how it is done. The most important principle is that decentralization of services must be done to a level that captures most of the externalities. For example, local roads, and local flooding need input from villages. Intra-village roads, water supply and waste disposal may also need provincial input because the spillovers may go beyond individual villages. Water basin management and intra-provincial roads require national management. Decentralization to government levels that are so small that they do not encompass all the benefits of "local public goods", or so large that they go for beyond the beneficiaries, may not yield much improvement in delivery. In addition, for complex investment projects, the benefits of decentralization tend to decline, because the costs of training all levels of government to handle very complex projects would be inefficient.

Figure 3.6: Countries with Decentralized Road Maintenance have Better Roads



Source: World Bank data for 42 developing

3.103 Efficiency gains from decentralization also are affected by how investments are linked with revenues. To be efficient, decentralization must entail a decentralization of revenues that are linked to the services. To the extent that beneficiaries do not pay full costs, they may demand costlier services to be paid for by the general tax payers, to the detriment of economy-wide efficiency. This tendency is confirmed by some studies. For example, in the review of road maintenance cited above, the decentralized systems tended to have more paved roads. Moreover, to the extent that local officials can induce non-local residents to pay for services—nicknamed the "grantsman" approach to local government finance in Chile (World Bank 1993a)—local officials spend their time raising money outside the locality, rather than ensuring efficiency of services. Another example is India, where periodic lobbying associated with Finance Commissions' awards to state governments is a major activity of governors. These problems can be eased to the extent that local areas pay part of the costs—a signal of demand and an incentive to use funds (at least local funds) more carefully. Even in poor areas, a link is important to improve service quality and accountability, because of their lack of resources. (See Annex to Chapter 3). Local "grantsmen" can be limited by Central Governments' scrutiny of projects that use "national funds". However, the bureaucratic rules to carry out that scrutiny may limit the ability of decentralization to adjust to local needs, and therefore the benefits of decentralization.

3.104 In Indonesia, the Government is decentralizing many responsibilities to the provinces and kabupatens. Central Government transfers are increasingly provided on a block grant basis. The Central Government has eliminated its share of property tax revenues, retaining only a 9% collection fee. Under a recent pilot initiative, Central Government bureaucracies are moving down into 26 kabupatens. All Central Departmental district offices (KANDEP) are being dissolved and their authority transferred to the concerned local office (DINAS). The "mayors" and district heads thus will become the focal points of government in these kabupatens. The Government plans to monitor these pilots and use the lessons to eventually decentralize in other areas. Despite these efforts, however, provinces and kabupatens lack resources to carry out their own programs and to maintain central projects that are turned over to them (in part because of low per capita income). Moreover, infrastructure project design, implementation, and procurement remain central government functions in many sectors. An example of the way things work is roads: typically a department in public works takes a decision to build based on some discussions, usually one-way, with local officials and some input of data, based on standard central designs. There is no second round of local feedback, nor are kabupaten officials well prepared for the impacts that these roads will have local development. These problems are complicated by the lack of clear land titles in most areas.

3.105 In Jabotabek, on the other hand, decentralization has fragmented jurisdictions. DKI Jakarta is a level 1 government that contains non-autonomous level 2 governments. Surrounding areas are level 2 kabupaten governments, with structures and capabilities geared to rural not urban development and the level 1 West Java government has many other interests including Bandung and Cirebon. Overlaying these problems are the above

mentioned problems of Central Government ministries dealing with kabupatens in the regions. Coordinating bodies do exist, but do not appear to be functioning well. The Central Government is concerned with rural and regional development outside Jabotabek, but it cannot find a coordinating body to deal with issues that should be region-wide such as mass transit, roads, land use, sewerage and solid waste management, and water basin management. In these areas, individual governments such as DKI Jakarta can take decisions, but cross region externalities are not taken into account fully. The Central Government typically ends up heavily involved with the decisions, such as mass transit. Resolving the need for a strong, regional authority to deal with these issues would yield substantial benefits but will be very difficult, if experience elsewhere is any guide.

3.106 **Participation and public accountability** increase the benefits of decentralization. Studies by the World Bank and other donors show that "without local participation, projects either have floundered at the implementation stage or were not maintained and failed to produce substantial benefits." (WDR 1994, p. 76). With participation of beneficiaries, project performance is much better. This is particularly true for rural projects. But participation, combined with technically innovative solutions, has led to benefits even in locally-focused urban sewerage projects such as the Orangi Pilot project in Karachi, Pakistan (WDR 1994, p. 83).

3.107 Participation has three key elements. First, it means involving beneficiaries, not just consulting with officials and voluntary organizations. (In a study of water supply projects, participation was strongly correlated with project performance, while consulting solely with officials and voluntary organizations did not seem to improve project performance much). (WDR 1994, p. 76-77). Second it means reaching early consensus on user needs, which can improve consumer satisfaction and reduce capital costs as well as improve maintenance. For example, studies of rural roads in Korea indicate significant savings. In Indonesia, traditionally strong village organizations are given various options under the Water Supply and Sanitation Services for Low Income Communities project (WSSSLIC See Box 3.8). Third, it means obtaining local contributions, in cash or kind, as a signal of commitment and to reduce "grantsmanship". Examples are WSSSLIC and Mexican irrigation, where conversion of irrigation management from a state company to water user associations led to users' voluntarily raising assessments to improve maintenance and more efficient water use (WDR 1994, p. 78). In Indonesia, on the other hand, irrigation maintenance is largely provided centrally. Although maintenance has improved, estimates suggest it is probably still too low.

3.108 As with decentralization, participation is not a cure-all; benefits depend on how it is done. It is most effective with small scale projects that are initiated, or have strong support from small, well-defined communities that receive most of the benefits and have limited spillovers. Works that benefit larger groups, such as construction or maintenance of feeder roads, as opposed to access roads, require much more effort to organize and mobilize larger groups. Support may be hard to generate and sustain because of the wider diffusion of benefits. Village works that have negative spillovers into neighboring villages, such as waste disposal and sewerage, require governments to manage the inter-village costs and benefits. Works that require technologically complex design benefits and implementation are not well suited to local participation. Indeed, even village works such as access road usually can benefit from design suggestions by technically trained personnel. Recent programs to improve infrastructure in "lagging" villages in Indonesia have made conscious efforts to deal with the design issue in a participatory way (See Box 3.8). Finally, there are risks that special interests, local elites, or powerful minorities can capture the process for their own benefit.

3.109 Participation also requires substantial changes in approach and is far from costless. Technological innovations may be needed, such as with the water pumps designed by UNICEF for operation in contaminated pools of water. Governments and donors often have to modify their approach, for example switching from detailed description of design and delivery systems to broad principles of service delivery, with the details to be developed on-site. Participation also depends on substantial inputs of time, to interact with the local organizations, explain the technological options, mediate disputes, and monitor and adjust programs.

Box 3.8: Delivery of Rural Infrastructure in Indonesia Through Participation: WSSSLIC and Infrastructure for Lagging Behind Villages.

Indonesia's strong rural village organizations have a tradition of providing and maintaining simple infrastructure. Government infrastructure programs are beginning to use these organizations to improve the quality of local public goods.

The Water Supply and Sanitation Services for Low Income Communities (WSSSLIC) program, supported by the World Bank, is the first large project that is community based and demand driven. The design builds on the experience of NGOs and Government grant activities. Under the WSSSLIC program, village water and sanitation committees act as decentralized water utilities. The committees dialogue extensively with project staff. They choose alternative levels of water and sanitation services from a set of tested technical solutions. The choice depends on the amount the village is willing to contribute over and above the basic funding provided by the Government under the program. The village committee is expected to manage the water and sanitation system on a sustainable basis, using community resources. The project now covers 1440 low income villages in 6 provinces and is expected to invest $120 million over five years.

A new Government program will provide infrastructure to "lagging" (IDT) villages, with support from the World Bank, ADB, and OECF. The programs rely on participation in various ways; on Java, the village committees choose the type of small infrastructure projects that they need most—access roads, suspension bridges, water, sanitation, etc. An engineer, assigned to a number of contiguous villages, provides the agreed-upon design following basic technical manuals, authorizes disbursements from local banks, certifies project quality and helps with training for future maintenance. Information about the project has been broadcast widely on rural radio stations and, when the project starts, accounts will be posted in the village. The Government provides a grant for each village, disbursed against work performed. An incentive fee encourages villagers to contribute their labor and help the grant go further. The program complements the Government's on-going IDT grant program of Rp. 20 million per village.

Annex to Chapter 3
Urban Infrastructure: A Case Study [7]

3A.1 **Overview.** The dimensions of the urban challenge facing Indonesia are well known. Although, like most other Asian countries, the share of urban population is still not as high as in other parts of the world, the pace of urban growth is very rapid. At 5.4% p.a. during the 1980's, it is among the highest in Asia; the 1990 census reported 55 million people living and working in urban areas and this figure is likely to reach 90 million by the end of the decade. Population in settlements around major cities, are growing at explosive double-digit rates. Rural-urban migration is only part of the story as in-situ urbanization of previously rural areas is equally significant, at least in Java.

3A.2 With only 32% population in urban areas, compared to an average of 62% for low middle income countries, a rapid pace of urbanization is not only inevitable but also intimately related to the high rates of economic growth and diversification in Indonesia. There is considerable scope for urban development to support, indeed promote, productivity enhancing economic activities and to improve the quality of life. However, this positive linkage between urbanization and improvements in productivity and welfare is beginning to fray under pressure in several parts of the country.

3A.3 Urban concentration, with its attendant diseconomies, is already excessive in some areas. Jabotabek ranks as the world's fifth largest metropolitan area. Between 1980 and 1990, it grew the fastest of the ten largest Indonesian cities. Jabotabek has an unusually high percentage of the country's urban population (30%) and of industry (34%) by international standards. Within the Jabotabek metropolitan area, over half the population live outside Jakarta, while in Jakarta's center population density is among the world's highest.

3A.4 The Government has a major role to play in the urban setting. On the institutional side it regulates land use. On the infrastructure side water, waste management, flood control, and roads traditionally have been government functions because of their externalities, in terms of pollution and negative spillovers, and the difficulties of charging for the services (non-exclusion) in some cases. Since the costs and benefits of these market failures are largely local, efficiency considerations suggest that local governments and institutions should play a major role in these services.

3A.5 The Government has invested significant amounts in urban infrastructure during the last decade but found it difficult to keep pace as cities and towns absorbed some 70% of the total population growth during the 1980's. As a result, and compounded by inadequate maintenance, service levels could not improve much. Only about 20% of urban households have piped water; public sewerage coverage and solid waste management are negligible; drainage and flood control remain problems; and transport facilities are inadequate.

3A.6 International comparisons suggest that urban access in Indonesia to safe water and sewerage is much lower than in the Philippines, Thailand or Malaysia, although these cross-country indicators are not fully comparable (WDR 1994, WB1993b). Moreover, as individuals have relied on the private solutions of wells, septic tanks, rivers and canals, negative externalities are developing. Ground water and rivers are increasingly contaminated—in Jakarta a (small) recent survey showed many shallow wells were contaminated with fecal coliform (JICA,

WB1994f). Sea water intrusion is affecting coastal cities' aquifers. Competition for groundwater in the dry season is developing between residential and industrial and agricultural uses (WB1993b, 1994f). Industrial and solid waste disposal is also handled privately. However, it is often dumped into canals and rivers where it causes clogging that leads to flooding and contamination of groundwater, rivers and bays, or transferred to uncontrolled dumps where chemicals leach into ground water and burning pollutes the air (WB1993b, 1994f). In transport, although inter-urban rush hour speeds are similar to corresponding East Asian cities (WB1993b), all these cities are developing well-known transportation, congestion and air pollution problems. Particulate air pollution exceeds WHO standards 173 days a year in Jakarta versus an average of 153 days in 15 Asian cities (WB1993b, 1994f); 2 cycle motorcycles and diesel vehicles are major culprits. Lead pollution may be becoming an issue in some of the larger cities, as it did in Mexico City.

3A.7 Currently, the benefits of urban infrastructure largely go to the upper half of the income distribution. For example, piped water currently is available to 91% of households spending more than Rp. 700,000 p. mo., compared to only 10% of households spending less than Rp. 100,000 p. m.(WB 1993b). And much of the benefit of standpipes, which are intended to serve the poor, may be siphoned off by caretakers or vendors. Road investment tends to benefit car owners, who are much wealthier than average, and industry, particularly since sidewalks are neglected. Air pollution and lack of good piped water tends to harm the poor more, because of where they live and their dependence on shallow wells or high cost vendors. All this suggests that while urban infrastructure services are important for growth, it also is important that beneficiaries pay for them, for distributional as well as efficiency reasons, and that greater efforts are needed to improve the access of the poor to services.

3A.8 To continue to grow rapidly, Indonesia needs to develop an efficient city network and cities that work well internally. The fundamentals for this are: a) a transport network that links the cities together; b) a substantial increase in urban infrastructure investment; c) a corresponding increase in local resources: property and other taxes and improved use of fees for services, which also would improve efficiency; d) improvements in public sector performance and more reliance on the private sector; e) institutional development, including decentralization, reduced complexity, and clearer assignment of responsibilities; and f) resolution of other institutional issues, the most important of which are governance of Jabotabek and land titling.

3A.9 The Second Long-term (25 year) Development Plan (PJP2) and REPELITA VI emphasize sustainable urban development through improvement in the quality of the living environment, support for economic growth, reduction in regional imbalances and poverty alleviation. In addition to the fundamental requirements of an efficient transport network linking population settlements and a substantial increase in urban infrastructure investment, the Government's aims translate into the following five operational objectives.

(1) **Poverty Alleviation** through reduction in the large backlog in the provision of urban infrastructure services, both by expanding access and capacity as well as by improving the efficiency of utilization of existing assets through better management, improved maintenance, correction of imbalances, and waste reduction (e.g. unaccounted-for-water).

(2) **An Improved Urban Environment** which will reverse the deterioration that is now occurring at a quickening pace particularly in larger urban centers, much of it related to water, sanitation and waste disposal. Air pollution is also increasingly serious, particularly due to rapidly rising levels of motorization and road congestion.

(3) **Enhanced Urban Productivity**, especially aspects related to agglomeration economies, is being threatened by traffic congestion, and requires better integration of economic and social functions of cities in their spatial organization and the transport networks within and around them.

(4) **Substantial and Sustained Increase in Financial Resources** is necessary both for investment as well as maintenance. Notwithstanding possible increases in central government funding, more efficient spending, and the scope for greater private sector participation, this requires more effective municipal finance policies and mechanisms to mobilize resources and recover costs effectively and equitably.

(5) **Institutional Development particularly at sub-national levels**, which is perhaps the biggest challenge because the scale and complexity of the urban effort is so vast that the central government can do little more than set policies and maintain a broad oversight role. More effective decentralization requires further articulation of policies, clearer definition of functional responsibilities and relations between different agencies and tiers of government, greater balance between resources and responsibilities, adequate management systems and procedures, as well as accumulation of requisite skills through training and experience.

3A.10 **Public investment in urban infrastructure** was only about 0.4% of GDP in REPELITA V, less than 10% of total infrastructure investment.[8] This represents an average of less than $10 per capita in urban areas per year. Real expenditures rose sharply with increased foreign assistance for urban projects in the late 1980s, but then slowed as these loans completed disbursement.

3A.11 Spending during REPELITA V appears to have been much less than planned. Central Government spending was less than projected, reflecting tight budgets, lack of local counterpart funds, and implementation problems. Local Governments were unable to finance the large increase projected in their spending—60% of the spending compared to 25% in REPELITA IV. This was to come from leveraging local borrowing (initially constrained by limits on borrowing) on a projected large revenue increase. In actuality, local governments financed about the same portion of (the lower actual) investment as in REPELITA IV. Finally, projected private water investment did not materialize.

3A.12 Projected (real) urban investment in REPELITA VI represents a needed, massive increase over REPELITA V outcomes and the sectoral distribution appears reasonable. A substantial increase in maintenance spending also is needed; persistent under-spending on maintenance has resulted in short lives for investments. However, the Central Government's tight budgetary situation is likely to limit its funding of local infrastructure. In any case, for reasons of efficiency and equity, discussed above, it would desirable for local governments and institutions to provide more of their own funding. Hence, a major, on-going constraint to needed higher investment appears to be local institutions' financing and implementation capacity. Although borrowing constraints have been eased, this is only a temporary solution unless local governments' and PDAMs' revenues increase sharply. The other major issue is the large proposed private participation in water, which is hindered by lack of a clear legal framework and difficulties of negotiation between most PDAMs and the potential bulk water suppliers.

3A.13 **Local revenues** are low, limiting local governments' ability to invest and provide counterpart funds. The main source of local tax revenue in most countries, property taxes, have a low effective rate of only 0.1% of self-

Table 3A.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 Prevent.& Drnge.	1.9	1.2	3.6
Sewerage & Waste	1.2	..	5.4
Kampung Impr.(KIP)	0.7	0.2	1.1
Memo:			
Ave. Expenditure p.a., [b] (000 1990 Rp. per person living in urban areas)	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: WB 1994a, p. 45; WB 1993b, pp. 47, 132.

assessed value in Indonesia.[9] Because of low assessments and the low rate, taxes on urban property amount to only 0.1% of GDP. Taxes per capita are about $17 in Jakarta and $2-3 in other cities, the latter is very low compared to the average of $17 in selected municipal areas in developing countries (See Bahl and Linn). The term property tax is something of a misnomer, however; the tax is largely a tax on mining, which represents over 50% of the revenues, versus 26% for urban property. Even Jakarta receives 10% of its revenues from mines! (Qureshi and Shah).

3A.14 Higher property taxes, a simple, although politically difficult, measure, would raise revenues to more closely match infrastructure needs on a decentralized basis. Higher property taxes also would have some macroeconomic efficiency benefits, since urban property currently is undertaxed relative to other sources of income. The first step could be a doubling of the assessment rate, which can be done administratively. Next, improved assessments are needed particularly outside Jakarta; the estimated urban base is at least twice as large as the self-assessed base (Shah and Qureshi, p. 125). The administrative reforms under the Sistem Management Obyek Pajak and the Nomor Obyek Pajak are likely to improve the base. It also would be helpful to develop well-publicized standards for valuing and annually adjusting market values of property. Closer coordination between property tax collection and the agencies/institutions concerned with acquisition, transfer, construction and lending for property also would improve the base. For example, audited properties could be required to produce loan documentation from their bankers, a process that also would help cut down on overvaluation of properties for borrowing purposes.

3A.15 Another solution, betterment levies for small urban works, has been used in Bogota Colombia and with less success in Jakarta and Korea. The levy's performance could probably be improved by greater participation/consultation with property owners on the improvements, developing and publicizing a system to provide quick construction for those ready to contribute, and direct payments of the levy to banks (to reduce the opportunity for collusion) with appropriate sanctions beginning with publicity for non-payment. (See Shah and Qureshi and Sukarman)

3A.16 Better pricing/cost recovery, would improve efficiency as well as raising revenues. **Water** firms' need to raise their charges and simplify their rates. Subsidies should be reduced sharply, they currently go largely to the better-off because access is limited and the poor have to pay vendors high prices for their water (Box 3.3). At most, a "lifeline" consumption of the first 10 or 15 m^3 could be subsidized. Moreover, any subsidies would probably best be funded centrally, through transparent, well-defined and focussed transfers. Competition from well water puts an upper bound on what can be charged, and has some externalities (depletion of aquifers, salinization) so the fees for groundwater usage, particularly for large, deep-well users, should be raised substantially and enforced much better. Charges for standpipes should be raised to eliminate scarcity values that now often go to the custodian (See Box 3.3). Connection charges should be raised (to eliminate the current scarcity value that now often goes to employees), better publicized, and spread out in the first monthly payments. To improve the efficiency of **transport** pricing, taxes on fuels should be imposed to reflect costs of maintaining the road network and environmental damage by raising diesel prices substantially—diesel powered vehicle generate substantial particulate pollution and account for most the deterioration of roads. Motor vehicle taxes on motor vehicles could be adjusted to reflect vehicles' impacts on roads and divided between the province and kabupatens based on maintenance requirements. Congestion charges/parking fees should be imposed to reduce congestion.

3A.17 Improvements in public sector urban infrastructure services, will depend on running these services more like commercial firms, focussing on providing services to users. In **water**, raising fees will help. Firms also need to focus more on distribution, maintenance, and reducing water loss (see below). Firms need to improve access of standpipe users, for example by stimulating participation of local users and agreeing to remove the custodian (and lower charges accordingly) provided the local users group pays the charges and manages the standpipe. Maintenance expenditures need to be increased substantially and transfers to local governments from the firms need to be redefined to permit much higher levels of capital spending and maintenance. Personnel policies need to be improved, by raising salaries, training, and better career opportunities. Finally, as discussed below, greater reliance on the private sector could be used to improve service, provided costs can be covered. In **urban transport**, a classic public sector area because of externalities of urban roads, improved maintenance is needed and greater attention could be paid to upgrading. This could be furthered by allowing fund transfers from central and provincial governments to be used for these purposes. Substantial returns also could be obtained from better traffic management—more resources, remodeling of one-way systems, more synchronized light systems, more bus lanes, and requirements on parking availability in new developments. Finally, the railroads serving urban areas could be given greater autonomy and "corporatized".

3A.18 The private sector could play a much larger role in urban infrastructure, which, if managed effectively could improve service delivery substantially. In **water**, use of

incentive contracts for services and management, as well as leasing and concessions could handle billing and collection, water losses and operations and maintenance. Private operators could be used more for water production, again through appropriately designed contracts. In **transport**, it would be desirable to privatize the remaining public urban bus services. Incentive contracts might be used to privatize maintenance. Greater use of transparent bidding for road construction would help lower costs. Toll roads may relieve some congestion for intra-urban trips, although they also tend to increase suburbanization that leads to "peak-load" problems on urban roads. Bidding on toll roads could be improved by greater use of prequalification, clearly stated criteria for award of contracts, fewer constraints on bidders' supply sources, and clearly indicating Governments' contributions. The private sector could also participate in mass transit, again through transparent bidding processes.

3A.19 **Major institutional issues** include institutional complexity and under responsibility, land titling and governance in Jabotabek. The institutional complexity inherent in the current fragmentation and overlap of investment, operational and regulatory responsibilities leads to poor policy definition, inefficient investment, capacity imbalances, unclear assignment of responsibility and accountability, and difficulties in private participation. Improvements would come from rationalizing sector management, reducing institutional complexity and assigning responsibilities better by clarifying roles, functions and authorities. The central government should shed implementation to lower tiers of government, public enterprises, and private operators, except as warranted by prudent management of public borrowing. The central government should focus on establishing national policies and sectoral regulatory frameworks, developing technical and financial standards and procedures, and giving technical assistance and guidance to lower tiers of government.

3A.20 Poor land titling is a major problem. Without better land titling, markets (land, credit) cannot function well and improved property taxation will be difficult. Individuals are subject to uncompensated expropriation and collateral becomes a problem for mortgages. Taxes cannot easily be imposed. (However, smallholders often try to pay taxes to develop titles in the absence of existing titles.) Lack of titles also have strong negative implications for efficiency of cities. Without titles a spatial mismatch is likely to develop as industry decentralizes and workers cannot sell off their assets to follow jobs. As the central city loses employment, wages will fall. Residents will demand infrastructure to connect them to the new job locations, leading to higher investment, longer commuting times, and increased congestion. The Government needs to perform its basic function of providing security of property by providing land titles to urban residents as soon as possible.

Endnotes

1. The figure is based on the 1983 base income; with the 1993 base, Indonesia would move to the right, but still remain close to the East Asia trend line.

2. These are the sectors for which comparable data is available over time and across countries. As noted, Repelita V figures exclude private power investment for self generation. In addition to these sectors, urban sewerage, flood prevention and kampung investments are projected at about $5 billion and there may be spending for Jakarta mass transit (See Annex Chapter 3). For cross country comparability, the transport figures reported here exclude new ships and planes as do the sources cited; adjustments were made in World Bank sources on Indonesia to exclude ships and planes.

3. Estimates in this paragraph are based on Indonesia's new 1993 based national accounts, which is about 10% higher than the old GDP in 1993; ratios to Indonesian GDP in previous years are estimated downward by 10% for comparability. All estimates exclude ships and planes, and urban investment other than water and roads, to maintain comparability across countries.

4. This figure allows for full implementation of urban sector investment (Annex Chapter 3).

5. Infrastructure investment was of course financed off-shore in many earlier periods. In the 19th century, British markets provided finance for canals and railroads in the US, Canada, and elsewhere; British and US markets provided finance for Latin American infrastructure. Foreign investors controlled much of Latin America's electric power and telecommunications well into the 20th century. In the 1970s, bank loans to developing countries supported investment after the first oil price rise (WDR 1985).

6. Domestic currency bonds must bear competitive interest rates that reflect expectations of inflation, and in open capital accounts such as Indonesia, depreciation, plus a premia for risk. The premia for risk is even greater if the bond bears a fixed interest, which shifts the interest rate risk to the lender. Under these circumstance, floating rate bonds often develop. Indexed bonds such as are used in Chile, or foreign currency bonds (which effectively are indexed to depreciation) also may develop, to reduce the up-front cash flow problem that high nominal interest rates entail. However, borrowers may not want to issue fixed interest rate bonds because of their the large up front cash flow cost implied by inflation, depreciation, and risk, while lenders may not want to buy fixed interest bonds, because of the risk of default. Not surprisingly, fixed rate bonds are scarce in such societies, or bear below-market rates and are absorbed by public pension funds as an effective tax on the pensioners.

7. Based on WB 1993b.

8. Estimation of urban investment is difficult because it is not separately identified in the Budget and Budget categories have changed over time. The Central Government provides resources for local infrastructure investment through direct investments (DIPS) and transfers to the local governments under the general INPRES' program and the Special Purpose INPRES for local roads. (Local personnel costs are largely covered by SDOs). Recently, the Central Government has shifted its transfers toward bulk grants, giving provincial and local governments greater latitude in allocating funds. Local government's and PDAM's resources come from taxes, fees and borrowing from either the Regional Development account or subsidiary loan agreements with foreign donors, both administered by the Ministry of Finance. The Home Affairs Ministry imposes borrowing guidelines on the local governments and PDAMs to avoid excess borrowing. Of course, the fundamental limit to borrowing capacity is limited revenue generation. Finally, the Central Government and the local institutions fund operations and maintenance.

9. Property taxes are assessed and collected by the Central Government. The Central Government keeps 9% for collection costs and returns the rest to the provinces (18%) and local governments (73%). The tax is 0.5% on 20% of self-assessed values, the lowest legal assessment ratio.

4
TRANSITION CHALLENGES IN THE HEALTH SECTOR

A. Introduction

4.1 The health sector provides an example of the transition challenges in improving human resources and the role of the public sector. Good health is vital to well-being. It also contributes to greater productivity and economic growth. Better health reduces production and income losses caused by illnesses, increases the ability of children to attend school and learn, and reduces the costs of treating illnesses. For the poor, gains from better health are even more important. They face a much larger burden of illness, depend on daily labor and have little savings to cushion income losses from illness.

4.2 The Government has important roles in ensuring better health. The three most important are to: (a) provide preventive health services which have large positive externalities; (b) provide a minimum essential package of clinical health services, especially targeted at the poor, of reasonable quality, affordability and responsive to needs; and (c) encourage more efficient private services, by appropriate regulatory and supporting policies. If these roles are effectively undertaken, the gap in better health does not need to be as large as it currently is. Health outcomes in Indonesia, as measured by life expectancy (of about 62 years), child mortality and maternal mortality—key indicators of community health—are poor. Most of the causes of deaths and diseases would be preventable by more effective health services. Sri Lanka or China, countries with per capita incomes of less than US$500, have achieved a life expectancy at birth of about 70 years, which is only slightly less than that in the United States (76 years). Costa Rica, or Chile, with per capita incomes nearly one-twentieth that in Switzerland, have nearly the same life expectancy at birth as those in Switzerland (78 years).

4.3 This Chapter discusses the role of the Government, and the main public health priorities in Indonesia, in Section B. The trends in the level of public health spending, and their allocation, are then discussed in Section C. The main causes of deaths and diseases, and comparative outcomes on health are highlighted in Section D. The health delivery system is analyzed in Section E. The last section, Section F, discusses ways to improve the quality of public health services, the public health workforce, medicine pricing and availability, and private health services.

4.4 The main messages of the Chapter are:

- **Increase public health spending, focused on essential health services and the poor.** Public spending on health is low (about 0.7% of GDP, compared to 2.0% of GDP in all developing countries). The Government needs to spend more on health, to assure an improved level and quality of basic services and complementary inputs (e.g., safe water and sanitation). The Government is aware of these needs, and intends to raise spending progressively.

- **Reach the Poor.** Health services for the poor need to be improved. Spending on health centers and sub-centers, that are more effective in reaching the poor, needs to be increased, and incentives for public health personnel to treat the poor need to be improved.

- **Improve the quality and efficiency of basic public services.** Reforms in the functioning of front-line health facilities are needed—towards improving their management, providing them with more resources, changing staff incentives, establishing quality assurance programs, and encouraging more community outreach programs. In regard to health staffing, policies should be geared to meeting local needs and demands, with more authority given to local governments and public facility managers responsible for district services. Adequate staffing of remote and rural facilities will need attention, as will entry requirements, selection and training of *bidan desa* (village midwives). In addition, the contract doctor scheme may need re-evaluation. The Government's promise not to compel recruits to serve in remote areas may conflict with the current use of the mechanism to guarantee an adequate supply of doctors in the Eastern Islands.

- **Improve supplies of medicine.** More medicine supplies (and lower-cost public procurement) are needed in public facilities. Better dispensing practices also need to be considered. Private producers need to be encouraged to become more competitive, by continued deregulation of the pharmaceutical sector to lower costs of medicines to consumers.

- **Encourage private medical services and improve standards.** Private medical services should be encouraged through greater use of non-profit organizations to deliver public health services; private health insurance, rather than Government-provided health insurance should be encouraged; existing regulatory mechanisms of accreditation, assessments of medical schools, curriculum reviews, licensing and student examinations should be used to raise the quality of medical personnel; and the Government should prepare appropriately to deregulate private health services to permit the entry of foreign medical practitioners and health management professionals. The Government has recently announced that it will permit joint ventures with foreign partners to establish private hospitals.

B. The Government's Role in Health

4.5 Governments in developing countries typically account for about one-half of total spending on health, and private health services account for the balance. Its role, however, extends beyond financing, and has profound effects on people's health.

4.6 Three principal rationales justify the Government's role. The first is that it should carry out those essential activities that the private sector cannot or will not do: some types of health investment may have large positive externalities, and these investments may be undersupplied in the absence of public investment. There are a number of such activities, such as epidemiological data collection; monitoring and evaluating key health outcomes; planning and establishing responsive health systems; investing in water supply and sanitation; establishing communicable disease control programs; undertaking public immunization, nutrition and universal child and maternal care (including family planning) programs; and policies and information campaigns against smoking and abuse of drugs, and for adequate standards of occupational safety.

4.7 A second key rationale is equity. The poor face the greatest burden of ill-health, and are least able to afford the cost of healthcare. Governments have a fundamental respon-

sibility for ensuring universal access to an essential package of clinical or individual health services, especially for the poor. Five groups, or clusters, of clinical interventions are likely to be the most important in every country's essential clinical package: pre-natal and delivery care; family planning services; treatment of the sick child; treatment of tuberculosis; and management of sexually transmitted diseases (STDs) including AIDS prevention. These risks affect the largest numbers of people in countries such as Indonesia, and the poor are at much higher risks than most (WDR 1993).

4.8 The third rationale is market failures in private health financing, and information. In lower middle-income countries, as in Indonesia, private health insurance tend to cover only high-income and low-risk populations (i.e., "adverse selection" problems); alternatively, in Government-run health insurance programs, there may be excess demands for health services and hence lead to rationing and services mainly for the privileged ("moral hazard" problems). Failure of information makes matters worse. People who are ill have far less information than private health service providers, and the latter may provide costly or wrong treatment, in the absence of adequate public information and standards. The Government's role should be to encourage more health insurance systems, higher standards of care in private services, and more public information.

4.9 Measured against the above objectives, Indonesia does better on some accounts, but poorly against others. The areas where the Government has done relatively well are: (a) the spread of a basic public health system—through the expansion of public health centers and sub-centers, village health-posts, and district hospitals; and (b) reasonable success in child immunization, micro-nutrient supplementation, and family planning programs—as measured by relatively high rates of immunization, reduction of micro-nutrient deficiencies, and falling fertility rates.

4.10 However, the public health system has some failures. First, public health spending is low (see Section C). Indonesia started with very low levels of spending, which have now increased to about 0.7% of GDP, but this level is still below the average of 2.0% of GDP for all developing countries. Hospitals account for one-half of the total public health spending, and such spending has been rising. Given relatively low levels of overall spending on health, a higher level of spending on hospitals means fewer resources for health interventions in other more important areas. Public services also need to emphasize preventive public health activities. Moreover, complementary investments in safe water and public sanitation, provided by infrastructure agencies, are low (see Chapter 3) and often neglect needs of the poor and isolated areas.

4.11 Second, public health services utilization by the poor have dropped between 1987 and 1992, and are now similar to the levels in 1978, despite a large increase in medical personnel and facilities (see Section E). About one-half of those who are ill do not visit any health services, and the coverage of the poor is especially low.

4.12 Third, the above also appears to be directly related to the quality of public health (see Section D): (a) health outcomes, as measured by child and maternal mortality rates—a key indicator of overall community health—are poor and the pace of their improvement slowed in the 1980s; (b) visit rates to public health centers, or hospital bed occupancy rates are far lower than in most countries; and (c) micro-level studies suggest a host of contributory factors, such as lack of standard safe practices (e.g., hygiene practices), inadequate nurses' knowledge and practices (e.g., re-use of syringes), target-

driven approaches, lack of community outreach, and the frequent unavailability of essential drugs and medicines.

4.13 Fourth, treatment of most diseases could be improved by better availability of medicines. Public supplies are often unavailable because of inefficiencies, and dispensing practices (e.g., "three-day" limits on supply, and preference for injectibles) often lead to inappropriate dosage and/or deter effective treatment. The pharmaceutical sector also has high rates of effective protection, and low competition (see Section F). Finally, private health services need to be improved. Private health insurance is undeveloped, partly because the Government dominates the provision of health insurance, and partly because public health charges for the non-poor, especially at hospitals, are heavily subsidized.

4.14 Major reforms are necessary in the public health system:

- ***Spend more on health, focusing on essential services and on the poor.*** There is also room for greater efficiency and effectiveness of public health spending;
- ***Address the needs of the poor***, and step-up investments to reach the poor more effectively;
- ***Improve the quality of health services*** in *puskesmas* and *puskesmas pembantus*, the first-line of primary health services;
- ***Increase the supply of essential and low-cost drugs and medicines***, by deregulating private medicine trade and improving the efficiency of public drug procurement and distribution practices;
- ***Encourage private health services.***

C. Public Spending on Health

4.15 **Spending on Health**. Among developing countries, Indonesia devotes a low level of national resources on health. Public spending, at about 0.7% of GDP annually, is especially low (see Table 4.1).

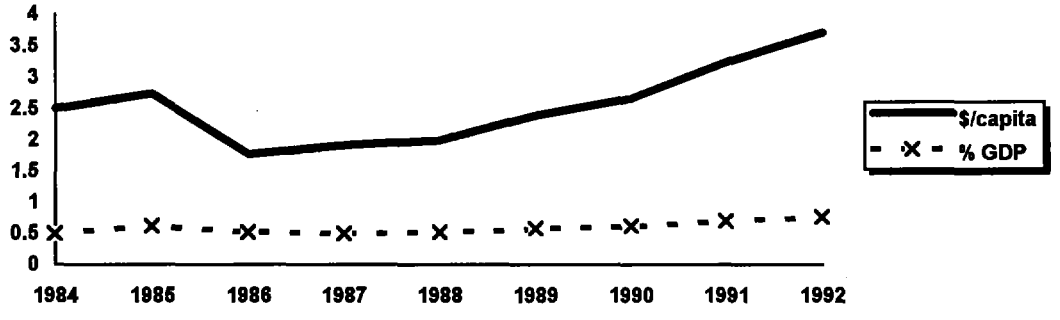
Table 4.1: Comparative Expenditures On Health--1990

Country	*Health Expenditure Per Capita ($)*	*Health Expenditure as % of GDP*		
		Total	*Public*	*Private*
Indonesia	12	2.0	0.7	1.3
India	21	6.0	1.3	4.7
Bangladesh	7	3.2	1.4	1.8
Sri Lanka	18	3.7	1.8	1.9
China	11	3.5	2.1	1.4
Philippines	14	2.0	1.0	1.0
Thailand	73	5.0	1.1	3.9
Malaysia	67	3.0	1.3	1.7
Korea	377	6.6	2.7	3.9
Asia (excl. India & China)	61	4.5	1.8	2.7
Sub-Saharan Africa	24	4.5	2.5	2.0
Latin America	105	4.0	2.4	1.6
Middle East	77	4.1	2.4	1.7
Developed Countries	1860	9.2	5.6	3.5
World	323	8.0	4.9	3.2

Source: World Development Report, 1993—Health.

4.16 The Government is aware of the low level of health spending, and has sought to increase spending. Indonesia started in the 1970s with a very low level of health spending, about 0.2% of GDP in 1975, which increased to about 0.5% of GDP by the early 1980s (see Figure 4.1). During the period of falling oil prices, 1986-88, health spending declined; expenditures on health fell to about 2.5% of total Government expenditure, compared to about 3.5% in 1985. Much of this was the result of lower real salaries for civil servants, including health workers. Since then, public health spending has improved, reaching about 0.7% of GDP in 1992/93, and about 4% of total Government expenditures. There is also scope for improving the efficiency and effectiveness of public health spending (see discussion below). The Government intends to assess the needs for further rises in spending and raise overall spending levels, focusing on basic health services for the poor and isolated areas.

Figure 4.1: Indonesia: Public Spending on Health 1984-92
Real (1984) $ per Capita, and % of GDP



Source: Ministry of Finance; Staff Estimates

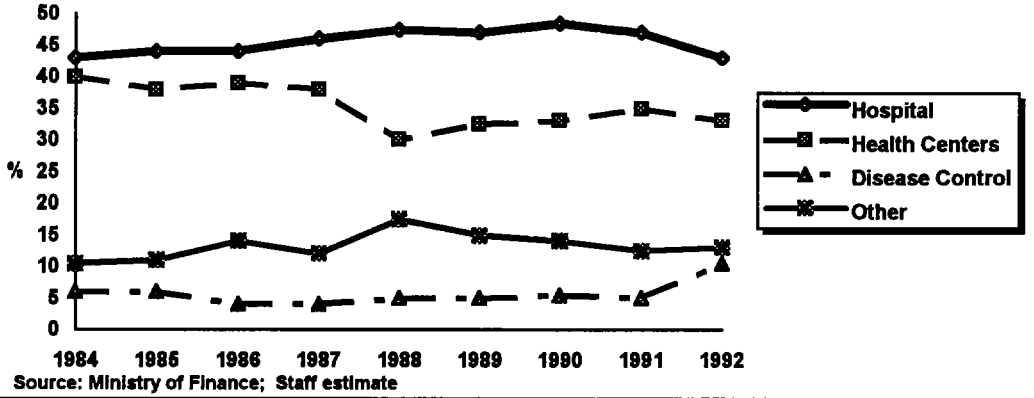
4.17 **Allocation of Public Spending**. The largest single expenditure is on hospitals (Figure 4.2). Its share in total spending increased from about 42% in 1984, to nearly 50% in 1991. However, this is inefficient spending, and in the context of low overall spending on health, a high proportion going to hospitals means that other services are heavily constrained. Each hospital bed in Indonesia costs about US$5000 per year. Given low occupancy rates, the cost per day of an inpatient stay in a hospital is about US$29 a day, versus average fees of about US$6-14 per day—implying a very high subsidy. Moreover, the poor use hospital services far less. The pattern of hospital spending is also regressive, since more hospitals tend to be located in richer and urbanized provinces. For example, Jakarta receives twice as much per capita health subsidies than does Nusa Tenggara Barat, even though per capita incomes and private health services are far greater in Jakarta.

4.18 Public spending on health centers and sub-centers has increased in absolute terms in recent years, with the higher levels of overall public spending on health. The Government has tried to increase the operational resources for these centers. However, the relative share of spending on health centers and sub-centers has lagged. Its share fell from about 40% of total public health spending in 1984, to about 35% in 1991. The decline in relative spending on health centers and sub-centers—which has the largest potential impact on the poor and on primary health services—is a matter of concern. Subsidies in health centers and sub-

centers are low, only about US$1-2 per visit (compared to US$4 per hospital outpatient visit, and US$15-23 per day for hospital in-patient stay, and over US$100 per person per episode of hospitalization). Low-income families use health centers and sub-centers far more than hospitals (World Bank, 1993d). Increased spending on health centers and sub-centers in the future could focus on poor and isolated areas, such as in the Inpres Desa Tertinggal (IDT) villages.

4.19 Control of communicable diseases (CDC) has a very low share of spending, about 5%. However, in 1992, expenditures on CDC apparently doubled to about 10% of total spending. If this is accurate, it would mark a significant improvement from past patterns. Other expenditures—on health administration, family planning, and nutrition—have been declining slightly, in relative terms (partly because of declining allocations, needs and reduced externally financed programs in the investment budget).

Figure 4.2: Health Spending By Different Sub-Sectors, 1984-92



Source: Ministry of Finance; Staff estimate

4.20 Routine spending—mostly for salaries—accounts for about 55% of total health sector spending. Routine expenditures have been fast rising in real terms in recent years, because of rapidly growing personnel. Civil service employment data show that employees under the Ministry of Health (MOH) have grown from 159,000 in 1986 to 266,000 in 1992 (i.e., a 9.0% p.a. increase). However, since 1992, a general "freeze" on further expansion of the civil service is being applied, which will restrain growth in employment, and permit more resources for other essential spending–such as more incentives to health workers to improve service quality, and community health activities

4.21 **Private Spending on Health.** As noted in Table 4.1 above, private spending on health is estimated to be about 1.3% of annual GDP. Surprisingly, rural households appear to spend relatively more (as a percentage of their expenditures) on health than urban households—related to the higher costs of healthcare in rural areas. The relatively larger spending by private households, compared to public spending, and the preference of private households for private sources of medical assistance suggest that there is no need for the Government to play an increasing role in curative services, except for those who cannot afford it. Given high elasticities of demand for health, private spending on health as a ratio of GDP is likely to rise steadily.

4.22 **Public Pricing Policies.** Currently, public health centers and sub-centers achieve a 10% recovery of costs, and public hospitals achieve a 30% recovery of costs. Studies suggest that there is a potentially difficult revenue-equity trade-off in charging more for services at health centers and sub-centers, unless the poor can be protected from higher costs. Different methods of providing subsidies only for the poor, rather than for all, have been suggested: geographic price discrimination in rural areas, and self-selection in urban areas (i.e., charge least for health sub-centers, and most for hospital outpatients). The Government has recently adopted a more direct method: granting free health cards to the poor.

4.23 Pricing policy improvements are needed in hospitals. Korea has full-cost recovery for hospitals (with a separate system of medical assistance for the needy). Thailand achieves a 50% cost-recovery at public hospitals (with free health cards for the poor). The self-selection method offers the best prospects for raising revenues from the better-off. The highest classes of services at hospitals should charge full-cost for such services, at a minimum; it could even set charges higher still. Recently, the Government has introduced a new hospital financing program entitled "Lembaga Swadana" (literally, "self-supporting institution"). Under the program, Government hospitals which have received the bulk (approaching 80%) of their operating revenues as direct Government subsidies, will be increasingly responsible for significantly raising their extra-budgetary revenues. The increase in revenues derived from user fees is expected to reduce the need for direct subsidies, and potentially permit the Government to reallocate such resources to other programs. Operationally, the new policy implies that hospitals can set their own fees for their services.

4.24 While Lembaga Swadana is, in principle, a movement towards improved pricing, the efficiency and equity aspects are unclear. First, while Lembaga Swadana hospitals are mandated to collect 40% of their costs through user fees, it is not clear whether these new revenues will add to existing subsidies, or substitute for them. If they substitute, than public resources would be saved, but not otherwise. Second, while Lembaga Swadana hospitals are mandated to set lower prices for the poor, the mechanisms for setting these fees and identifying the poor are undefined. Given that hospitals are to retain the fees, there is no incentive for them to support the poor. Consequently, the Government needs to set clearer equity guidelines, and monitor the Lembaga Swadana program carefully.

4.25 In addition to the above, those with access to health insurance should be charged full-costs—especially the ASKES civil-service employee members. At current prices, ASKES members are charged only 65% of the costs normally charged to uninsured users, and have much higher visit rates and inpatient use of public hospitals.

D. Health Condition, and Outcomes

4.26 Although significant epidemiological/ demographic changes are underway in Indonesia—towards more constitutional diseases and deaths in an older age group—infectious diseases of children and women in reproductive age groups are still the most important public health issues. The leading causes of child mortality and morbidity are acute respiratory illnesses, and diarrhea. Significant malnutrition is also present, and is associated with high rates of child deaths and diseases. Maternal mortality rates are very high—signaling poor health and nutrition of mothers. Regional patterns show

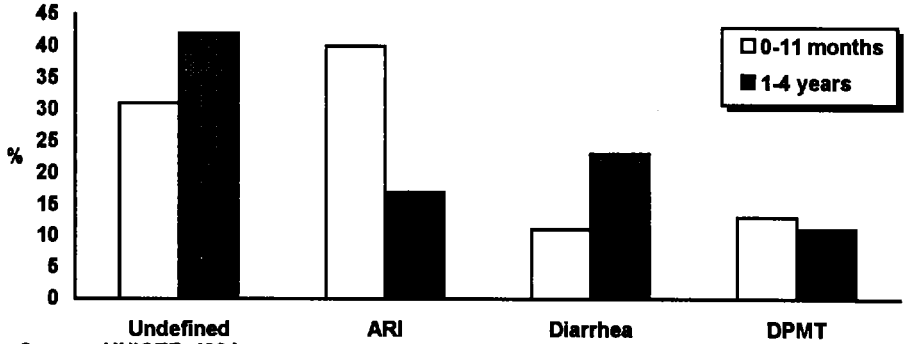
wide variations in public health conditions, with especially poor conditions in remote/poor provinces in the outer islands. Lack of progress in environmental conditions—i.e., in access to safe water and sanitation—is an especially serious public health issue.

4.27 According to a Indonesian health survey (Ministry of Health, 1985), infectious diseases were the leading cause of death accounting for about 53% of all deaths, and was much higher than that in other developing countries (36%). Circulatory diseases were the second-leading cause of deaths—about 10% of all deaths (compared to an average of 20% in all developing countries). Pregnancy and neonatal problems were the third leading cause of death—about 7% of all deaths (compared to 8% in all developing countries).

4.28 **Child Mortality and Morbidity.** Child mortality accounted for about 30% of all deaths in Indonesia. The major causes of child death are acute respiratory diseases (ARI) and diarrhea, and malnutrition—which together probably account for over 80% of all child mortality (Figure 4.3). The immune-preventable diseases are a smaller cause of death, but tetanus still accounts for 10% of infant mortality, and measles, diphtheria and pertussis for 9% of child mortality. The household health survey did not find malnutrition to be a cause of child mortality, because malnutrition is rarely certified as a cause of death. But a recent analysis (Pelletier, et. al., 1993, and UNICEF) argues that about 40% of infant mortality and 60% of child mortality in Indonesia could be attributed to underlying malnutrition, mostly associated with mild malnutrition (70-80% of the standard weight for age). While data on morbidity patterns are very sparse, existing information suggests that the prevalence of ARI (i.e., a cough with rapid breathing, which should require hospitalization) was about 9.8% among under five children—which was very high (IDHS, 1991; UNICEF, 1994). Diarrhea was relatively less frequent, and low by international standards, but gastrointestinal parasites (related to poor sanitation) affect about 80% of all children.

4.29 **Maternal Mortality and Morbidity.** Maternal mortality rates are very high. The immediate causes of death were hemorraghia (in turn, aggravated by high rates of anemia), toxemia, infection, obstructed labor and abortion. The risk factors were age, low income, rural residence, anemia, and lack of ante-natal care and delivery assistance (UNICEF, 1994). A heavy workload and poor nutrition (e.g., dietary energy intakes during pregnancy and lactation range between 50-80% of recommended levels) among the

Figure 4.3: Indonesia—Major Causes of Child Deaths



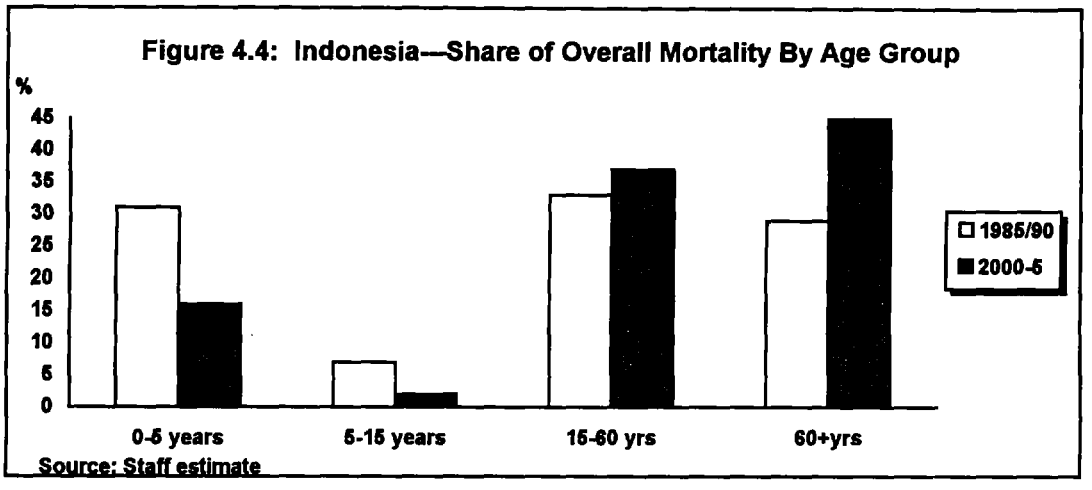
Source: UNICEF, 1994

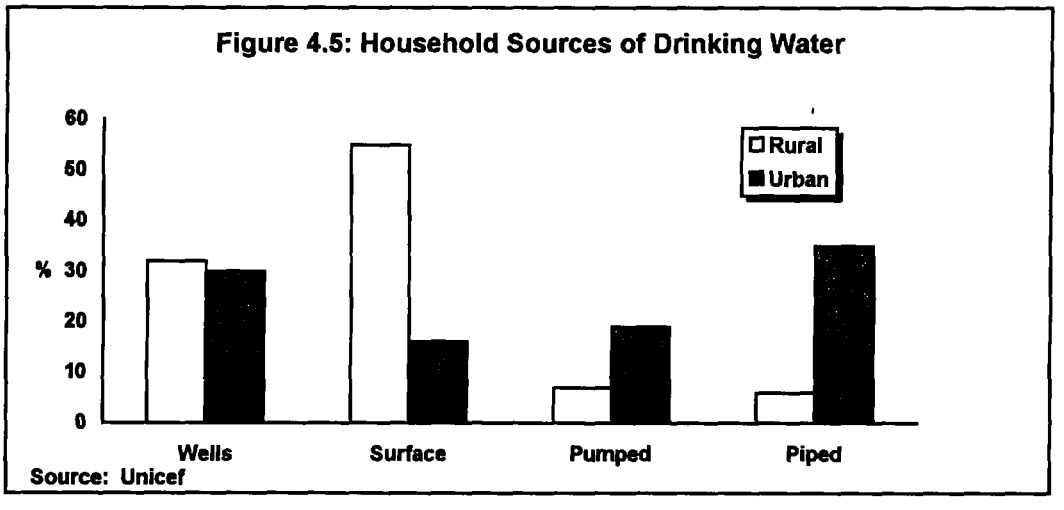
majority of women are also cited to be common factors. Cultural food taboos were common amongst pregnant women, as was the practice that colostrum (which provides vital antibodies to babies) is commonly thrown away and the baby given water for the first 24 hours. Exclusive breastfeeding on demand up to 4 months or more is practiced only by a minority of women.

4.30 **The Epidemiological Transition, and Regional Patterns**. Although a large part of the current mortality and morbidity burden is concentrated on young children and mothers—and this will continue to be the predominant health issue—dropping fertility rates portends some changes in the coming decades. Slower growth in child population, and declining mortality rates will lead a rapid increase in the adult and aging population. As a consequence, the health needs of this population will be increasing. Infectious diseases and malnutrition which now exact a high mortality and morbidity among children and adult women, will be progressively replaced by degenerative and man-made diseases among an older age group (e.g., heart diseases, cancer, strokes), and new diseases (e.g., AIDS) (Figure 4.4). This transition is already evident regionally. In Java-Bali, where the fertility decline has been the steepest, child mortality now accounts for 22% of all deaths, whereas in the poorest-remotest outer island provinces, child mortality still accounts for some 55% of all deaths (e.g., in Maluku, Irian Jaya, East Timor), and some 44% in East and West Nusa Tenggara and West Kalimantan. Correspondingly, estimated life-expectancy at birth is highest—averaging about 67 years—in 5 urban-rich areas (e.g., DKI Jakarta, Yogyakarta, Bali, North Sumatra), whereas they are lowest in six remote-poor provinces, averaging about 57 years.

4.31 Access to **safe water and sanitation** are two powerful environmental determinants of health across countries. In a crowded and densely populated island area such as Java-Bali—which has one of the highest population densities in the world—this is an especially serious hazard. More spending on safe water and sanitation is urgent, as discussed further below (paragraphs 4.32-4.33). Public spending on safe water and sanitation is low, implementation has been a problem, and there are a number of pricing and institutional reforms that are needed in the sector to accelerate the delivery of services. These issues have been examined in Chapter 3. There also needs to be better integration of the investment program in these sectors (undertaken largely by the infrastructure agencies), and public health priorities.

4.32 Cultural practices in Java-Bali already distinguish carefully between different sources of water—for drinking, and those for other purposes such as bathing and washing. It is reported that in a survey of two districts, 98% of respondents reported always using boiled drinking water (UNICEF, 1994). Nevertheless, dug wells continue to be the main source of water, followed by surface waters, mechanical or electrical pumped water, and last by piped water (Figure 4.5). All sources are subject to increasing fecal and bacterial contamination, and water quality is a serious problem. Approximately 30% of urban and 19% of rural groundwater sources are located less than 10 meters from a septic tank or latrine leaching pit, and most open dug wells have some fecal coliform from surface contamination. Surface waters are increasingly heavily polluted with industrial effluents and domestic waste. Piped water analysis shows that 58% of sample failed to meet Ministry of Health standards—because raw water quality intake has deteriorated, and because of contamination from leaks.





4.33 Safe excreta disposal may be a greater problem (UNICEF, 1994). The sanitation coverage is only 47% nationally—74% in urban areas and 35% in rural areas. Moreover, much of existing sanitation is simple pit latrines. Only the wealthier housing areas in urban locations have septic tanks. A few public sewerage systems are under development in the central cities of Jakarta, Bandung, Yogyakarta, Cirebon, and Surabaya, but the coverage of such systems is only about 5% of households in urban areas.

4.34 **Child Mortality Trends.** Gains in public health can be measured in terms of two broad indicators: (a) life expectancy; and (b) child mortality. Life expectancy at birth is the number of years that a person born in a given year could expect to live, given the age specific mortality rates for that year. However, much of what is known about mortality in the developing world, and in Indonesia is limited to the mortality of children because of the absence of vital statistics and registration of births and deaths, and has come from a series of standardized internationally funded demographic surveys. Life expectancy at birth is derived from the child mortality rates in a given year, combined with assumptions about the relationship between child and adult mortality based on country-specific projections. The child mortality rate is, thus, a key indicator of the status of public health.

Table 4.2: International Comparisons of Under Five Mortality Rates

Countries	*Under 5 Mortality (per thousand), 1991*	*Rate of Fall (% p.a., 1980-91)*	*Per Cap. GNP US$ 1991*
Bangladesh	127	4.2	220
Myanmar	113	2.1	220
Zaire	188	0.7	230
India	124	3.0	330
Kenya	74	3.5	340
Sri Lanka	19	8.4	500
Egypt	55	9.9	610
Zimbabwe	86	3.2	650
Ivory Coast	124	3.1	690
Cameroon	117	3.3	850
Guatemala	76	4.8	930
Morocco	61	7.2	1030
Peru	65	5.8	1070
Colombia	20	8.9	1260
Costa Rica	16	4.9	1850
Chile	18	4.9	2160
Iran	58	6.5	2170
Mexico	33	7.5	3030
East Asia:			
China	43	3.4	370
Indonesia	110	1.2	650
Philippines	60	1.2	730
Thailand	33	5.1	1570
Malaysia	19	6.6	2520
Korea	9	5.3	6330

Source: UNICEF, 1994.

4.35 Although there are some data comparability issues, it appears that after a large decline in the 1970s (from 215 in 1960 to 151 in the mid 1970s), the rate of child mortality in Indonesia has begun to stagnate at a relatively high level in the 1980s and early 1990s.[1] The most recent available data (Table 4.2) suggests that the under five mortality rate in Indonesia in 1991 was 110 births per thousand live births—i.e., more than 1 child in 10 dies before reaching the age of 5. The child mortality rate in Indonesia was more than double that in China, nearly twice as high as in the Philippines, nearly three times as high as in Thailand, and five times as high as in Malaysia. In this respect, the child mortality rate in Indonesia was closer to the average for South Asian countries (an average of 135, excluding Sri Lanka), than to the East Asian countries (an average of 35 for China, Philippines, Thailand and Malaysia). Moreover, the rate of decline in child mortality in Indonesia between 1980-91 slowed to about 1.2% per annum, which was about the slowest in the world (Table 4.2). Elsewhere in the developing world, the rate of decline in child mortality in developing countries accelerated to more than 5% per annum in the 1980s (World Development Report, 1993).

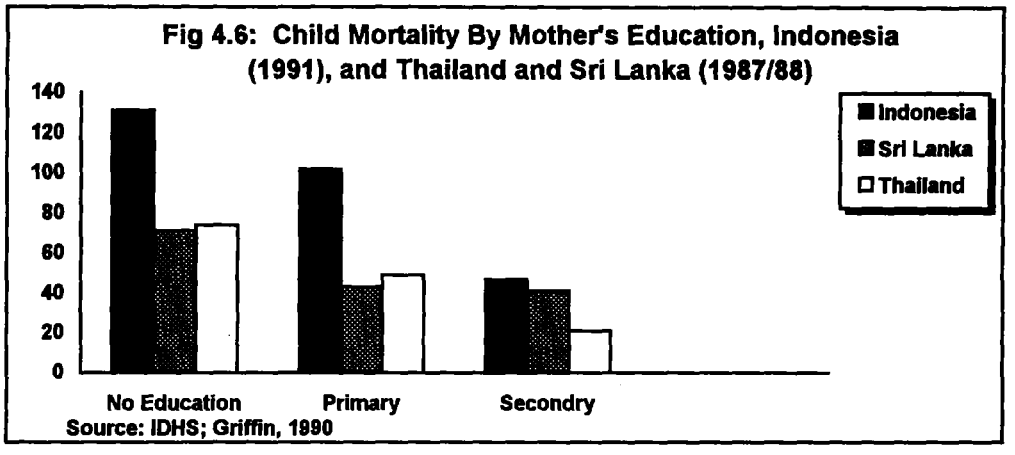
4.36 Indonesia's public health situation and trends in the 1980s, as measured by child mortality rates above, is a matter of concern. The reasons for higher child mortality are not well understood, and need more research. One possible reason for Indonesia's poor health situation could be the relatively low incomes of the country (UNICEF, 1993). But a recent paper (Dasgupta, 1994) suggests that when other proximate determinants of child health—such as rates of female education, food availability, access to public health facilities, child immunization, poverty incidence, and female fertility rates—are taken into account (in addition to per capita income), the actual child mortality rate (i.e., about 110 per thousand) for Indonesia was about double the rate that would be otherwise predicted (i.e., about 52).

4.37 Table 4.3 below reports child mortality differentials by background characteristics of mothers. As evident, better education, or better medical care lowers child mortality rates significantly. But still, the data suggests it would take all mothers to have some secondary education before the average expected child mortality in Indonesia would decline to about the average levels in East Asian countries, which could be some decades away. A comparison with Thailand and Sri Lanka (Figure 4.6) suggests that reducing child mortality rates quickly in Indonesia may have much more to do with ensuring near universal prenatal and antenatal care (i.e., effective public health inputs to all); improved environmental factors (e.g., safe water and sanitation), health care targeted at high-risk cases, and effective health education.

Table 4.3: Indonesia: Mortality Differentials By Background Characteristics, 1991

Background Characteristic	*Under Five Mortality*
Education:	
-No Education	131.1
-Some Primary	125.1
-Completed Primary	102.1
-Some Secondary	46.8
Medical/Maternity Care:	
-No antenatal/delivery care	159.8
-Either antenatal or delivery care	82.4
-Both antenatal and delivery care	51.5

Source: IDHS, 1991, op. cit.

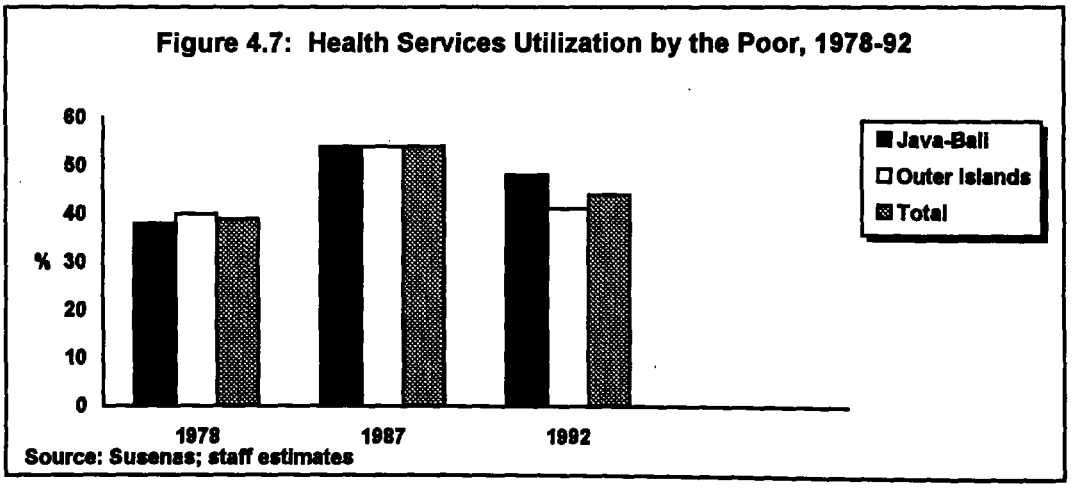


E. The Delivery of Health Services

4.38 Public health services have expanded dramatically in Indonesia—with a network of health centers and sub-centers that cover virtually all the population, and within reasonable access, except in a few remote and low-population density provinces. The numbers of medical personnel—doctors, nurses, midwives and paramedics—have also expanded rapidly. Private services have correspondingly increased. However, the utilization of health services remains very low, especially among the poor.

4.39 About 46% of those who are ill do not visit a health care provider; and among the poorest quintile, about 56% of those who are ill do not visit a health care provider (SUSENAS, 1992). The utilization of modern health services by the poor, after improving sharply 1978-87 from 39% to 54%, appear to have fallen since then to about 44% (see Figure 4.7).

4.40 Of those who do visit a health care provider, less than one-half use the extensive public health facilities, and the utilization of public health facilities, by the poor is very low. Hospital services largely cater to the well-off, while health centers and sub-centers are used more by the poor than the well-off. The causes of low demand for health services in Indonesia are as yet not well understood. In part, behavioral issues may be important. However, in part, they also appear to be related to the low quality of health services.



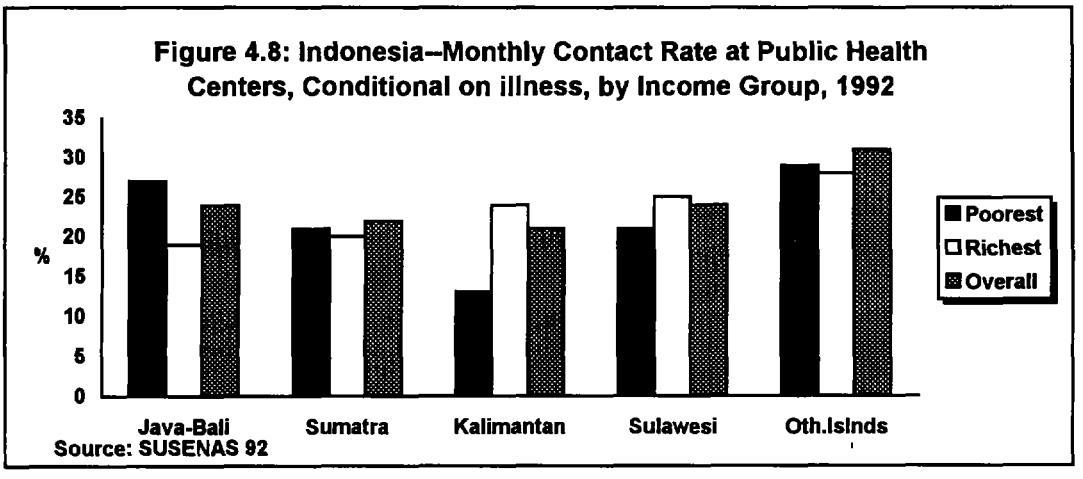
4.41 **Public Health Services.** Public health services in Indonesia are delivered through a variety of sources. The locus of services today is the health center (*puskesmas*), which have expanded from 4353 to 6588 between 1978-93, so that each of the 3,400 districts have at least 1 health center. Each *puskesmas*, covering about 30,000 people, has at least 1 doctor (and sometimes 2 or 3), sometimes a dentist, 6 nurses and midwives, 9 auxiliary health workers, and several administrative workers. The senior doctor is the primary medical authority and administrator. The health center provides curative, outpatient care and undertakes preventive health activities. Below and linked to the health centers are 18816 (up from 6636 in 1978) village level health sub-centers (*puskesmas pembantu*), each covering about 7000 people, which offer limited curative and preventive care, including vaccinations. They are generally headed by a nurse or midwife, and total staff are generally less than 3. The health centers directs those needing inpatient treatment to district level (class C and D) referral hospitals, which have increased from 260 in 1978 to 298 in 1993.

4.42 Even though the spread and ease of access to public health facilities are now good in most places—the average distance to a medical facility is about 2.8 kms, 1 km in urban areas and 3.7 kms in rural areas–the utilization of public health facilities is low. Bed occupancy rates for all classes of public hospitals fell between 1984-92, and averaged less than 60% (World Bank, 1994d). Recourse to health centers for curative purposes and preventive care was also very low. As shown below in Figure 4.8, only about 25% of those who reported ill, visited a public health center or sub-center. Households in the remote/poor easternmost islands—East and West Nusa Tenggara, Maluku, Irian Jaya and East Timor—tended to use public health centers more (i.e., nearly one-third of those reporting illnesses) than in the other provinces. The poor tended to use the public health centers more in Java-Bali and in the eastern islands. Overall, rural and urban residents made only 1 visit to a public health center for preventive or curative purposes in a year. By contrast, public health centers in Malaysia are contacted, on average per person, more than 5 times a year.

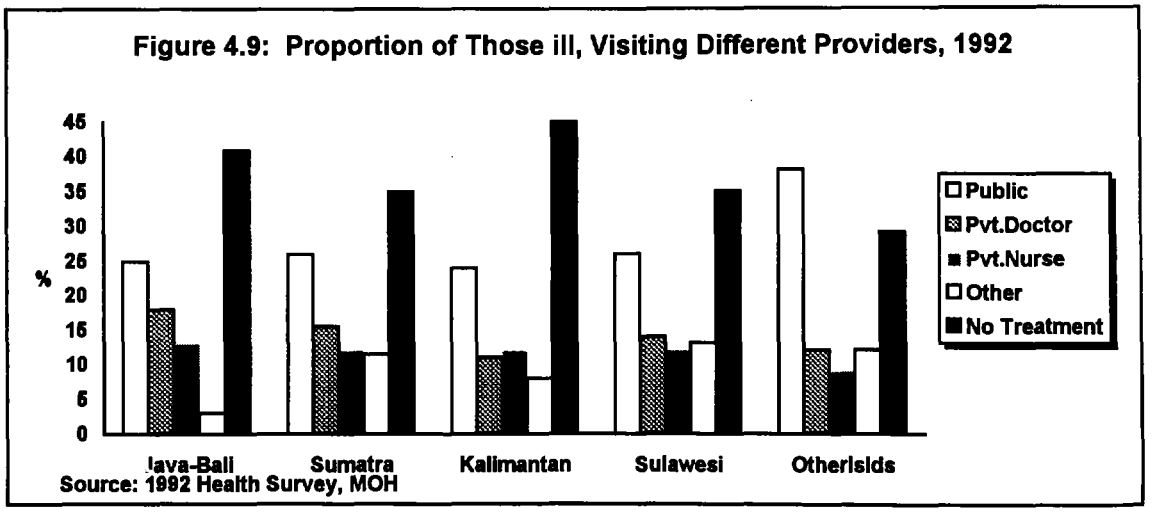
4.43 Why are visit rates to public health centers low? A cross-kabupaten analysis suggests that the most significant factor influencing visit rates was the availability of medical drugs and materials, and only to a small extent, the increased availability of doctors and nurses (World Bank, 1994d). Micro-level studies of *puskesmas* operations also suggest quality issues: (a) process-related deficiencies in treating patients—e.g., lack of standard safe practices, perfunctory physical examination, and inconsistent diagnoses and prescriptions, etc.; and (b) poor client services—e.g., short effective operating hours, inadequate knowledge and procedures of nurses, target-driven practices, and lack of community-reach, etc. (World Bank, 1994d).

4.44 Maternal and child health (MCH) and family planning services are delivered through the primary health care system, and is coordinated between the Ministry of Health (MOH) and the National Family Planning Coordination Board (BKKBN). The BKKBN (and MOH) provides support to a community outreach program, through village-level health posts, or *posyandus*, that provides MCH, immunization, diarrhea control, and family planning and nutrition (child weighing and nutrition supplementation) programs. Despite concerns whether the village health posts actually reach a significant proportion of children and mothers, they appear to be an important point of contact–perhaps because of the free distribution of nutrition supplements, such as Vitamin A. For the nation as a whole, the average number of visits to *posyandus* by children under age 5 within the previous 6 months ranged from 2 in the poorest quintile

to 3 for the richest quintile. Overall, about 50% of all children under 5 years old made at least 1 visit to a *posyandu* within the previous 6 months (SUSENAS, 1992). As a result, child immunization rates are reported to be high (e.g., over 90% for DPT3). However, maternal care services remain very low (UNICEF, 1994).



4.45 **Private Health Services.** A larger role is played by private services (World Bank, 1994). About 34% of those who are ill seek such private services (see Figure 4.9), compared to 26% who visit public facilities (and nearly 40% are self-treated or seek no medical assistance), even though such private visits cost (Rp.15,000 for treatment and drugs in 1991 for a private doctor's service) many times more than the public health center charges (Rp.1200 for treatment and drugs). Government doctors and nurses (are officially allowed to) conduct private practice after the close of official work day (i.e., after 2 pm). Most (about 80%) public service doctors also practice privately, and those working in health centers report the most private practice—for 6 days a week and up to 4 hours a day—but their fees are lower than other doctors. Doctors charge significantly more in rural areas than in urban areas (Rp.5,600 per visit versus Rp.4,500 a visit). Private practice accounted for about 70% of total earnings for specialists, and 25-70% for rural health center physicians.



F. Improving The Quality and Effectiveness of Health Services

4.46 While Indonesia spends a relatively low level of resources on public health, increased public spending is not the only issue. The Philippines and Egypt—not particularly better achievers in public health—achieve better child mortality outcomes with about the same level of public spending as in Indonesia. China spends in absolute terms less per capita on health (about US$11) than Indonesia does (about US$12 per capita), but achieves far better outcomes—life expectancy is about 8 years higher, and child mortality about half the level in Indonesia (Griffin, 1990). How Government funds are spent relative to health problems, and the efficiency and quality of such spending, are crucial issues. So are issues relating to the pricing and availability of essential drugs and medicines, and the role of the private sector.

4.47 **Re-orienting Public Health Interventions.** The Government has expanded public health services and health personnel. While poor regions and poor villages are less well served, the coverage of health services is reasonably comprehensive. The main policy issues are: (a) the demand for public health services is low; (b) the low quality of services is apparently a major factor which leads to the underutilization of public services; (c) the poor do not use public services intensively; and (d) the overall health outcomes—i.e., the effectiveness of health services—remains low.

4.48 A rethinking of the management of public health services is, thus, urgent. A recent report (World Bank, 1994d) and ongoing implementation of health improvement projects suggest the following key elements of public health reform.

4.49 First, more policy attention and investment is needed on health system performance and preventive health services. Research is needed on what are the "best practices" and factors behind successful puskesmas activities, how to improve the quality of public health services, and how to make health-centers more responsive to client needs. Similarly, major differences in local epidemiological conditions need to be clearly identified through systematic local health surveys, and the results conveyed to local health service delivery institutions. Public investment in safe water and sanitation, combined with greater local community participation needs to be accelerated. Instead of a focus on these activities, more policy attention and resources are going into curative activities (e.g., in hospitals) and input-driven public supply programs (i.e., so many health centers, application of standard staffing norms, etc.).

4.50 Second, attention needs to be paid to high child and maternal mortality, which are the most serious public health issues. Given falling birth rates, and the extensive coverage of the public health system, it should be possible for public health system personnel to make a visit to each birth that takes place in a given local setting—at least in the high child mortality districts—so that high-risk cases are identified and followed-up, advice provided on preventive medical steps, and improved maternal care, child birth and child survival services provided the next time around. The public health system is now planning an accelerated program to add more *bidan desa* or village midwives—employing new, inexperienced, and young midwives who would have little support systems to count on, or engender much confidence amongst their potential clients (especially relative to traditional birth attendants). The entry requirements, selection procedures and training activities for *bidan desa* will need to

be improved, if they are to be accepted and function effectively in the villages (World Bank, 1994d).

4.51 Third, attention needs to be paid to the ability and motivation of front-line health managers and staff to deliver higher quality, and more accessible health services. The key to this is to make reforms at the individual facility level—i.e., health centers and sub-centers. One part of the reform package will need to focus on decentralization and of management. The puskesmas doctor in charge will need to be given full responsibility for all health processes and outcomes in his/her local area, together with requisite financial resources to carry out the responsibilities. Another part of the reforms will need to focus on appropriate incentives for staff for better performance (together with a monitoring system). A third essential package will need to focus on monitoring health outcomes, establishing quality-assurance mechanisms and incentives (see para. 4.65 below), and providing in-service training on management to improve quality and equity.

4.52 Fourth, a low and declining use by the poor of public health services needs attention. The Government has recently started an accelerated program of providing health cards to poor families to entitle them to free health care in public facilities. The program needs to be carefully monitored. However, free health cards may not by itself ensure that the poor receive adequate health care, unless outreach and community services by public health staff to reach poor families are accelerated, and incentives for health staff to treat the poor are put in place, and made an integral part of the health system's objectives.

4.53 **Public Health Work Force Issues.** For public health services to be effective, the public health work force will need attention. The most important generic recommendation is to make the work force responsive to local public health needs and more selective and cognizant of market forces and opportunities. Policy no longer needs to be driven by gap-filling imperative, characterized by detailed and rigid staffing norms, nor on extensive subsidization of medical education and training or conscription. Instead, policy needs to be demand sensitive. One way to do this would be to make public facility managers, including the district health officer, develop realistic service priorities and decide on the appropriate staffing, skill mix and task assignments in health centers and hospitals, and give them greater authority over personnel matters. With work force needs in public facilities determined in this bottom-up fashion, there will also be less need for setting targets for numbers of trained graduates, or to heavily subsidize medical education.

4.54 Government health workers still tend to be concentrated in urban and some rural areas. This has resulted in continuing shortages of key staff in some districts, whereas other localities are overendowed with workers. The contract doctors scheme represents a special issue and may need re-evaluation to be sustainable. Given a large increase in output of doctors, the absorbtion of all of them in public service is no longer possible. An answer to this problem was the 1992 decision to hire newly drafted medical graduates on three-year, non-renewable contracts rather than as civil servants. The contract scheme may however prove to be problematic because the Government has promised not to compel recruits to serve in remote areas. This pledge may have made it more difficult to use this mechanism to guarantee a supply of doctors in the Eastern Islands. Therefore, consideration needs to be given to other incentive-based mechanisms to ensure an adequate supply of doctors in remote areas.

4.55 **Medicines**. Purchase of medicines for treatment are a large part of household expenses for health. It is estimated that the per capita expenditures on drugs and medicines was about US$4.5 in 1994, or about one-third of total expenditures on health. Yet, this large expenditure on drugs and medicines "buys" far fewer quantities of actual medicines than in most countries. Griffin (1990) estimates that from international comparisons of the quantity and prices of medical care, Indonesians consumed (per capita) about one-sixth the quantities of pharmaceuticals in India or the Philippines, and less than one-twentieth that in Sri Lanka, but paid twice as high a price for these medicines as the other countries. The very high prices of pharmaceuticals relative to health services (the ratio of the price of pharmaceuticals relative to medical personnel services was estimated at about 11:1 in Indonesia, versus 5:1 in India, and 1:1 in Sri Lanka) results in substitution of medical services (i.e., more health personnel) for pharmaceuticals, but with far less effectiveness.

4.56 Most of the causes of child mortality in Indonesia can be addressed effectively by the use of appropriate medicine—selected antibiotics, vaccines, vitamins, and others. The adequate supply of medicines could cut the child mortality rate by one-half, according to one study (Ministry of Health, 1987). INPRES funds provide for the supply of 178 essential drugs through the public health system, for a relatively nominal cost to patients. However, a "three-day" rule limits dispensing quantities to three days supply (encouraging sub-therapeutic doses of multiple products), there is a strong preference for injectable medicines by public providers (raising public costs to high levels and dissuading patient treatment), and public health facilities are frequently out of stock of prescription drugs. As a result, privately purchased drugs are the most common source of medicines.

4.57 The pharmaceuticals industry carries an average about 20% nominal protection, and 60% effective protection. Competition in the industry, especially in distribution, is also low. Consequently, prices of most essential drugs (e.g., antibiotics) are relatively high. A price comparison for a common antibiotic (e.g., ampicillin 500 mg) suggested that the domestic price under the INPRES program was 240% (or, more than twice as expensive) as the UNICEF published price (World Bank, 1987). The retail price of the same, but branded, product sold through an "apotik"—the price facing the consumer—may have been about 4 times higher than the INPRES public procurement price. On average, the prices of 40 essential drugs in the INPRES program were about twice as expensive as UNICEF list prices, and retail prices were presumably many times higher still. It should be noted that the UNICEF prices are based on international competitive tendering, which lowers prices. A separate study (Ministry of Health, 1987), in contrast, suggests that average INPRES procurement prices were not much higher than average international prices from a mix of sources.

4.58 However, both these analyses are dated, and a more careful recent evaluation of drug pricing, marketing, distribution, import tariffs and competition policies is urgently needed to ascertain if, indeed, medicine costs are unusually high and a deterrent to effective health care in Indonesia. Better medicine dispensing practices, and greater availability of essential drugs in public health centers are also needed in the public health system (e.g., as noted earlier, the availability of medical supplies seemed to be a far more important and statistically significant determinant of health center visits, than the availability of health staff—doctors and nurses).

4.59 **Private Health Services**. The third part of the answer to improving health services is to encourage private health

services. Here, the role of the Government remains critical with regard to its regulatory, pricing and standard setting roles in several areas.

4.60 Higher *user fees* for curative services at public facilities are one key element. As already discussed, hospital fees should be raised to reduce subsidies for the better-off. Even in health centers and sub-centers, price discrimination (e.g., by self-selecting methods, or geographic targeting) by charging higher fees for the better-off should be explored and encouraged. Higher fees for the better-off would lead them to opt for private services and provide a tool for targeting Government subsidies to those patients who are least able to pay. In major urban areas and in relatively more prosperous provinces, there are few grounds for subsidizing public curative health services heavily.

4.61 A second element would be to *encourage private voluntary services* (e.g., NGOs) to provide public services in primary health care. There are many NGOs who are already providing effective community health services. It does not matter whether public or private providers deliver such services, provided that the costs and quality of private provision are the same or better than a comparable public facility. Consequently, such private NGO activities should be encouraged with explicit financial support from the Government, to provide more alternatives and competition to public service provision.

4.62 A third element would be to *encourage private health insurance*. It would bring important benefits in terms of resource mobilization, smooth health care payments across times of good health and ill health, and reduce the burden on the Government. At present, the Government is seeking to provide health insurance coverage for workers as part of the new Social Security Law (JAMSOSTEK), financed by a mandatory payroll tax, and administered by a public monopoly. It would be better if private employers are encouraged to buy alternative private health insurance for their workers, and to allow private service providers to provide health services under such insurance schemes, to avoid burdening the public budget and public health system for the non-poor.

4.63 A fourth key element would be to encourage *better quality of services* in the private sector. Improvements in standards can come from basically three main sources: (a) better pre-service education and training; (b) higher standards in public services; or, (c) more inputs in quality of services from outside professionals.

4.64 The pre-service education and training system needs to be further improved, and there is an important role of the Government in this regard. The quality of such education remains uneven. Three mechanisms—*assessments of medical schools, curriculum reviews, and student examinations*—that can be used to achieve higher standards need to be strengthened. As regards nurses, midwives and paramedic workers, current arrangements for *school accreditation, curriculum reviews, examinations, licensing and scholarships* remain underutilized. These regulatory mechanisms can be used to achieve qualitative improvements in worker standards and performance (World Bank, 1994d).

4.65 While better pre-service education and training are needed, improvements in in-service standards are likely to be more immediately effective. One of the management tools to achieve this is to encourage the *adoption of quality assurance programs* in public health services. This would be expected to have an important impact on the quality of private health services, because much of the private medical services now being provided come from

doctors, nurses and paramedics who are in public employment, and provide private services outside official hours. Even those fully in private practice are often trained in public health services. Quality assurance programs focus on the process of providing health services—i.e., what is actually done to and for the patient in giving and receiving care. It includes the patient's activities in seeking care and carrying it out, as well as the practitioner's activities in making a diagnosis and recommending or implementing a treatment. Process indicators are chosen by expert committees, and outcomes measured (de Geyndt, 1994).

4.66 Another potentially important source of improving the quality of private medical services, and which might have spillover benefits for public services, would be to deregulate medical services, and allow the entry of health practitioners and health management professionals from abroad. The Government has recently announced that it intends to allow joint ventures in hospitals.

Endnotes

1. The preliminary report of the 1994 Indonesia Demographic and Health Survey (IDHS) suggests a reduction in child mortality, after relative stagnation in the late 1980s. The full results of the survey, however will only be available in September 1995. The comparability of the IDHS data over time, and with other surveys results are also not known. The Government's REPELITA VI document suggests a lower level of child mortality than that in the IDHS.

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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

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Population And Growth Rates by Province, 1930–1990

Region	Population ('000)						Average growth rate (% p.a.)				
	1930	1961 /a	1971 /a	1980	1985	1990	1930–61	1961–71	1971–80	1980–85	1985–90
Java	41,718	63,059	76,086	91,270	99,852	107,528	1.3	1.9	2.0	1.8	1.5
DKI Jakarta	811	2,973	4,579	6,503	7,885	8,225	4.3	4.4	4.0	3.9	0.8
West Java	10,586	17,615	21,624	27,454	30,830	35,380	1.7	2.1	2.7	2.3	2.8
Central Java	13,706	18,407	21,877	25,373	26,945	28,519	1.0	1.7	1.7	1.2	1.1
DI Yogjakarta	1,559	2,241	2,489	2,751	2,930	2,915	1.2	1.1	1.1	1.3	−0.1
East Java	15,056	21,823	25,517	29,189	31,262	32,490	1.2	1.6	1.5	1.4	0.8
Sumatra	8,255	15,739	20,809	28,017	32,603	36,436	2.1	2.8	3.4	3.1	2.2
Lampung	361	1,668	2,777	4,625	5,905	6,006	5.1	5.2	5.8	5.0	0.3
Bengkulu	323	406	519	768	943	1,181	0.7	2.5	4.5	4.2	4.6
South Sumatra	1,378	2,773	3,441	4,630	5,370	6,278	2.3	2.2	3.4	3.0	3.2
Riau	493	1,235	1,642	2,169	2,548	3,283	3.0	2.9	3.1	3.3	5.2
Jambi	245	744	1,006	1,446	1,745	2,016	3.6	3.1	4.1	3.8	2.9
West Sumatra	1,910	2,319	2,793	3,407	3,698	4,001	0.6	1.9	2.2	1.7	1.6
North Sumatra	2,542	4,965	6,622	8,361	9,422	10,254	2.2	2.9	2.6	2.4	1.7
Aceh	1,003	1,629	2,009	2,611	2,972	3,417	1.6	2.1	3.0	2.6	2.8
Kalimantan	2,170	4,102	5,155	6,723	7,722	9,111	2.1	2.3	3.0	2.8	3.4
West Kalimantan	802	1,581	2,020	2,486	2,819	3,237	2.2	2.5	2.3	2.5	2.8
Central Kalimantan	203	497	702	954	1,118	1,398	2.9	3.5	3.5	3.2	4.6
South Kalimantan	836	1,473	1,699	2,065	2,273	2,599	1.8	1.4	2.2	1.9	2.7
East Kalimantan	329	551	734	1,218	1,512	1,877	1.7	2.9	5.8	4.4	4.4
Sulawesi	4,231	7,079	8,528	10,409	11,554	12,519	1.7	1.9	2.2	2.1	1.6
Central Sulawesi	390	693	914	1,290	1,511	1,705	1.9	2.8	3.9	3.2	2.4
North Sulawesi	748	1,310	1,719	2,115	2,313	2,480	1.8	2.8	2.3	1.8	1.4
South Sulawesi	2,657	4,517	5,181	6,062	6,610	6,983	1.7	1.4	1.8	1.7	1.1
Southeast Sulawesi	436	559	714	942	1,120	1,351	0.8	2.5	3.1	3.5	3.8
Other Islands	4,219	7,106	8,630	11,071	12,316	13,654	1.7	2.0	2.8	2.2	2.1
Bali	1,101	1,783	2,120	2,470	2,649	2,779	1.6	1.7	1.7	1.4	1.0
West Nusa Tenggara	1,016	1,808	2,203	2,725	2,995	3,371	1.9	2.0	2.4	1.9	2.4
East Nusa Tenggara	1,344	1,967	2,295	2,737	3,061	3,270	1.2	1.6	2.0	2.3	1.3
Maluku	579	790	1,089	1,410	1,609	1,853	1.0	3.3	2.9	2.7	2.9
Irian Jaya	179	758	923	1,174	1,371	1,631	4.8	2.0	2.7	3.2	3.5
East Timor	n.a	n.a	n.a	555	631	750	n.a	n.a	n.a	2.6	3.5
Total Indonesia	60,593	97,085	119,208	147,490	164,047	179,248	1.5	2.1	2.4	2.2	1.8

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

Source: Central Bureau of Statistics, Population Census Reports, 1961, 1971, 1980 and 1990; Statistical Yearbook Of Indonesia, 1984; and SUPAS 1985.

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Distribution of Population by Age Group and Sex, 1961–1990 /a
('000)

Age Group	1961			1971			1980			1985			1990		
	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
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
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
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
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
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
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
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	7,056	7,284	14,320
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
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
Not stated	60	57	117	7	8	15	11	9	20	4	3	7	3	5	8
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
						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
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
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
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
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
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
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
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
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
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
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
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

Source : Central Bureau of Statistics, Census Reports, 1961, 1971, 1980, and 1990; Intercensal Population Survey, 1985.

Table 1.2

Table 1.3

INDONESIA

COUNTRY ECONOMIC REPORT

Employment by Main Industry , 1971–1990 /a

Main Industry	1971 million	1971 %	1980 million	1980 %	1982 million	1982 %	1985 million	1985 %	1990 million	1990 %
Agriculture, forestry, hunting & fishery	26.5	64.2	28.0	54.8	31.6	54.7	34.1	54.6	35.5	50.1
Mining and quarrying	0.1	0.2	0.4	0.7	0.4	0.7	0.4	0.7	0.7	1.0
Manufacturing	2.7	6.5	4.4	8.5	6.0	10.4	5.8	9.3	8.2	11.6
Electricity, gas & water	0.0	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Construction	0.7	1.6	1.6	3.1	2.2	3.7	2.1	3.4	2.8	4.0
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
Transportation, storage & communications	1.0	2.3	1.5	2.9	1.8	3.1	2.0	3.1	2.7	3.8
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
Public services	4.1	10.0	7.7	15.1	7.1	12.3	8.3	13.3	9.7	13.7
Others	1.9	4.6	0.7	1.4	0.0	0.0	0.1	0.1	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

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

Source: Central Bureau of Statistics, Statistical Yearbook of Indonesia, 1975, 1982, 1985 and 1990 Census.

Table 1.4

INDONESIA

COUNTRY ECONOMIC REPORT

Population Distribution by Province and Urban & Rural, 1980–1990

Region	1980 Urban	1980 Rural	1990 Urban	1990 Rural	Growth Rates (% p.a.) Urban	Growth Rates (% p.a.) Rural
Java	**22,926,377**	**68,290,593**	**38,335,297**	**69,182,666**	**5.28**	**0.00**
DKI Jakarta	6,071,748	408,906	8,222,515	0	3.08	0.00
West Java	5,770,868	21,678,972	12,208,176	23,170,307	7.78	0.67
Central Java	4,756,007	20,611,337	7,694,539	20,822,247	4.93	0.10
DI Yogyakarta	607,267	2,142,861	1,294,056	1,618,555	7.86	(2.77)
East Java	5,720,487	23,448,517	8,916,011	23,571,557	4.54	0.05
Sumatera	**5,481,488**	**22,514,439**	**9,293,747**	**27,128,739**	**5.42**	**1.88**
Lampung	576,872	4,047,366	747,327	5,256,782	2.62	2.65
Bengkulu	72,492	695,496	240,192	938,759	12.73	3.04
South Sumatra	1,267,009	3,360,710	1,839,492	4,438,453	3.80	2.82
Riau	588,212	1,575,684	1,047,454	2,233,592	5.94	3.55
Jambi	182,846	1,261,630	432,727	1,581,327	9.00	2.28
West Sumatra	433,120	2,973,012	807,983	3,190,694	6.43	0.71
North Sumatra	2,127,436	6,223,514	3,638,832	6,613,479	5.51	0.61
Aceh	233,501	2,377,027	539,740	2,875,653	8.74	1.92
Kalimantan	**1,441,300**	**5,275,596**	**2,506,657**	**6,596,249**	**5.69**	**2.26**
West Kalimantan	416,923	2,067,968	642,989	2,592,377	4.43	2.29
Central Kalimantan	98,257	855,919	245,249	1,150,612	9.58	3.00
South Kalimantan	440,901	1,622,326	702,950	1,893,697	4.78	1.56
East Kalimantan	485,219	729,383	915,469	959,563	6.55	2.78
Sulawesi	**1,654,190**	**8,746,358**	**2,761,021**	**9,750,142**	**5.26**	**1.09**
Central Sulawesi	115,472	1,169,056	281,134	1,422,196	9.31	1.98
North Sulawesi	354,607	1,760,215	564,795	1,913,151	4.76	0.84
South Sulawesi	1,096,075	4,963,489	1,685,443	5,295,146	4.40	0.65
Southeast Sulawesi	88,036	853,598	229,649	1,119,649	10.06	2.75
Other Islands	**1,342,474**	**9,659,008**	**2,494,449**	**11,150,256**	**6.39**	**1.45**
Bali	363,336	2,106,388	734,237	2,043,119	7.29	(0.30)
West Nusa Tenggara	383,421	2,340,257	582,180	2,789,519	4.26	1.77
East Nusa Tenggara	205,457	2,531,531	372,242	2,895,677	6.12	1.35
Maluku	152,944	1,255,507	352,438	1,498,649	8.71	1.79
Irian Jaya	237,316	869,975	395,131	1,233,956	5.23	3.56
East Timor	0	555,350	58,221	689,336	0.00	2.18
Total Indonesia	**32,845,829**	**114,485,994**	**55,391,171**	**123,808,052**	**5.36**	**0.79**

Source : Central Bureau of Statistics

Table 2.1

INDONESIA

COUNTRY ECONOMIC REPORT

Gross Domestic Product by Industrial Origin at Current Market Prices, 1983–1994 /a
(Rp. billion)

	1983 base											1993 base	
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994
1. Agriculture, Livestock, Forestry and Fishery	17,764.7	20,419.7	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	65,821.1
a. Farm food crops	11,125.9	12,691.8	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	34,739.9
b. Non–food crops /b	2,670.2	3,331.7	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	10,135.4
c. Livestock products	1,754.3	2,084.1	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	7,210.5
d. Forestry	994.2	939.0	938.0	1,000.6	1,246.8	1,446.3	1,634.7	1,854.6	2,018.0	2,179.6	2,541.4	6,267.6	7,451.6
e. Fishery	1,220.1	1,373.1	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	6,283.7
2. Mining & Quarrying	16,107.4	16,937.6	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	31,361.0
a. Oil & natural gas	15,103.0	15,916.7	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	21,223.0
b. Oth. mining & quarrying	1,004.4	1,020.9	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	10,158.0
3. Manufacturing	9,896.4	13,112.9	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	90,206.8
a. Refinery oil	358.9	1,012.7	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	5,742.7
b. LNG	1,871.2	2,706.7	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	4,483.9
c. Non–oil & gas mfg.	7,666.3	9,393.5	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	79,980.2
4. Electricity, gas & water	313.9	354.2	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	3,912.8
5. Construction	4,597.2	4,756.6	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	27,942.2
6. Trade, Hotel & Restaurant	11,416.7	13,434.5	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	62,561.5
a. Retail & wholesale trade	9,810.5	11,371.4	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	49,751.5
b. Hotels & Rest.	1,606.2	2,063.1	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	12,810.0
7. Transport & Communications	4,096.1	5,050.8	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	26,927.0
a. Transport	3,693.7	4,611.3	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	23,018.7
b. Communications	404.4	439.5	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	3,908.3
8. Banks & Finance	2,358.6	3,058.2	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	16,871.2
9. Ownership of Dwellings/ Real Estate /c	2355.5	2572.6	2775.0	2976.0	3349.1	3736.0	4151.1	4890.8	5924.7	6505.9	7610.6	9695.1	11239.0
10. Other Services	8,712.3	10,187.8	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	37,706.9	40,491.7
a. Public	5,711.5	6,469.9	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	22,817.7
b. Other Private & Services /d	3,000.8	3,717.9	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	17,674.0
Gross Domestic Products	77,622.8	89,885.1	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	377,354.3

/a. In 1995, 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 2.2

INDONESIA

COUNTRY ECONOMIC REPORT

Gross Domestic Product by Industrial Origin at Constant Market Prices, 1983–1994 /a
(Rp. billion)

	1983 base											1993 base	
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994
1. Agriculture, Livestock, Forestry and Fishery	17,764.7	18,512.8	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	59,153.8
a. Farm food crops	11,125.9	11,660.2	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	31,226.9
b. Non–food crops /b	2,670.2	2,794.8	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	9,480.6
c. Livestock products	1,754.3	1,890.1	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	6,515.2
d. Forestry	994.2	894.4	850.7	888.7	967.9	1,013.0	973.8	1,002.7	1,002.9	980.4	996.6	6,267.6	6,309.6
e. Fishery	1,220.1	1,253.1	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	5,621.5
2. Mining & Quarrying	16,107.4	17,120.1	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	33,172.4
a. Oil & natural gas	15,103.0	16,186.9	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	23,651.6
b. Oth. mining & quarrying	1,004.4	933.2	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	9,520.8
3. Manufacturing	9,896.4	12,078.8	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	81,690.3
a. Refinery oil	358.9	625.6	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	5,685.8
b. LNG	1,671.2	2,790.2	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	4,600.2
c. Non–oil & gas mfg.	7,666.3	8,663.0	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	71,404.3
4. Electricity, gas & water	313.9	324.0	360.9	429.8	494.6	548.9	615.6	725.7	842.8	928.2	1,022.3	3,290.2	3,707.4
5. Construction	4,597.2	4,393.8	4,506.0	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	25,824.6
6. Trade, Hotel & Restaurant	11,418.7	11,811.0	12,398.6	13,396.5	14,356.2	15,656.8	17,338.1	18,568.6	19,576.2	21,009.1	22,850.1	55,297.6	60,381.0
a. Retail & wholesale trade	9,810.5	10,028.0	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	48,559.4
b. Hotels & Rest.	1,608.2	1,783.0	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	11,821.6
7. Transport & Communications	4,098.1	4,443.1	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	25,014.2
a. Transport	3,693.7	4,008.1	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	21,228.6
b. Communications	404.4	435.0	455.2	490.3	544.8	585.5	660.2	771.5	866.7	953.6	1,110.1	3,147.7	3,785.6
8. Banks & Finance	2,358.6	2,829.0	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	15,732.7
9. Ownership of Dwellings Real Estates /c	2,355.5	2,411.5	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. Other Services	8,712.3	9,113.5	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	37,706.9	39,210.2
a. Public	5,711.5	5,996.7	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	22,903.7
b. Other Private & Services /d	3,000.8	3,116.8	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	16,306.5
Gross Domestic Products	77,622.8	83,037.4	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	353,973.4

/a. In 1995, 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.

INDONESIA

COUNTRY ECONOMIC REPORT

Table 2.3

Expenditure on GDP at Current Market Prices, 1983–1994 /a
(Rp. billion)

	1983 base											1993 base	
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994
1. Private consumption	47,063.0	54,066.5	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	183,530.5	213,256.5
2. Government consumption	8,077.3	9,121.5	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
3. Gross fixed investment	19,467.9	20,136.1	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	104,220.7
4. Changes in stock /c	2,793.5	3,406.4	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	22,908.2	24,105.7
5. Exports of goods and nonfactor services	19,847.0	22,999.3	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	85,296.2	94,537.4
6. Less: Imports of goods and nonfactor services	19,625.9	19,844.7	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	89,780.0
Gross Domestic Product	**77,622.8**	**89,885.1**	**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**	**377,354.3**

/a. In 1995, 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. Includes Business Services.

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Expenditure on GDP at Constant Market Prices, 1983 – 1994 /a
(Rp. billion)

Table 2.4

	1983 base											1993 base	
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994
Private consumption	47,063.0	48,942.2	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	183,530.5	194,185.2
Government consumption	8,077.3	8,353.0	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	30,608.6
Gross fixed investment	19,467.9	18,296.6	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	97,582.8
Changes in stock /c	2,793.5	4,451.9	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	22,908.2	28,900.0
Exports of goods and nonfactor services	19,847.0	21,144.9	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	85,296.2	91,517.3
Less: Imports of goods and nonfactor services	19,625.9	18,151.2	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	88,820.7
Gross Domestic Product	**77,622.8**	**83,037.4**	**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**	**329,775.9**	**353,973.2**

/a. In 1995, 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. Includes Business Services.

Source: Central Bureau of Statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Distribution of GDP at Current Market Prices, 1983–1994 /a
(%)

	1983 base											1993 base	
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994
Economic sectors													
Agriculture, forestry, fishery and livestock	22.9	22.7	23.2	24.2	23.3	24.1	23.4	21.5	19.7	19.5	18.5	17.9	17.4
Mining & quarrying	20.8	18.8	14.0	11.2	13.8	12.1	13.1	13.4	13.8	11.5	10.2	9.6	8.3
Manufacturing	12.7	14.6	16.0	16.7	16.9	18.5	18.1	19.9	21.0	21.8	22.3	22.3	23.9
Electricity, gas and water	0.4	0.4	0.4	0.6	0.6	0.6	0.6	0.6	0.8	0.8	0.9	1.0	1.0
Construction	5.9	5.3	5.5	5.2	4.9	5.0	5.3	5.5	5.7	5.9	6.0	6.8	7.4
Transport & communications	5.3	5.6	6.3	6.2	6.0	5.7	5.6	5.6	6.1	6.6	6.9	7.0	7.1
Other services	32.0	32.5	34.7	35.8	34.5	33.9	33.9	33.4	33.0	33.9	35.3	35.4	34.8
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expenditure categories													
Private consumption	60.6	60.2	59.0	61.7	57.7	57.0	53.1	54.4	55.0	52.3	52.4	55.7	56.5
Government consumption	10.4	10.1	11.2	11.0	9.4	9.0	9.4	9.0	9.1	9.5	9.9	9.0	8.2
Gross domestic investment	26.7	26.2	28.0	28.3	31.4	31.5	35.2	36.1	35.5	35.9	35.3	33.2	34.0
Net exports	0.3	3.5	1.8	−1.0	1.5	2.5	2.3	0.5	0.4	2.3	2.4	2.1	1.3
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

/a. In 1995, 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.

Source: Central Bureau of Statistics.

Table 2.5

INDONESIA

COUNTRY ECONOMIC REPORT

Distribution of GDP at Constant Market Prices, 1983 – 1994 /a
(%)

	1983 base											1993 base	
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1993	1994
Economic Sectors													
Agriculture, forestry, fishery and livestock	22.9	22.3	22.7	22.0	21.4	21.2	20.4	19.4	18.4	18.5	17.6	17.9	16.7
Mining & quarrying	20.8	20.6	18.2	18.1	17.3	15.9	15.5	15.2	15.7	14.5	13.9	9.6	9.4
Manufacturing	12.7	14.5	15.8	16.3	17.2	18.2	18.5	19.4	20.0	20.6	21.1	22.3	23.1
Electricity, gas and water	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7	1.0	1.0
Construction	5.9	5.3	5.3	5.1	5.1	5.3	5.5	5.8	6.0	6.3	6.6	6.8	7.3
Transport & communications	5.3	5.4	5.3	5.2	5.2	5.2	5.4	5.5	5.6	5.8	5.9	7.0	7.1
Other services	32.0	31.5	32.3	32.8	33.3	33.7	34.2	34.0	33.7	33.8	34.2	35.4	35.4
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expenditure categories													
Private consumption	60.6	58.9	58.1	56.1	55.2	54.2	52.6	53.9	54.0	52.2	51.9	55.7	54.9
Government consumption	10.4	10.1	10.6	10.3	9.8	9.9	10.2	9.8	9.8	9.8	9.2	9.0	8.6
Gross domestic investment	28.7	27.4	30.9	30.8	29.2	26.3	27.9	31.3	29.9	29.7	30.1	33.2	35.7
Net exports	0.3	3.6	0.5	2.8	5.8	9.5	9.3	5.0	6.2	8.4	8.8	2.1	0.8
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

/a. In 1995, 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.

Source: Central Bureau of Statistics.

Table 2.6

INDONESIA

COUNTRY ECONOMIC REPORT

Balance of Payments, 1983/84 – 1993/94
(US$ million)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94 /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
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
3. Non-oil exports (net)	-11522	-9784	-7955	-6635	-5466	-4919	-5510	-9751	-8914	-6076	-5474
Exports, fob	5,367	5,907	6,175	6,731	9,502	12,184	14,493	15,380	19,008	24,823	27,170
Imports, cif	-14346	-12921	-11186	-10385	-11763	-13586	-16478	-21609	-24066	-26390	-26157
Services (nonfreight)	-2543	-2770	-2944	-2981	-3205	-3517	-3525	-3522	-3856	-4509	-6487
4. Current account (1+2+3)	-4151	-1968	-1832	-4051	-1706	-1859	-1599	-3741	-4352	-2561	-2940
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
IGGI	4,255	3,189	2,751	3,978	4,368	5,603	4,698	4,929	5,292	5,567	5,795
Special assistance						2,169	1,807	1,542	1,069	886	0
Program aid	84	52	38	48	30	23	6	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	5,795
ODA	1,902	1,442	1,332	1,932	2,807	2,406	2,300	2,766	3,165	3,078	3,921
Non-ODA	2,269	1,695	1,381	1,998	1,531	1,005	585	621	1,058	1,603	1,874
Non-IGGI	1,538	330	681	1,494	207	985	818	77	308	188	400
Cash loan	0	0	0	0	0	0	0	0	0	0	0
6. Amortization	-1010	-1292	-1644	-2129	-3049	-3763	-3686	-4082	-4182	-4840	-5132
7. Other capital (net)	1,191	499	572	1,232	1,709	-211	575	5,856	4,133	4,284	4,648
Direct investment	193	245	299	252	544	585	722	1424	1,531	1,705	1,971
Oil sector	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Others	998	254	273	980	1165	-796	-147	4,432	2,602	2,579	2,677
8. Total (4 through 8)	1,823	758	528	524	1,529	755	806	3,039	1,199	2,638	2,771
9. Errors and omissions	247	-91	-498	-1262	57	-1432	-558	263	-218	-1199	-2044
10. Monetary movements /b	-2070	-667	-30	738	-1586	677	-248	-3302	-981	-1439	-727

/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.

Source: Bank Indonesia.

Table 3.1

Table 3.2

INDONESIA

COUNTRY ECONOMIC REPORT

Non – oil Exports, 1984/85 – 1993/94

	Value (US $ million)									
	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94
Agricultural	3,663	3,635	4,493	5,764	6,927	7,027	7,262	7,815	8,884	11,313
Timber	1,167	1,217	1,586	2,461	2,884	3,465	3,452	3,732	4,343	6,374
a. Log	135	2	0	0	0	6	5	10	13	7
b. Plywood	697	848	1,160	1,851	2,095	2,438	2,764	2,868	3,270	4,745
c. Sawn timber	320	349	321	483	592	600	90	90	93	163
d. Other	16	18	105	127	197	421	593	764	967	1,459
Rubber	856	714	749	1,037	1,229	956	887	932	1,054	1,005
Palm oil	95	170	114	214	313	279	284	349	495	518
Coffee	568	659	753	499	577	452	371	362	264	392
Tea	211	134	106	119	137	181	154	145	143	156
Tobacco	44	55	72	47	43	44	72	65	79	72
Pepper	66	82	152	158	144	94	78	69	55	59
Copra cake	18	35	34	41	43	51	56	51	63	59
Tapioca	31	42	52	93	154	97	121	99	119	74
Rattan	96	80	99	162	37	235	230	295	298	355
Hides	40	37	45	59	68	70	58	43	43	44
Other foodstuff	98	122	122	153	202	250	324	304	341	418
Animal products	219	274	390	488	839	781	1,076	1,150	1,266	1,499
of which shrimps	183	228	297	352	541	520	711	810	745	898
Others	155	14	221	234	258	72	100	120	202	216
Mineral	775	799	719	1,112	1,556	1,582	1,440	1,692	2,195	2,109
Tin	252	248	156	143	165	213	147	146	145	132
Copper	132	133	144	186	238	321	447	528	719	650
Nickel	121	139	112	152	438	404	326	289	283	260
Aluminum	208	223	201	245	301	267	202	159	199	192
Granite	9	8	8	6	6	9	14	–	–	–
Others	53	49	98	379	407	368	304	570	849	875
Manufactured	1,469	1,739	1,519	2,626	3,701	5,884	6,678	9,501	13,744	14,119
Textiles	418	577	713	1,128	1,571	2,219	2,731	4,011	5,876	5,763
Handicraft	116	30	30	67	184	250	357	489	605	645
Electrical app.	134	109	46	55	105	176	259	544	1,100	1,223
Cement	14	23	47	54	85	128	69	68	104	60
Fertilizer	31	109	97	117	136	167	214	291	147	166
Others	757	892	585	1,205	1,619	2,944	3,049	4,098	5,912	6,262
Unclassified	0	0	0	0	0	0	0	0	0	0
Total Non–oil Exports	5,907	6,173	6,731	9,502	12,184	14,493	15,380	19,008	24,823	27,541

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

INDONESIA

COUNTRY ECONOMIC REPORT

Value of Exports by Principal Country of Destination, 1983–1994
(US$ million)

Countries	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Asean	3,476	2,487	1,982	1,515	1,703	2,079	2,429	2,515	3,197	4,360	4,746	5,704
Malaysia	58	98	77	82	94	184	220	253	342	488	586	738
Thailand	49	98	81	83	87	151	234	189	267	353	468	401
Philippines	242	166	199	108	71	87	149	161	168	181	285	365
Singapore	3,128	2,126	1,626	1,239	1,449	1,653	1,818	1,902	2,410	3,314	3,372	4,150
Brunei	0	0	0	2	3	4	8	11	10	25	35	50
Hongkong	182	261	348	345	420	554	549	618	703	881	901	1,321
Japan	9,678	10,353	8,594	6,644	7,393	8,018	9,321	10,923	10,767	10,761	11,172	10,929
Other Asia	801	1,254	1,475	1,170	1,869	2,415	2,934	4,035	5,540	6,567	6,980	7,645
Africa	79	140	160	179	150	272	217	199	394	419	463	638
USA	4,267	4,505	4,040	2,902	3,349	3,074	3,497	3,365	3,509	4,419	5,230	5,829
Canada	28	46	46	60	94	101	108	139	172	289	304	322
Other America	1,015	1,031	326	182	48	47	50	102	184	328	469	562
Australia	208	275	149	159	310	293	387	403	628	746	774	705
Other Oceania	264	236	81	83	43	31	59	84	39	53	78	67
EEC	953	1,036	1,113	1,340	1,541	2,152	2,338	3,028	3,742	4,843	5,295	5,825
United Kingdom	199	168	191	197	212	349	384	517	654	844	1,005	1,038
Netherlands	289	332	392	453	493	646	681	723	838	1,100	1,086	1,324
West Germany	252	246	255	334	361	456	493	750	907	978	1,178	1,263
Belgium & Luxemburg	33	63	45	91	109	177	173	210	258	401	366	409
France	53	49	71	93	102	164	209	286	386	495	500	426
Denmark	4	6	3	6	13	20	36	54	74	97	98	110
Ireland	1	4	2	2	7	17	22	35	43	46	40	37
Italy	120	167	152	152	175	221	234	276	382	583	615	661
Greece	1	1	3	6	3	2	4	9	18	29	46	63
Portugal	0	0	0	7	10	22	24	17	14	16	29	39
Spain	0	0	0	0	55	78	80	152	169	255	333	454
Soviet Union	50	59	78	52	82	38	100	81	40	70	125	91
Others in Europe	145	206	194	174	133	144	171	183	229	231	288	417
Total	21,146	21,888	18,587	14,805	17,136	19,219	22,159	25,675	29,142	33,967	36,823	40,053

Source: Central Bureau of Statistics.

Table 3.3

Table 3.4

INDONESIA

COUNTRY ECONOMIC REPORT

Value of Imports by Principal Country of Origin, 1983–1994
(US$ million)

Countries	1983	1984 /a	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994 /b
Asean	3,915	1,948	962	1,121	1,244	1,305	1,765	2,430	2,464	2,592	2,604	2,928
Malaysia	60	86	52	50	139	276	369	326	407	525	517	579
Thailand	209	55	48	72	75	96	210	183	278	345	235	407
Philippines	182	15	23	28	82	36	63	649	81	52	57	65
Singapore	3,465	1,791	839	969	947	896	1,122	1,272	1,699	1,670	1,793	1,877
Brunei	0	0	0	1	0	1	2	0	0	1	1	0
Hongkong	65	86	53	94	104	133	179	273	232	229	247	241
Japan	3,793	3,308	2,644	3,128	3,596	3,386	3,767	5,300	6,327	6,014	6,248	7,734
Other Asia	2,220	2,338	1,727	1,681	1,924	2,266	3,203	4,633	5,156	5,496	5,972	6,870
Africa	135	171	160	103	153	201	202	170	195	213	140	332
USA	2,534	2,560	1,721	1,483	1,415	1,736	2,218	2,520	3,397	3,822	3,255	3,594
Canada	186	319	198	214	303	274	311	407	354	459	410	497
Other America	129	139	191	174	211	224	455	519	597	488	625	755
Australia	402	372	461	413	463	578	925	1,186	1,378	1,413	1,399	1,542
Other Oceania	72	78	69	71	80	96	98	115	118	136	161	186
EEC	2,234	2,062	1,706	1,796	2,353	2,510	2,575	4,061	4,704	5,401	5,652	5,827
United Kingdom	364	297	300	342	325	340	360	440	603	719	782	710
Netherlands	257	266	215	189	316	258	248	550	505	507	626	564
West Germany	741	820	677	719	836	887	920	1,502	2,061	2,141	2,072	2,473
Belgium & Luxemburg	124	102	101	89	142	159	167	232	254	324	340	292
France	591	432	284	281	392	465	406	643	544	816	853	786
Denmark	21	20	18	26	26	22	31	61	49	124	158	106
Ireland	8	8	9	4	6	6	8	74	13	23	21	22
Italy	125	113	101	144	237	248	348	410	536	558	523	670
Greece	3	4	0	0	2	3	3	6	5	8	12	26
Portugal	0	0	0	2	6	3	2	6	4	2	2	4
Spain	0	0	0	0	66	120	82	136	131	178	262	174
Soviet Union	25	12	3	5	16	45	51	53	48	47	97	220
Others in Europe	641	490	365	435	510	494	611	764	899	969	1,517	1,264
Total	16,352	13,882	10,259	10,719	12,370	13,249	16,360	22,431	25,869	27,279	28,328	31,989

/a Since 1984, excludes the value of processing deals in the oil sector.

Source: Central Bureau of Statistics.

Table 4.1

INDONESIA

COUNTRY ECONOMIC REPORT

Summary of External Debt Data, 1981–93

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
External debt data						(US$ million)							
Disbursed and outstanding debt (DOD) /a/b	15,908	18,318	21,494	22,266	26,777	32,634	40,908	41,241	41,092	44,979	48,732	49,342	52,363
Bilateral/multilateral	10,096	10,913	11,818	12,203	15,063	18,565	24,788	26,552	28,256	33,301	37,738	40,092	44,276
Other /c	5,813	7,405	9,676	10,063	11,714	14,069	16,120	14,689	12,836	11,679	10,994	9,250	8,087
Total debt outstanding, including undisbursed (TDO)	26,953	32,008	35,298	36,352	42,784	50,089	60,448	60,076	59,715	65,154	69,151	68,306	71,813
Bilateral/multilateral	17,705	19,326	20,556	21,496	25,359	29,480	37,334	38,984	41,454	47,430	53,340	54,642	59,081
Other /c	9,248	12,682	14,741	14,856	17,425	20,609	23,114	21,093	18,261	17,724	15,811	13,664	12,732
Commitments	4,951	7,070	5,667	4,816	4,638	4,103	5,992	6,066	7,166	6,327	6,143	6,268	6,335
Bilateral/multilateral	2,157	2,593	2,294	2,745	2,421	2,004	4,791	4,779	5,752	5,257	6,321	5,092	5,723
Other /c	2,795	4,477	3,393	2,071	2,217	2,099	1,202	1,308	1,413	1,070	1,822	1,175	2,612
Gross disbursements	2,672	3,951	4,979	3,690	3,553	4,240	5,463	6,423	6,472	4,771	6,333	6,245	5,932
Bilateral/multilateral	1,362	1,595	1,737	1,937	1,625	1,900	3,694	4,287	4,265	4,163	5,012	5,004	4,463
Other /c	1,310	2,356	3,242	1,953	1,928	2,340	1,769	2,136	2,206	607	1,321	1,241	1,469
Net disbursements	1,618	2,847	3,689	2,290	1,223	1,618	2,057	1,965	2,036	646	2,151	1,534	723
Bilateral/multilateral	985	1,126	1,166	1,366	1,010	1,007	2,543	2,952	2,890	2,529	3,204	2,982	2,294
Other /c	633	1,721	2,503	922	212	611	(486)	(966)	(854)	(1,884)	(1,053)	(1,449)	(1,572)
Net resource transfers	628	1,715	2,456	661	(420)	(454)	(216)	(540)	(465)	(1,869)	(497)	(1,201)	(2,159)
Bilateral/multilateral	654	732	733	802	314	81	1,462	1,643	1,495	932	1,413	966	46
Other /c	(26)	983	1,723	(141)	(733)	(535)	(1,677)	(2,183)	(1,960)	(2,821)	(1,910)	(2,169)	(2,205)
Public debt service	2,045	2,236	2,523	3,229	3,972	4,694	5,679	6,963	6,936	6,660	6,830	7,446	8,091
Amortization	1,054	1,104	1,290	1,600	2,330	2,622	3,406	4,436	4,435	4,125	4,182	4,711	5,210
Interest	991	1,132	1,233	1,629	1,643	2,072	2,273	2,525	2,501	2,535	2,648	2,735	2,881
Public debt service	2,045	2,236	2,523	3,229	3,972	4,694	5,679	6,963	6,936	6,660	6,830	7,446	8,091
Bilateral/multilateral	708	863	1,004	1,135	1,311	1,819	2,232	2,645	2,770	3,232	3,599	4,037	4,417
Other /c	1,336	1,373	1,519	2,093	2,661	2,875	3,447	4,319	4,166	3,428	3,231	3,409	3,674
Disbursement indicators						(%)							
Undisbursed debt/TDO /b	41	43	39	39	37	35	32	31	31	31	30	28	27
Bilateral/multilateral	43	44	43	43	41	37	34	32	32	30	29	27	25
Other /c	37	42	34	32	33	32	30	30	30	34	30	32	36
Gross disbursements/commit.	54	56	88	61	77	103	91	106	90	75	78	100	71
Bilateral/multilateral	63	62	76	71	67	95	77	90	74	79	79	98	78
Other /c	47	53	96	94	87	111	147	163	156	57	73	106	56
Gross disbursements/undisbursed debt and commitments /d	21	24	38	28	24	27	22	28	32	9	20	22	20
Bilateral/multilateral	14	14	16	16	13	15	21	25	23	21	23	25	22
Other /c	21	24	38	28	24	27	22	28	32	9	20	22	20
Net disbursemnts/gross disbs.	61	72	74	59	34	38	38	31	31	14	34	25	12
Bilateral/multilateral	72	71	66	71	62	53	69	69	68	61	64	60	51
Other /c	48	73	77	47	11	26	(27)	(45)	(39)	(310)	(80)	(117)	(107)
Net resource transfers/gross disbs.	23	43	49	17	(12)	(11)	(4)	(8)	(7)	(40)	(8)	(19)	(36)
Bilateral/multilateral	46	46	42	41	19	4	40	38	35	22	28	19	1
Other /c	(2)	42	53	(7)	(38)	(23)	(95)	(102)	(89)	(465)	(145)	(175)	(150)

/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.
/d Gross disbursements as a percentage of undisbursed debt (TDO–DOD) at beginning of year plus commitments during the year.

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

Table 4.2
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INDONESIA

COUNTRY ECONOMIC REPORT

External Public Debt Outstanding as of December 31, 1993
(US$ '000)

Type of creditor/ creditor country	Debt outstanding Disbursed	Undisbursed	Total	Major reported new commitments Jan 1 – Dec 31 1993
Suppliers' Credits				
Finland	8,707	·	8,707	0
France	33	·	33	0
Hong Kong	156,460	·	156,460	0
Japan	1,733,600	674,895	2,408,495	241,140
Korea, Republic of	1,197	·	1,197	0
Pakistan	1,268	·	1,268	0
Switzerland	1,102	·	1,102	0
Total suppliers' credits	1,902,367	674,895	2,577,262	241,140
Financial Institutions				
France	48,873	·	48,873	0
Germany, Fed. Rep. of	0	·	0	0
Hong Kong	679,331	700,000	1,379,331	0
Italy	1,218	·	1,218	0
Japan	1,574,753	867,689	2,442,442	6,387
Multiple Lenders	0	·	0	0
Netherlands	0	·	0	0
Singapore	26,822	·	26,822	0
United Kingdom	43,934	–	43,934	0
United States	0	160,000	160,000	0
Total financial institutions	2,374,933	1,727,689	4,102,620	6,387
Bonds				
Germany, Fed. Rep. of	0	·	0	0
Netherlands	0	·	0	0
Switzerland	0	·	0	0
United Kingdom	0	·	0	0
United States	98,500	·	98,500	0
Total bonds	98,500	0	98,500	0
Nationalization				
Netherlands	87,176	·	87,176	0
Total nationalization	87,176	0	87,176	0
Multilateral Loans				
Asian Dev. Bank	5,522,580	3,558,079	9,080,659	2,064,623
EEC	4,135	·	4,135	0
IBRD	11,283,401	4,329,189	15,612,590	924,100
IDA	796,191	·	796,191	0
Intl. Fund Agr. Dev. (IFAD)	73,790	7,911	81,701	0
Islamic Dev. Bank	165	·	165	0
Nordic Invest. Bank	144,370	60,862	205,232	72,855
Total multilateral loans	17,824,632	7,956,041	25,780,673	3,061,578

Table 4.2
Page 2 of 2

INDONESIA

COUNTRY ECONOMIC REPORT

External Public Debt Outstanding as of December 31, 1993
(US$ '000)

Type of creditor/ creditor country	Debt outstanding Disbursed	Undisbursed	Total	Major reported new commitments Jan 1–Dec 31 1993

INDONESIA

COUNTRY ECONOMIC REPORT

External Public Debt Outstanding as of December 31, 1993
(US$ '000)

Type of creditor/ creditor country	Debt outstanding Disbursed	Undisbursed	Total	Major reported new commitments Jan 1–Dec 31 1993
Bilateral Loans				
Australia	449,286	24,694	473,980	23,905
Austria	12,423	–	12,423	0
Belgium	80,272	37,575	117,847	7,237
Brunei	100,000	·	100,000	0
Bulgaria	684	·	684	0
Canada	336,406	232,826	569,232	239,651
China	15,374	29,749	45,123	29,749
Czechoslovakia	22,806	·	22,806	0
Denmark	34,506	21,251	55,757	0
Egypt, Arab Republic of	955	·	955	0
France	829,143	137,589	966,732	2,107
German Dem. Rep.	18,756	·	18,756	0
Germany, Fed.Rep.of	2,177,550	1,293,802	3,471,352	776,642
Hungary	5,689	·	5,689	0
India	3,864	–	3,864	0
Italy	138,122	54,766	192,888	0
Japan	18,012,429	4,629,332	22,641,761	1,527,232
Korea, Republic of	11,923	32,658	44,581	11,025
Kuwait	58,277	6,702	64,979	0
Netherlands	1,000,722	11,210	1,011,932	0
New Zealand	644	·	644	0
Norway	0	23,676	23,676	0
Other	20,000	·	20,000	0
Pakistan	2,322	·	2,322	0
Poland	32,034	·	32,034	0
Romania	4,591	·	4,591	0
Saudi Arabia	72,963	28,100	101,063	0
Spain	75,848	84,600	160,448	40,432
Switzerland	27,167	–	27,167	0
United Arab Emirates	1,932	·	1,932	0
United Kingdom	54,379	14,181	68,560	0
United States	2,478,085	185,969	2,664,054	3,250
USSR	334,247	·	334,247	0
Yugoslavia	38,396	·	38,396	0
Total bilateral loans	26,451,817	6,848,680	33,300,498	2,661,231
Export Credits				
Austria	478,039	193,295	671,334	162,142
Belgium	153,333	21,786	175,119	0
Denmark	39060	57,694	96,774	0
Finland	19,635	732	20,367	0
France	1,068,036	615,856	1,683,892	351,115
Germany, Fed.Rep.of	77,344	17,663	95,007	0
Hong Kong	125,606	53,585	179,191	71,162
Japan	240,850	31,810	272,660	6,640
Netherlands	176,201	85,053	261,254	65,327
Norway	0	·	0	0
Singapore	0	17,310	17,310	17,310
Spain	35,462	·	35,462	0
Sweden	106,161	·	106,161	0
Switzerland	143,651	197,415	341,066	0
United Kingdom	637,783	741,408	1,379,191	1,159,163
United States	322,517	209,062	531,579	531,579
	3623697			
Total export credits	3,623,696	2,242,669	5,866,367	2,364,438
Total external public debt	52,363,121	19,449,974	71,813,096	6,334,774

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

Table 4.3

INDONESIA

COUNTRY ECONOMIC REPORT

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

	Debt outstanding at end of period		Transactions during period					Other Changes	
	Disbursed only	Including Undisbursed	Commitments	Disbursements	Service Payments: Principal	Service Payments: Interest	Service Payments: Total	Cancellations	Adjustment/a
Actual									
1980	15,027,314	24,509,975	4,277,373	2,550,505	939,494	823,811	1,763,305	118,261	–
1981	15,908,458	26,953,145	4,951,129	2,672,429	1,054,106	990,708	2,044,814	163,286	–1,290,566
1982	18,317,545	32,007,959	7,069,817	3,951,336	1,104,100	1,132,291	2,236,391	5,472	–
1983	21,493,904	35,297,509	5,686,879	4,979,024	1,289,872	1,233,096	2,522,968	197,669	–909,788
1984	22,264,983	36,350,948	4,816,038	3,889,587	1,599,785	1,628,892	3,228,677	25,234	–
1985	26,761,715	42,768,087	4,637,815	3,552,669	2,344,003	1,642,728	3,986,731	514,815	4,638,142
1986	32,616,897	50,072,359	4,104,406	4,238,493	2,621,052	2,071,629	4,692,681	184,999	6,005,918
1987	40,838,571	60,428,369	5,992,347	5,420,542	3,407,650	2,273,105	5,680,755	635,419	8,406,732
1988	41,176,463	60,092,203	6,109,657	6,396,090	4,422,041	2,525,596	6,947,637	491,962	–1,431,819
1989	41,032,480	59,683,292	7,131,022	6,472,955	4,436,037	2,501,373	6,937,410	303,892	–2,800,002
1990	44,979,155	65,153,754	6,327,116	6,770,666	4,125,282	2,534,999	6,660,281	900,518	4,169,147
1991	48,732,284	69,150,957	8,143,214	6,333,065	4,181,855	2,648,255	6,830,110	2,005,318	2,041,162
1992	49,341,886	68,305,496	6,267,700	6,244,584	4,711,099	2,734,865	7,445,964	1,381,146	–1,020,891
1993	52,363,115	71,813,092	8,334,772	5,932,353	5,209,781	2,881,427	8,091,208	626,476	1,009,078
Projected									
1994	53,717,205	65,471,620	–	5,977,833	4,622,608	2,855,840	7,478,448	1,717,729	–1,133
1995	54,070,957	60,970,864	–	4,854,507	4,500,756	2,876,171	7,376,927	–	–
1996	52,846,776	56,595,075	–	3,151,620	4,375,800	2,798,601	7,174,401	–	11
1997	50,412,609	52,308,941	–	1,851,973	4,286,141	2,660,640	6,946,781	–	7
1998	47,043,383	47,901,284	–	1,038,489	4,407,715	2,481,259	6,888,974	–	49
1999	43,081,496	43,514,327	–	425,100	4,386,987	2,257,651	6,644,638	–	~~38~~
2000	39,100,486	39,307,474	–	225,973	4,206,983	1,998,371	6,205,354	–	130
2001	35,013,683	35,149,948	–	70,724	4,157,527	1,759,049	5,916,576	–	1
2002	31,296,787	31,428,625	–	4,428	3,721,324	1,532,056	5,253,380	–	1
2003	27,746,132	27,877,197	–	773	3,551,428	1,328,364	4,879,792	–	–
2004	24,497,692	24,628,747	–	–	3,248,440	1,138,384	4,386,824	–	–9
2005	21,568,026	21,699,079	–	–	2,929,666	973,417	3,903,083	–	–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.

INDONESIA

COUNTRY ECONOMIC REPORT

DEVELOPMENT ASSISTANCE FLOWS, 1987–1992 /a
(US$ million)

COUNTRIES	1988			1989			1990			1991			1992		
	Comm. /b	Disb. /c		Comm. /b	Disb. /c		Comm. /b	Disb. /c		Comm. /b	Disb. /c		Comm. /b	Disb. /c	
		Gross	Net/d		Gross	Net/d		Gross	Net/d		Gross	Net/d		Gross	Net/d
CGI members :															
AUSTRALIA	84.0	71.7	71.7	106.2	83.1	83.1	62.8	77.4	77.4	105.7	72.9	72.9	99.4	77.0	77.0
AUSTRIA	19.2	10.5	6.9	20.7	15.7	4.4	26.8	34.3	21.2	124.1	49.3	36.1	149.5	121.6	104.8
BELGIUM	11.9	13.3	6.2	10.7	10.7	10.7	6.5	6.5	(1.6)	6.5	42.4	37.6	6.5	8.2	2.5
CANADA	88.9	43.3	40.1	81.7	38.4	33.4	37.6	51.9	48.4	14.1	45.4	42.7	37.7	40.1	33.6
FRANCE	137.2	67.6	57.1	288.9	115.3	108.9	209.7	136.0	122.4	41.8	141.6	126.5	77.4	185.3	168.8
GERMANY	151.4	190.2	97.6	179.4	138.8	52.4	268.2	211.4	99.0	621.8	253.8	135.8	293.8	261.4	116.4
ITALY	8.1	2.8	1.3	48.4	21.2	17.5	0.5	11.3	9.8	18.0	15.8	14.3	130.9	13.8	12.5
JAPAN	1,701.0	1,264.7	984.9	1,455.2	1,407.1	1,145.3	1,500.9	1,131.9	867.8	1,500.9	1,382.5	1,065.5	1,508.7	1,696.5	1,356.7
NETHERLANDS	254.6	186.5	156.2	222.2	191.0	161.5	202.6	228.4	190.1	234.6	180.5	139.4	13.2	56.1	8.0
NEW ZEALAND	2.4	2.3	2.3	–	2.2	2.2	3.3	3.1	3.1	1.8	2.4	2.4	2.9	2.6	2.6
SPAIN	–	–	–	–	0.1	–	–	23.2	23.2	–	21.5	21.5	50.0	9.5	9.5
SWITZERLAND	8.3	28.4	28.4	7.0	21.4	21.4	19.6	19.4	19.4	53.4	13.8	13.8	23.5	29.7	29.7
UNITED KINGDOM	35.6	21.7	17.2	45.2	18.2	14.5	317.0	26.4	22.4	103.0	42.9	38.9	103.0	36.6	32.7
UNITED STATES	79.8	86.0	22.0	64.4	97.0	31.0	54.2	101.0	31.0	69.4	83.0	18.0	59.8	84.0	(1.0)
Other DAC countries :															
DENMARK	–	1.1	0.6	3.4	11.5	11.1	0.6	5.7	4.9	0.8	3.0	2.2	12.0	5.9	3.7
FINLAND	8.9	3.3	3.3	0.6	5.8	5.8	3.9	2.7	2.7	1.7	3.1	3.1	1.9	1.8	1.8
IRELAND	–	–	–	–	–	–	–	–	–	0.0	–	0.0	0.0	0.0	0.0
NORWAY	–	2.2	2.0	–	1.2	0.5	–	0.3	(0.2)	0.3	0.8	(0.2)	12.3	12.6	11.8
SWEDEN	–	–	–	–	–	–	–	0.1	0.1	0.0	0.2	0.2	0.0	0.4	0.4
ARAB COUNTRIES	19.7	27.9	9.1	–	20.5	1.9	0.7	39.2	23.0	0.4	23.1	9.0	5.5	22.5	13.0
SUBTOTAL	2,611.0	2,023.5	1,506.9	2,534.0	2,199.2	1,705.6	2,714.9	2,110.2	1,564.1	2,898.3	2,378.0	1,779.7	2,588.0	2,665.6	1,984.5
MULTILATERAL															
AS.D.B.	561.1	530.4	470.1	694.9	700.7	631.1	1,049.6	778.1	667.8	990.0	655.0	446.1	0.0	55.6	453.0
E.E.C.	2.9	8.3	8.3	1.2	13.9	13.9	26.1	13.9	12.4	27.7	12.0	12.0	45.0	13.0	13.0
IBRD	1,066.9	1,647.9	1,219.2	2,007.4	1,256.4	783.4	1,565.2	987.3	436.4	1,533.0	1,398.0	790.0	1,256.3	1,003.4	326.6
IDA	–	1.3	(4.8)	–	1.1	(7.0)	–	–	(11.2)	–	–	0.0	0.0	0.0	0.0
IFAD	0.3	12.2	10.8		12.6	10.1	21.9	12.8	8.6	–	9.6	4.4	0.0	9.6	4.4
U.N. AGENCIES	47.2	40.6	40.6	53.6	45.2	45.2	51.6	43.3	43.3	58.4	49.2	49.2	0.0	58.4	58.4
UNDP	–	20.6	20.6	–	19.1	19.1	–	17.0	17.0	–	17.2	17.2	0.0	19.0	19.0
UNTA	–	3.7	3.7	–	5.2	5.2	–	4.3	4.3	–	6.7	6.7	0.0	5.8	5.8
UNICEF	–	11.9	11.9	–	11.3	11.3	–	10.0	10.0	–	11.3	11.3	0.0	14.8	14.8
UNRWA	–	–	–	–	–	–	–	–	–	–	–	0.0	0.0	0.0	0.0
WFP	–	2.7	2.7	–	7.6	7.6	–	8.0	8.0	–	7.6	7.6	0.0	14.7	14.7
UNHCR	–	1.7	1.7	–	2.0	2.0	–	4.0	4.0	–	6.4	6.4	0.0	4.1	4.1
OTHER MULTILATERAL	–	6.7	6.7	–	10.0	10.0	–	8.4	8.4	–	9.3	9.3	0.0	8.0	8.0
ARAB AGENCIES	–	0.3	(1.4)	–	–	(1.0)	–	–	(2.0)	–	1.6	1.3	5.0	2.2	13.0
SUBTOTAL	1,678.4	2,247.7	1,749.5	2,757.1	2,039.8	1,485.7	2,714.4	1,843.8	1,163.7	2,609.1	2,134.7	1,312.3	1,306.3	1,150.2	876.4
TOTAL	**4,289.4**	**4,271.2**	**3,256.4**	**5,291.1**	**4,239.0**	**3,191.3**	**5,429.3**	**3,954.0**	**2,727.8**	**5,507.4**	**4,512.7**	**3,092.0**	**3,894.3**	**3,815.8**	**2,860.9**

/a Calendar year.
/b Commitments.
/c Disbursements.
/d Net of repayments of principal.

Source : OECD : "Geographical Distribution of Financial Flows to Developing Countries"; For Spain, As.D.B., IBRD and IDA : Debtor Reporting System, World Bank.

Table 4.4

Table 5.1

INDONESIA

COUNTRY ECONOMIC REPORT

Central Government Budget Summary, 1983/84–1995/96
(Rp. billion)

	Actual											Budget	
	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
1. Domestic revenues	14,433	15,906	19,253	16,141	20,803	23,004	28,740	39,546	41,585	47,453	52,280	59,737	66,265
2. Routine expenditures /a	8,412	9,429	11,952	13,559	17,482	20,739	24,331	29,998	30,228	34,031	38,799	42,351	47,241
3. Government saving (1–2)	6,021	6,477	7,301	2,581	3,322	2,265	4,409	9,549	11,357	13,421	13,481	17,386	19,025
4. Development expenditures	9,899	9,952	10,873	8,332	9,477	12,251	13,834	19,453	21,764	24,135	25,661	27,398	30,784
5. Balance (3–4)	(3,878)	(3,475)	(3,572)	(5,751)	(6,156)	(9,985)	(9,426)	(9,905)	(10,407)	(10,713)	(12,181)	(10,012)	(11,759)
Financed by:													
6. Program aid	15	69	69	1,958	728	2,041	1,007	1,397	1,563	512	441	0	0
7. Project aid	3,868	3,409	3,503	3,795	5,430	7,950	8,422	8,508	8,846	10,204	9,931	10,012	11,759
8. Change in balances (– = increase)	(4)	(3)	(1)	(2)	(2)	(5)	(4)	(0)	(2)	(2)	1,809	0	0

/a Includes debt service payments.

Source: Ministry of Finance.

INDONESIA

COUNTRY ECONOMIC REPORT

Central Government Receipts, 1983/84 – 1995/96
(Rp. billion)

	Actual											Budget	
	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
Taxes on income	11,605	12,847	13,625	8,798	12,986	13,901	17,330	25,278	25,494	28,344	29,315	33,323	34,438
Income tax	399	451	675	2,271	2,663	3,949	5,488	6,755	9,580	11,913	15,273	18,843	19,239
Corporate tax /a	757	1,670	1,638										
Corporate tax on oil /b	9,520	10,430	11,144	6,338	10,047	9,527	11,252	17,712	15,039	15,330	12,508	12,851	13,276
Witholding tax /b	628												
IPEDA/property tax /c	132	157	168	190	275	424	590	811	875	1,101	1,534	1,629	1,923
Others /d	168	138											
Taxes on domestic consumption	1,392	1,510	3,479	5,156	4,719	6,187	7,589	9,624	11,452	13,455	16,168	18,662	21,749
Sales/value added tax	575	637	2,327	2,900	3,390	4,505	5,837	7,463	8,926	10,714	12,282	13,239	16,655
Excises	773	873	944	1,056	1,106	1,390	1,477	1,917	2,223	2,381	2,560	2,623	3,299
Other oil revenues /e	0	0	0	1,010	0	0	0	0	0	0	1,041	2,519	1,475
Miscellaneous levies	44	0	208	190	223	292	276	244	303	360	285	282	319
Taxes on international trade	916	862	658	1,039	1,122	1,348	1,759	2,530	2,152	2,661	2,902	3,460	3,588
Import duties	557	530	607	960	938	1,192	1,587	2,486	2,133	2,652	2,888	3,443	3,543
Sales tax on imports /f	255	241											
Export tax	104	91	51	79	184	156	172	44	19	9	14	16	44
Nontax receipts	520	687	1,492	1,147	1,977	1,569	2,062	2,115	2,487	2,993	3,895	4,293	6,491
Domestic revenue	14,433	15,906	19,253	16,141	20,803	23,004	28,740	39,546	41,585	47,453	52,280	59,737	66,265
Development funds	3,882	3,478	3,573	5,752	6,158	9,991	9,429	9,905	10,409	10,716	10,372	10,012	11,759
Program aid	15	69	69	1,958	728	2,041	1,007	1,397	1,563	512	441	0	0
Project aid /g	3,868	3,409	3,503	3,795	5,430	7,950	8,422	8,508	8,846	10,204	9,931	10,012	11,759
Total revenues	18,315	19,384	22,825	21,893	26,961	32,995	38,169	49,451	51,994	58,168	62,652	69,749	78,024

/a Since 1986/87 included in income tax.
/b Since 1984/85, witholding tax eliminated as separate category and combined with income tax.
/c Since January 1986, Ipeda replaced by land and building tax.
/d Classification changed to other tax (included in miscellaneous levies which consist of other taxes and stamp duty).
/e Oil subsidies shown as Government expenditures from 1977/78 (see Table 5.3).
/f Since 1984/85 classification changed to value–added tax and tax on luxury goods.
/g Includes commercial bank and suppliers' credits for development projects.

Source: Ministry of Finance.

Table 5.3

INDONESIA

COUNTRY ECONOMIC REPORT

Central Government Expenditures, 1983/84 – 1995/96
(Rp. billion)

	Actual											Budget	
	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
Personnel expenditures	2,757	3,047	4,018	4,311	4,617	4,998	6,202	7,054	8,103	9,466	11,214	13,011	15,347
Wages and salaries	1,996	2,207	3,073	3,330	3,561	3,833	4,826	5,571	6,299	7,533	9,167	10,456	12,416
Rice allowance	346	407	402	406	451	518	588	640	922	888	905	1,039	1,140
Food allowance	261	271	300	288	299	327	373	382	393	473	498	783	835
Other	88	90	161	177	176	185	243	264	279	313	342	392	511
External	66	72	82	110	130	135	171	198	209	259	302	341	445
Material expenditures	1,057	1,183	1,367	1,366	1,329	1,492	1,702	1,830	2,373	2,870	3,042	3,751	4,745
Domestic	1,007	1,134	1,310	1,294	1,239	1,378	1,569	1,670	2,217	2,681	2,848	3,526	4,457
External	50	49	58	73	90	114	133	160	155	189	194	225	288
Subsidies to region /a	1,547	1,883	2,489	2,650	2,816	3,038	3,566	4,237	4,834	5,283	6,796	7,095	8,409
Irian Jaya	42	0	0	0	0	0	0	0	0	0	0	0	0
Other region	1,505	1,883	2,489	2,650	2,816	3,038	3,566	4,237	4,834	5,283	6,796	7,095	8,409
Debt service payments	2,103	2,777	3,323	5,058	8,205	10,940	11,939	13,395	13,434	15,217	17,288	17,970	18,215
Internal	30	39	20	0	39	78	149	250	251	275	121	317	319
External	2,073	2,737	3,303	5,058	8,166	10,863	11,790	13,145	13,183	14,942	17,167	17,652	17,896
Other expenditures	948	540	754	174	515	271	923	3,483	1,484	1,195	459 /d	525	524
Food subsidy	0	0	0	29	0	0	0	0	–	0	0	0	0
Oil subsidy	928	507	374	0	0	0	0	0	–	692	0	0	0
Others /b	20	33	380	145	515	271	923	3,483	–	503	459	525	524
Routine expenditures	8,412	9,429	11,952	13,559	17,482	20,739	24,331	29,998	30,228	34,031	38,799	42,351	47,241
Development expenditures /c	9,899	9,952	10,873	8,332	9,477	12,251	13,834	19,452	21,764	24,135	25,661	27,398	30,784
Total expenditures	18,311	19,381	22,825	21,891	26,959	32,990	38,165	49,450	51,992	58,166	64,460	69,749	78,024

/a Since 1984/85, this item is sub-divided into wage/salary and non wage/salary expenditures without identifying regions.
/b This line shows debt service transfers to PERTAMINA (1976/77 – Rp. 31.0 billion, 1977/78 – Rp. 86.4 billion), PERTAMINA subsidy (1979/80 – Rp. 81.0 billion) and expenditures on the general election (1976/77 – Rp. 37.0 billion, 1981/82 – Rp. 81.0 billion, 1985/86 – Rp. 40.0 billion).
/c For details see Tables 5.4 and 5.5.
/d Included oil subsidy.

Source: Ministry of Finance.

Table 5.4

INDONESIA

COUNTRY ECONOMIC REPORT

Development Expenditures, 1983/84 – 1995/96 /a
(Rp. billion)

	Actual											Budget	
	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
1. Departments	3,220	3,474	4,467	2,004	2,113	1,861	2,509	4,854	5,971	7,858	8,560	9,946	10,910
2. General INPRES programs	539	540	575	568	656	714	706	1,058	1,407	1,853	2,198	4,449	4,702
Subsidies to provinces	253	253	287	293	290	334	324	486	574	701	783	1,219 /b	1,277
Subsidies to kabupatens	194	195	189	188	263	267	270	392	583	825	1,025	2,418 /c	2,525
Subsidies to villages	92	93	99	86	102	112	112	181	250	327	390	813 /d	900
3. Sectoral INPRES programs	771	824	754	721	451	429	536	1,282	1,838	2,296	2,535	891	868
Primary schools	549	572	526	496	193	131	100	374	521	655	699	498 /e	499
Health	87	65	111	108	74	99	122	193	269	320	377	393	370
Markets	11	26	4	12	3	3	3	3	2	2	4	0	0
Replanting/reforestration	59	61	43	31	16	17	17	33	75	95	104	0	0
Roads	65	101	70	75	164	180	295	679	972	1,225	1,352	0	0
4. PBB/b	132	157	168	171	223	344	478	657	709	892	1,243	1,482 /f	1,750
5. Irian Jaya and East Timor	5	4	7	7	5	0	0	0	0	0	0	0	0
Total (2–5): Transfer to local governments	1,448	1,526	1,503	1,467	1,334	1,486	1,720	2,998	3,953	5,040	5,976	6,822	7,320
6. Fertilizer subsidy	324	732	477	467	756	200	278	265	301	175	265	175	143
7. Government capital participation (PMP)	592	336	412	86	336	125	141	323	470	150	126	50	50
8. Others	449	475	511	514	515	629	765	505	722	708	803	393	601
9. Development expenditures in reserves	–	–	–	–	–	–	–	2,000	1500.0	–	–	–	–
Total (1 – 8)	6,032	6,543	7,370	4,537	5,054	4,301	5,413	10,944	12,919	13,931	15,730	17,386	19,025
9. Project aid	3,868	3,409	3,503	3,795	4,423	7,950	8,422	8,508	8,846	10,204	9,931	10,012	11,759
Total (1 – 9)	9,899	9,952	10,873	8,332	9,477	12,251	13,835	19,452	21,764	24,135	25,661	27,398	30,784

/a Excluding project aid in Rupiah.
/b Included subsidies aforestration and subsidies road development (provinces).
/c Included subsidies for rural housing, subsidies to market reconstruction and development, subsidies reforestration, subsidies for primary school reconstruction. and subsidies road development (regencies);
/d Included subsidies to backward villages.
/e Included subsidies for preliminary school reconstruction (accomodated to subsidies to regencies).
/f 91 percent from total land and building tax revenues.

Source: Ministry of Finance.

INDONESIA

COUNTRY ECONOMIC REPORT

Development Expenditures by Sector, 1983/84 – 1995/96
(Rp. billion)

Sector	Actual											Budget	
	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
Agriculture and irrigation	913	1,699	1,138	890	1,937	1,614	2,049	2,308	2,713	3,240	2,887	2,677	3,146
(of which fertilizer subsidy)	(324)	(732)	(477)	(467)	(756)	(200)	(278)	(265)	(301)	(175)	(175)	(175)	(143)
Industry and mining	2,153	839	1,189	681	335	565	420	714	722	861	575	518	592
Electric power	660	911	1,447	960	1,085	1,955	1,397	1,707	2,286	3,042	3,230	3,514	3,800
Transportation and tourism	1,528	1,428	1,484	1,131	1,598	2,011	3,006	3,743	3,910	4,537	5,192	5,947	6,904
Manpower and transmigration	456	422	665	292	200	266	281	580	718	897	836	1,103	1,196
Regional development	749	791	850	939	930	1,137	1,369	1,938	2,478	2,920	3,632	4,548	5,114
Education	1,032	1,231	1,413	1,184	1,181	1,606	1,507	2,052	2,417	3,147	3,264	3,061	3,359
Population & Health	279	320	398	326	225	339	470	723	891	957	1,146	1,321	1,352
Housing and water supply	221	224	335	337	432	481	495	677	802	1,053	861	888	1,102
General public services /a	899	927	977	769	652	733	909	1,247	1,345	1,606	1,595	1,823	2,120
Government capital participation	234	292	221	211	219	238	625	335	411	409	364	0	0
Others /b	776	1,599	1,235	1,078	684	1,305	1,306	1,429	1,572	1,466	2,079	1,998	2,098
Development budget in reserves	–	–	–	–	–	–	–	2,000	1,500	–	–	–	–
Total development expenditures	9,899	9,952	10,873	8,332	9,477	12,251	13,834	19,452	21,764	24,135	25,661	27,398	30,784
Total (excluding fertilizer subsidy)	9,575	9,220	10,396	7,865	8,721	12,051	13,556	19,187	21,463	23,960	25,486	27,223	30,641

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

Source: Ministry of Finance.

Table 5.5

INDONESIA

COUNTRY ECONOMIC REPORT

Project Aid by Sector, 1983/84 – 1995/96
(Rp. billion)

	Actual											Budget	
	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
Agriculture and irrigation	155	472	180	237	576	1,087	1,345	1,513	1,763	2,169	1,801	1,205	1,605
Industry and mining	1,051	671	668	632	267	327	240	409	454	709	516	338	380
Electric power	1,182	653	1,172	791	769	1,783	1,269	1,314	1,830	2,400	2,550	2,746	2,967
Transportation and tourism	889	601	688	729	845	1,424	2,174	1,976	1,507	1,388	1,786	2,271	3,003
Manpower and transmigration	45	76	36	123	62	98	83	91	83	52	52	146	137
Regional development	7	1	8	25	4	45	121	155	240	22	122	266	425
Education	211	180	59	346	718	1,236	1,085	957	1,045	1,204	1,142	703	751
Population & Health	37	78	56	100	38	99	177	188	188	32	132	260	240
Housing and water supply	51	84	77	139	273	400	351	444	514	648	461	419	588
General public services	152	255	186	257	350	382	566	471	567	728	629	664	722
Government capital participation	45	160	203	185	168	213	419	100	116	235	180	0	0
Others /a	42	179	171	231	355	855	594	890	539	616	560	995	941
Total project aid /b	3,867	3,409	3,503	3,795	4,423	7,950	8,422	8,508	8,846	10,204	9,931	10,012	11,759

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

Source: Ministry of Finance.

Table 6.1

INDONESIA

COUNTRY ECONOMIC REPORT

Money Supply, 1982 – 1994
(Rp. billion)

End of	Total	Currency		Demand deposits		Change over period	
		Amount	(%)	Amount	(%)	Amount	(%)
1982	7,121	2,934	41	4,187	59	635	10
1983	7,569	3,333	44	4,236	56	448	6
1984	8,581	3,712	43	4,869	57	1,012	13
1985	10,104	4,440	44	5,664	56	1,523	18
1986	11,677	5,338	46	6,339	54	1,573	16
1987	12,685	5,782	46	6,903	54	1,008	9
1988	14,392	6,246	43	8,146	57	1,707	13
1989	20,114	7,426	37	12,688	63	5,722	40
1990	23,819	9,094	38	14,725	62	3,705	18
1991	26,342	9,346	35	16,996	65	2,523	11
1992	28,779	11,478	40	17,301	60	2,437	9
1993	37,036	14,431	39	22,605	61	8,257	29
1994	45,622	18,637	41	26,985	59	8,586	23

Source: Bank Indonesia.

Table 6.2

INDONESIA

COUNTRY ECONOMIC REPORT

Changes in Factors Affecting Money Supply, 1982–1994
(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 Money Supply: Amount	Total change in Money Supply: Percentage (%)
1982	−1,237	129	689	2,260	−591	635	10
1983 /c	1,180	−1,286	−42	2,183	815	448	6
1984	3,531	−3,359	190	3,646	882	1,012	13
1985	1,750	−214	511	3,333	−115	1,523	18
1986 /d	1,870	469	252	4,547	−2496	1,573	16
1987	2,444	1,538	728	625	−4710	1,008	9
1988	−549	247	659	11,069	−3053	1,707	13
1989	409	−939	1,444	22,132	−2370	5,722	40
1990	−2171	−4113	−920	35,809	−6126	3,705	18
1991	7,430	−1356	104	20,263	−10795	2,523	11
1992	7081	−1291	492	15,227	−1546	2,437	9
1993	(23)	804	916	31,138	−6289	8,257	29
1994	−4160	−4606	1141	36,463	−560	8,586	23

/a Refers to government accounts blocked for special purposes.

/b Does not include revaluation adjustment to foreign exchange balances resulting from the rupiah devaluation of November 15, 1978. The adjustments amount to Rp. 650 billion in net foreign assets; Rp. 46 billion in net claims on Central government; Rp. 551 billion in claims on official entities; Rp. 164 billion in blocked account; Rp. 41 billion in claims on businesses and individuals; Rp. 83 billion in time and savings deposits; and Rp. 1,041 billion in net other items.

/c 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.

/d Includes revaluation adjustment due to devaluation on September 12, 1986.

Source: Bank Indonesia.

INDONESIA

COUNTRY ECONOMIC REPORT

Consolidated Balance Sheet of the Monetary System, 1982–1994
(Rp. billion)

End of period	1982	1983 /a	1984	1985	1986 /b	1987	1988	1989	1990	1991	1992	1993	1994
Net foreign assets	5,565	8,837	12,368	14,119	15,989	18,433	17,884	18,293	16,122	23,552	30,634	30,611	26,451
Domestic credit	8,846	9,744	10,345	14,325	19,323	26,729	39,802	62,131	93,142	112,154	126,612	159,470	192,469
Claims on public sector													
Central government	−4,193	−5,739	−9,098	−9319	−8798	−8366	−7036	−8309	−12202	−13582	−14873	−14069	−18675
Claims on official entities and public enterprises	4,979	5,040	5,230	6,034	5,993	6,725	7,381	8,825	7,904	8,009	8,501	9,417	10,559
Government–blocked account	−252	−240	−116	−52	−81	−84	−66	−40	−24	0	0	0	0
Claims on private enterprises and individuals	8,312	10,683	14,329	17,662	22,209	28,454	39,523	61,655	97,464	117,727	132,984	164,122	200,585
Loans	7,995	10,184	13,550	16,392	20,409	26,072	36,502	55,933	90,109	105,599	115,190	138,880	178,017
Other claims	317	499	779	1,270	1,800	2,382	3,021	5,722	7,355	12,128	17,794	25,242	22,568
Assets = liabilities	14,411	18,581	22,713	28,444	35,312	45,162	57,686	80,424	109,264	135,706	157,246	190,081	218,920
Import deposits	300	242	218	268	402	424	684	632	1,048	966	890	1,321	679
Net other items	3,036	3,676	4,558	5,291	7,651	11,277	15,688	21,087	23,586	35,681	37,303	43,161	43,922
Money and quasi money	11,075	14,663	17,937	23,153	27,661	33,885	41,998	58,705	84,630	99,059	119,053	145,599	174,319
Money	7,121	7,569	8,581	10,104	11,677	12,685	14,392	20,114	23,819	26,342	28,779	37,036	45,623
Currency	2,934	3,333	3,712	4,440	5,338	5,782	6,246	7,426	9,094	9,346	11,478	14,431	18,637
Demand deposits	4,187	4,236	4,869	5,664	6,339	6,903	8,146	12,688	14,725	16,996	17,301	22,605	26,985
Quasi money	3,954	7,094	9,356	13,049	15,984	21,200	27,606	38,591	60,811	72,717	90,274	108,563	128,696

/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

Table 6.4

INDONESIA

COUNTRY ECONOMIC REPORT

Banking System Credits by Economic Sector, 1982–1994 /a
(Rp. billion)

Sectors	1982	1983 /f	1984	1985	1986 /g	1987	1988	1989	1990	1991	1992	1993	1994
Agriculture	1,025	1,226	1,318	1,656	2,097	2,657	3,648	5,350	7,368	8,465	10,281	12,074	13,815
In rupiah	1,025	1,226	1,318	1,656	2,097	2,631	3,610	5,281	7,176	7,979	9,173	10,432	12,049
In foreign exchange	0	0	0	0	0	26	38	69	192	486	1,108	1,642	1,766
Mining /b	1,472	806	384	258	394	381	144	591	615	743	762	752	752
In rupiah	1,472	806	384	258	394	371	124	456	570	614	605	408	346
In foreign exchange	0	0	0	0	0	10	20	135	45	129	157	344	414
Manufacturing industry /c	3,923	5,207	6,667	7,592	9,005	10,912	14,956	20,333	30,502	33,131	37,458	49,608	57,993
In rupiah	3,429	4,595	6,205	7,069	8,839	10,503	13,994	17,654	25,002	24,828	26,197	35,309	41,048
In foreign exchange	494	612	462	523	166	409	962	2,679	5,500	8,303	11,261	14,299	16,945
Trade /d	4,129	5,132	6,344	7,255	8,399	10,247	13,888	20,109	29,737	33,049	32,944	37,271	43,695
In rupiah	4,009	4,781	6,299	7,214	8,329	10,065	13,682	19,342	27,267	28,842	28,100	31,148	36,391
In foreign exchange	120	351	45	41	70	182	206	767	2,470	4,207	4,844	6,123	7,304
Service rendering industry /e	1,867	2,277	3,169	4,183	4,345	5,460	7,382	10,424	17,867	20,066	25,899	35,486	50,253
In rupiah	1,860	2,253	3,088	4,047	4,130	5,151	6,917	9,600	14,913	16,683	21,979	30,228	42,337
In foreign exchange	7	24	81	136	215	309	465	824	2,954	3,383	3,920	5,258	7,916
Others	606	651	931	1,213	2,162	3,187	3,721	1,866	11,709	17,371	15,574	13,107	22,059
In rupiah	606	651	929	1,210	2,156	3,143	3,667	1,709	11,197	16,326	14,653	13,094	22,051
In foreign exchange	0	0	2	3	6	44	54	157	512	1,045	921	0	8
Total	13,022	15,299	18,813	22,157	26,402	32,844	43,739	58,673	97,798	112,825	122,918	148,298	188,575
In rupiah	12,401	14,312	18,223	21,454	25,945	31,864	41,994	54,042	86,125	95,272	100,707	120,619	154,222
In foreign exchange	621	987	590	703	457	980	1,745	4,631	11,673	17,553	22,211	27,679	34,353

/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.

INDONESIA

COUNTRY ECONOMIC REPORT

Banking Credits Outstanding in Rupiah and Foreign Exchange by Group of Banks, 1982–1994 /a
(Rp. billion)

	1982	1983 /b	1984	1985	1986 /c	1987	1988	1989	1990	1991	1992	1993	1994
Bank Indonesia													
direct credits /d	2,771	2,356	870	964	1,144	1,347	1,547	696	718	783	771	949	958
In rupiah	2,771	2,356	870	964	1,144	1,347	1,547	696	718	783	771	949	958
In foreign exchange	0	0	0	0	0	0	0	0	0	0	0	0	0
State commercial banks /e	8,031	9,787	13,345	15,374	17,782	21,676	28,631	39,579	55,826	59,861	68,236	71,760	80,224
In rupiah	7,474	8,910	12,959	14,925	17,711	21,225	27,614	37,151	50,648	52,628	58,133	59,955	68,299
In foreign exchange	557	877	386	449	71	451	1,017	2,428	5,178	7,233	10,103	11,805	11,925
National Private Banks /f	1,554	2,294	3,552	4,746	6,272	8,423	11,910	20,216	34,975	44,452	45,352	63,976	93,034
In rupiah	1,534	2,279	3,480	4,631	6,061	8,175	11,536	18,955	31,458	39,467	39,685	55,363	79,339
In foreign exchange	20	15	72	115	211	248	374	1,261	3,517	4,985	5,667	8,613	13,695
Foreign Banks	666	862	1,046	1,073	1,204	1,406	1,913	3,115	6,177	8,512	9,330	11,612	14,359
In rupiah	622	767	914	934	1,029	1,122	1,559	2,173	3,039	3,177	2,889	4,352	5,626
In foreign exchange	44	95	132	139	175	284	354	942	3,138	5,335	6,441	7,260	8,733
Total	13,022	15,299	18,813	22,157	26,402	32,852	44,001	63,606	97,696	113,608	123,689	148,297	188,575
In rupiah	12,401	14,312	18,223	21,454	25,945	31,869	42,256	58,975	85,863	96,055	101,478	120,619	154,222
In foreign exchange	621	987	590	703	457	983	1,745	4,631	11,833	17,553	22,211	27,678	34,353

/a Credits outstanding at end of period. Includes investment credits, KIK and KMP. Excludes interbank credits, credits to Central Government and to non-residents, and foreign exchange component of project aid.
/b Includes foreign exchange revaluation amounting to Rp. 251.0 billion.
/c Includes revaluation adjustment due to devaluation on September 12, 1986.
/d Excludes liquidity credits, includes credits to Pertamina for repayment for foreign borrowing.
/e Includes state development bank and liquidity credits.
/f 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, 1982–1994 /a
(Rp. billion)

End of period	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993 /c	1994
Credits approved /b	2,679	3,900	4,509	5,898	7,966	9,814	13,500	18,263	26,450	32,906	42,333	50,544	55,266
Agriculture	467	734	809	1,402	2,274	2,584	3,393	5,009	6,811	9,788	11,534	12,844	13,194
Mining	54	57	179	229	363	382	495	481	502	517	525	298	216
Manufacturing industry	1,369	1,983	2,374	2,765	3,253	3,540	5,182	7,615	10,742	11,774	16,910	17,758	21,160
Trade	134	129	237	277	369	355	536	1,012	2,298	3,375	4,475	8,611	6,798
Service rendering industry	641	986	866	1,173	1,638	2,900	3,788	4,021	4,914	6,336	7,724	11,020	13,890
Others	14	11	44	52	69	53	106	125	1,183	1,116	1,165	13	8
Credits outstanding /b	2,099	2,861	3,802	5,471	6,486	7,635	10,422	14,292	19,961	25,748	35,994	42,352	46,861
Agriculture	322	477	555	948	1,292	1,690	2,284	3,357	4,361	5,450	7,050	8,777	9,890
Mining	34	49	178	224	367	342	372	358	372	459	459	296	175
Manufacturing industry	1,095	1,635	2,102	2,781	3,098	3,567	4,817	6,424	8,866	10,484	15,416	16,459	18,572
Trade	120	115	168	396	443	435	632	1,022	1,859	3,372	4,099	7,004	5,966
Service rendering industry	519	576	770	1,098	1,215	1,560	2,249	3,010	4,060	5,032	7,896	9,803	12,250
Others	9	9	29	24	71	41	68	121	443	951	1,074	13	8

/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 November 1993.

Source: Bank Indonesia.

Table 6.6

Table 6.7

INDONESIA

COUNTRY ECONOMIC REPORT

Outstanding Bank Funds in Rupiah and Foreign Exchange by Group of Banks, 1982–1994 /a
(Rp. billion)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Deposits													
State Banks	6,169	8,381	10,035	12,916	15,193	18,111	22,527	29,731	40,638	41,812	52,600	61,683	64,283
Private Banks	1,284	2,119	3,020	4,550	5,435	8,040	11,167	19,655	33,951	43,143	51,079	67,395	88,498
Regional Development Banks	411	498	700	825	797	954	1,300	1,674	2,550	3,228	3,697	4,773	6,183
Foreign Banks	1,004	1,398	1,743	1,883	2,086	2,226	2,516	3,315	6,016	6,935	7,474	8,095	9,983
Total	8,868	12,396	15,498	20,174	23,511	29,331	37,510	54,375	83,155	95,118	114,850	141,946	168,947
Share in Total Deposits													
State Banks	69.6	67.6	64.8	64.0	64.6	61.7	60.1	54.7	48.9	44.0	45.8	43.5	38.0
Private Banks	14.5	17.1	19.5	22.6	23.1	27.4	29.8	36.1	40.8	45.4	44.5	47.5	52.4
Regional Development Banks	4.6	4.0	4.5	4.1	3.4	3.3	3.5	3.1	3.1	3.4	3.2	3.4	3.7
Foreign Banks	11.3	11.3	11.2	9.3	8.9	7.6	6.7	6.1	7.2	7.3	6.5	5.7	5.9
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	2.2	30.6	18.0	25.2	16.2	17.6	21.8	27.7	31.3	2.9	25.8	17.3	4.2
Private Banks	40.0	50.1	35.4	41.0	17.8	39.2	32.9	56.5	54.7	27.1	18.4	31.9	31.3
Regional Development Banks	16.1	19.2	34.0	16.4	−3.4	18.0	30.9	25.3	42.1	26.6	14.5	29.1	29.5
Foreign Banks	27.2	33.1	22.1	7.7	6.5	6.5	12.2	27.6	59.6	15.3	7.8	8.3	23.3
Total	10.2	33.5	22.3	26.4	22.1	22.1	24.6	37.1	42.5	14.4	20.7	23.6	19.0

/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 6.8

INDONESIA

COUNTRY ECONOMIC REPORT

Interest Rates on Deposits at Commercial Banks, 1982–1994 /a
(% p.a)

End of Period	Demand Deposits /b	TABANAS Savings Deposits /c	TASKA Savings Deposits /d	Certifi-cate of Deposits /e	Time Deposits									
					State Bank					Private National Bank /a				
					Less than 3 mos /f	3 mos	6 mos	12 mos	24 mos	Less than 3 mos /f	3 mos	6 mos	12 mos	24 mos
1982	1.8–3	6–15	9.0	12.5	7.7	8.6	6.0	9.0	12–15	16.9	17.1	18.5	19.3	18.8
1983 /g	1.8–3	12–15	9.0	15.4	14.4	14.8	13.1	17.5	12.5	18.7	17.4	18.8	19.7	19.3
1984	1.8–3	12–15	9.0	16.5	15.1	17.1	17.2	18.7	17.2	19.8	20.7	20.7	20.4	21.0
1985	1.8–3	12–15	9.0	14.5	13.4	14.6	16.0	17.8	18.3	14.6	15.9	17.8	19.8	21.3
1986	1.8–3	12–15	9.0	14.0	13.3	14.2	14.7	15.2	16.0	14.8	15.5	16.2	17.3	20.1
1987	1.8–3	15.0	9.0	15.6	15.5	17.0	17.3	17.0	17.4	17.3	18.6	19.3	19.1	19.9
1988	1.8–3	15.0	9.0	15.9	15.8	18.1	18.4	18.7	18.8	20.2	20.1	20.3	20.2	20.9
1989	n.a	n.a	n.a	16.3	15.1	16.2	17.2	18.7	18.8	17.0	18.0	18.8	19.7	20.5
1990	n.a	n.a	n.a	15.9	20.5	20.7	20.7	20.5	20.0	20.9	21.3	21.3	21.2	21.0
1991	8.9	n.a	n.a	19.0	20.0	21.3	22.3	22.5	21.0	21.8	22.6	23.3	23.4	18.6
1992	7.2	n.a	n.a	15.7	14.6	15.7	17.3	18.6	20.7	16.5	17.7	18.9	19.6	16.6
1993	5.3	n.a	n.a	15.1	8.3	9.3	12.3	13.5	15.9	11.3	12.8	14.0	14.5	18.5
1994	4.9	n.a	n.a	15.1	11.2	10.8	12.4	11.9	13.5	15.4	15.4	14.8	14.1	17.9

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

Source: Bank Indonesia.

Table 7.1

INDONESIA

COUNTRY ECONOMIC REPORT

Principal Agricultural Products by Subsectors, 1982–1993
('000 tons)

Product	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993 /a
Food crops												
Rice /b	22,837	35,302	38,134	39,033	39,726	40,078	41,676	44,726	45,179	44,689	48,240	48,181
Corn	3,235	5,087	5,288	4,330	5,920	5,155	6,652	6,193	6,734	6,256	7,995	6,460
Cassava	12,988	12,103	14,167	14,037	13,312	14,356	15,471	17,117	15,830	15,954	16,516	17,285
Sweet potato	1,676	2,213	2,156	2,161	2,091	2,013	2,159	2,224	1,971	2,039	2,171	2,088
Soya beans (shelled)	521	536	769	870	1,227	1,161	1,270	1,315	1,487	1,555	1,870	1,709
Groundnuts (shelled)	437	460	535	528	642	533	589	620	651	652	739	639
Fisheries												
Saltwater fish	1,490	1,682	1,713	1,822	1,923	2,017	2,170	2,272	2,370	2,505	2,692	2,837
Freshwater fish	524	533	548	573	607	653	711	765	793	807	851	907
Meat and dairy												
Meat	629	650	742	808	860	895	937	971	1,028	1,099	1,239	1,328
Eggs	297	319	355	370	432	452	443	456	484	510	572	593
Milk /c	117	143	179	192	220	235	265	338	346	360	367	413
Cash crops												
Rubber	900	1,007	1,033	1,055	1,109	1,130	1,176	1,209	1,275	1,284	1,399	1,413
Palm oil	884	979	1,147	1,243	1,350	1,506	1,800	1,965	2,413	2,658	3,266	3,422
Coconut/copra	1,718	1,604	1,750	1,920	2,114	2,075	2,139	2,208	2,332	2,337	2,455	2,479
Coffee	281	305	315	311	339	380	386	401	413	419	437	442
Tea	94	110	126	127	136	126	137	141	155	159	154	154
Cloves	32	41	49	42	55	58	61	55	66	84	73	67
Pepper	34	46	46	41	40	49	56	68	70	69	65	59
Tobacco	106	109	108	161	164	113	116	81	156	161	112	115
Cane sugar	1,627	1,628	1,810	1,899	1,894	2,176	1,918	2,108	2,119	2,253	2,307	2,471
Cotton /d	13	14	12	45	53	48	39,731	38,374	32,857	13,443	12,670	14,017
Forestry /e												
Teakwood	692	718	758	777	798	689	725	725	780	778	765	752
Other timber	13,236	24,180	27,716	24,277	27,403	28,255	28,485	24,409	25,312	23,892	28,267	25,087

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

Source: Supplement to the President's Report to Parliament, August 16, 1994.

Table 7.2

INDONESIA

COUNTRY ECONOMIC REPORT

Production of Major Crops by Type of Estate, 1982–1993
('000 tons)

Product	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993 /a
Smallholders												
Rubber	586	673	704	720	763	795	839	853	913	919	1,030	1,041
Coconut/copra	1,707	1,590	1,737	1,905	2,098	2,055	2,117	2,193	2,313	2,317	2,426	2,450
Coffee	262	287	291	288	316	359	362	377	384	390	409	410
Cloves	32	40	48	41	53	57	59	53	64	82	70	65
Tea	17	23	24	30	31	25	26	25	31	32	32	32
Sugar	1,373	1,249	1,397	1,450	1,417	1,744	1,499	1,621	1,609	1,610	1,653	1,669
Tobacco	97	100	104	156	159	110	113	77	152	157	110	112
Pepper	34	46	46	41	40	49	56	68	70	69	65	59
Cotton	13	14	12	45	53	48	40	38	33	13	13	14
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	125	133	121	124	150	135	143	141	145	146	163	164
Coconut/copra	11	14	13	15	16	20	22	15	19	20	29	29
Coffee	6	8	9	10	10	8	10	11	13	13	11	14
Cloves	0	1	1	1	2	1	2	2	2	2	2	2
Tea	16	17	18	17	18	21	23	26	29	30	28	28
Sugar	72	88	83	106	106	109	103	181	204	257	178	281
Tobacco	0	0	0	0	0	0	0	0	0	0	0	0
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	285	269	329	339	385	352	435	597	789	884	1,077	1,370
Palm kernel	47	68	69	71	73	76	87	119	179	181	172	209
Government estates												
Rubber	189	201	208	211	196	200	194	215	217	219	205	208
Coconut/copra	0	0	0	0	0	0	0	0	0	0	0	0
Coffee	13	10	15	13	13	13	14	13	16	16	17	18
Cloves	0	0	0	0	0	0	0	0	0	0	0	0
Tea	61	70	84	80	87	80	88	90	95	97	94	95
Sugar	182	291	330	343	371	323	316	306	306	386	476	521
Tobacco	9	9	4	5	5	3	3	4	4	4	2	3
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	599	713	818	904	965	1,154	1,365	1,368	1,624	1,774	2,189	2,051
Palm kernel	110	98	178	187	193	243	273	274	325	370	388	393
Total												
Rubber	900	1,007	1,033	1,055	1,109	1,130	1,176	1,209	1,275	1,284	1,399	1,413
Coconut/copra	1,718	1,604	1,750	1,920	2,114	2,075	2,139	2,208	2,332	2,337	2,455	2,479
Coffee	281	305	315	311	339	380	386	401	413	419	437	442
Cloves	32	41	49	42	55	58	61	55	66	84	73	67
Tea	94	110	126	127	136	126	137	141	155	159	154	154
Sugar	1,627	1,628	1,810	1,899	1,894	2,176	1,918	2,108	2,119	2,253	2,307	2,471
Tobacco	106	109	108	161	164	113	116	81	156	161	112	115
Pepper	34	46	46	41	40	49	56	68	70	69	65	59
Cotton	13	14	12	45	53	48	40	39	33	14	13	14
Palm oil	884	982	1,147	1,243	1,350	1,506	1,800	1,965	2,413	2,658	3,266	3,422
Palm kernel	157	166	247	258	266	319	360	393	504	551	559	602

/a Preliminary figures.

Source: Supplement to President's Report to Parliament, August 16, 1994.

Table 7.3

INDONESIA

COUNTRY ECONOMIC REPORT

Rice – Area Harvested, Production and Yield, 1982–1994

Year	Area harvested ('000 ha)	Average yield (tons/ha)	Paddy output ('000 tons)	Rice output /a ('000 tons)	Growth (%)
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	10,646	4.34	46,245	30,059	−4.0

/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.

Source: Central Bureau of Statistics.

Table 7.4

INDONESIA

COUNTRY ECONOMIC REPORT

Area Covered Under Rice Intensification Programs, 1982–1993
('000 ha)

Year	BIMAS /a	INMAS /b	Total	Of which INSUS /c
1982	1,296	5,047	6,343	2,945
1983	1,308	5,387	6,695	3,477
1984	434	6,936	7,369	3,806
1985	200	7,461	7,661	4,100
1986	258	7,533	7,791	4,480
1987	n.a	n.a	8,035	4,922
1988	n.a	n.a	8,283	5,837
1989	n.a	n.a	8,826	6,847
1990	n.a	n.a	8,876	7,260
1991	n.a	n.a	8,734	7,162
1992	n.a	n.a	9,396	7,870
1993	n.a	n.a	9,460	8,007

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

Source: Supplement to the President's Report to Parliament, August 16, 1994.

Table 8.1

INDONESIA

COUNTRY ECONOMIC REPORT

Index of Manufacturing Production by Selected Industry Group, 1986–1994 /a
(1983 = 100)

Code of Industry Group	Description /b	1986	1987	1988	1989	1990	1991	1992	1993	1994 /c /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	119.6
31330	Malt liquor and malt (5)	94.4	113.2	116.4	117.2	146.8	160.1	142.0	173.5	129.7
31420	Clove cigarettes (80)	147.4	166.5	177.7	196.2	226.4	165.5	165.3	176.2	122.3
31430	Other cigarettes (13)	78.8	81.9	79.2	78.2	80.7	95.4	111.3	87.1	106.6
32111	Yarn and thread (53)	129.9	130.5	169.0	196.2	253.5	273.7	313.1	312.0	101.5
32112	Weaving mills (except jute weaving products (409)	130.7	144.3	172.9	187.6	216.9	215.0	238.2	236.3	107.4
32114	Batik (65)	95.8	81.8	83.9	111.1	144.0	218.5	190.0	176.5	137.6
32130	Knitting mills (73)	219.2	233.3	239.8	312.8	347.2	449.2	332.0	324.4	160.8
32400	Footwear (32)	113.1	91.5	111.2	184.9	208.2	230.4	324.5	355.2	112.4
33113	Plywood (40)	139.3	192.7	242.1	266.2	256.7	273.7	295.7	268.0	98.8
34111	Paper manufacture (all kinds) (23)	159.2	159.7	242.0	251.5	298.1	292.2	429.8	459.2	89.4
35110	Basic chemicals (except fertilizer) (50)	119.0	156.4	139.0	152.9	174.0	189.5	151.8	178.1	117.4
35120	Fertilizer (10)	166.0	121.8	129.7	143.7	158.1	158.1	152.1	153.6	114.9
35210	Paint, varnish, and lacquers (25)	135.6	126.5	91.2	129.9	136.6	127.2	182.6	283.7	112.6
35232	Matches (8)	108.7	142.3	175.5	154.4	167.3	178.5	216.0	113.6	102.6
35510	Tyres and tubes (22)	109.5	79.2	109.7	141.2	157.4	205.6	223.8	220.2	68.6
36210	Glass and glass products (21)	178.0	149.3	124.6	145.2	163.3	254.6	236.8	265.8	114.5
36310	Cement (7)	144.4	150.9	149.8	198.1	206.4	217.9	244.9	300.7	158.4
37100	Basic iron and steel industries (16)	154.9	147.1	167.4	199.0	259.1	476.5	427.1	552.6	112.7
38130	Structural metal products (59)	110.2	118.7	125.7	180.6	224.4	190.9	210.4	202.3	244.4
38312	Drycell batteries (7)	123.9	115.5	158.6	179.1	192.6	158.7	174.1	190.8	140.4
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	112.4
38430	Motor vehicles assembly and manufacture (23)	114.7	126.8	115.8	132.5	200.0	212.9	116.0	98.0	192.5
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	91.5
	General index	128.4	143.5	164.2	184.1	209.4	232.3	257.9	286.8	120.5

/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 Second quarter 1994.
/c 1993 = 100.

Source: Central Bureau of statistics.

INDONESIA

COUNTRY ECONOMIC REPORT

Production of Minerals, 1982–1994

Year	Petroleum (mln bbls)	Tin concentrate	Copper ore concentrate	Nickel ore ('000 tons)	Bauxite	Coal	Iron sand concentrate	Gold /a (kg)	Silver /a (kg)	Natural gas (mcf)
1982	488.2	33.8	223.7	1,640.9	700.2	588.0	144.5	222.7	3,057.9	1,111.9
1983	490.5	26.6	205.0	1,278.0	777.9	648.2	132.9	2,391.5	35,293.1	1,186.4
1984	516.5	23.2	190.3	1,066.8	1,003.2	1,468.2	83.0	2,247.1	38,584.7	1,521.5
1985	483.8	21.8	223.4	961.9	830.5	1,942.1	130.9	2,604.4	38,075.2	1,580.0
1986	507.2	24.0	251.2	1,533.1	648.8	2,572.3	153.3	2,947.5	44,075.1	1,628.9
1987	479.0	26.1	259.8	1,825.7	635.3	2,813.5	194.0	3,116.7	49,046.2	1,732.1
1988	484.7	30.6	294.7	1,733.2	505.8	4,094.6	202.7	3,877.0	57,603.0	1,846.9
1989	514.2	31.3	331.5	2,020.9	862.3	9,246.7	142.7	4,624.5	63,597.2	1,968.3
1990	533.6	30.4	398.6	2,217.4	1,205.7	10,461.5	145.4	9,355.3	62,158.4	2,828.2
1991	581.2	30.4	656.5	2,300.3	1,406.1	14,143.0	173.2	13,889.1	63,452.0	2,465.8
1992	550.7	28.2	906.7	2,511.6	803.5	23,120.5	287.8	37,986.0	65,117.9	2,586.3
1993	547.4	28.6	928.2	1,975.8	1,320.4	27,584.4	341.3	41,575.8	90,285.4	2,663.9
1994 /b	507.5	25.3	841.1	1,902.0	1,215.0	22,455.2	273.4	36,173.0	84,011.5	1,915.6

/a Since 1983, production of gold and silver including private enterprises.
/b Jan – Nov 1994 except for Petroleum and Natural Gas, Jan – Aug 1994.

Source: Central Bureau of Statistics.

Table 8.2

Table 8.3

INDONESIA

COUNTRY ECONOMIC REPORT

Crude Oil Production by Company, 1981 – 1994
('000 bbls)

	PERTAMINA	LEMIGAS	Contract of work: Caltex	Contract of work: C & T	Contract of work: Stanvac	Subtotal	Production sharing contract	Total	Average daily output
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 /c
1993	26,427	/b		1,327	5,304	6,631	518,121	551,179	1,510 /c
1994	23,826	/b		–	–	–	527,416	551,242	1,510 /c

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

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

Table 8.4

INDONESIA

COUNTRY ECONOMIC REPORT

Petroleum Product Supply and Demand, 1981 – 1994
(million bbls)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
1. Production of crude	584.8	488.2	518.0	550.8	489.9	514.9	512.4	491.5	514.2	533.7	550	550.7	551.2	551.2
2. Crude imports	37.0	22.0	25.7	34.2	32.1	27.7	30.2	31.2	28.1	45.7	45	49.4	70.8	62.7
3. Subtotal (1+2)	621.8	510.2	543.7	585.0	522.0	542.6	542.6	522.7	542.3	579.4	595.0	600.1	622.0	613.9
4. Crude exports	383.4	320.9	336.2	354.6	295.1	327.4	291.9	276.6	291.5	288.7	330.5	292.9	282.2	324
5. Crude available for refineries (3–4)	238.4	189.3	207.5	230.4	226.9	215.2	250.7	246.1	250.8	290.7	264.5	307.2	339.8	289.9
6. Changes in crude stocks (decrease = –)	44.7	6.7	23.5	39.7	27.1	–2.3	16.9	0.3	3.2	16.9	19.7	14.3	2.3	–5.3
7. Refinery input (including swaps) (5–6)	193.7	182.6	184.0	190.7	199.8	217.5	233.8	245.8	247.6	273.8	284.8	301.7	298.6	295.2
8. Refinery consumption	6.5	6.5	7.2	9.2	13.1	13.3	13.0	13.0	13.9	14.3	16.0	15.3	14.9	14.9
9. Refinery output (7–8)	187.2	176.1	176.8	181.5	186.7	204.2	220.8	232.8	233.7	259.5	268.8	286.4	283.7	280.3
10. Exports of refined products (11+12)	49.9	39.0	43.3	66.0	47.3	55.2	62.4	63.7	55.4	57.8	56.0	66.1	52.0	63.2
11. Waxy residues	47.9	33.7	40.5	49.9	32.1	34.9	42	45.3	40.6	42.0	43.3	53.6	43.8	47.4
12. Bunker fuel, AVTUR, etc.	2.0	5.3	2.8	16.1	15.2	20.3	20.4	18.4	14.8	15.8	12.7	12.5	8.2	15.8
13. Available for domestic consumption (9–10)	137.3	137.1	133.5	115.5	139.4	149.0	158.4	169.1	178.3	201.7	212.8	220.3	231.7	217.1
14. Product imports	42.6	28.0	23.5	5.0	2.7	5.4	10.3	13.3	21.3	23.9	21.8	25.8	46	37.3
15. Total supply (13+14)	179.9	165.1	157.0	120.5	142.1	154.4	168.7	182.4	199.6	225.6	234.6	244.1	277.7	254.4
16. Domestic consumption	156.0	161.1	155.5	157.6	155.3	152.8	162.9	171.3	183.6	211.4	225.6	246.2	263.3	260.4
17. Changes in refined stocks (15–16)	23.9	4.0	1.5	–37.1	–13.2	1.6	5.8	11.1	16.0	14.2	9.0	–2.1	14.4	–6.0

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

Table 8.5

INDONESIA

COUNTRY ECONOMIC REPORT

Domestic Sales of Petroleum Products, 1981–1994 /a
('000 bbls)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990 /b	1991	1992	1993	1994
Aviation gas	110	103	83	73	66	63	56	60	60	59	58	54	51	50
Aviation turbo	4,869	4,899	3,686	4,374	4,442	3,806	4,199	4,445	4,286	4,607	4,889	5,315	6,039	10,188
Premium gasoline	392	238	247	523	738	1,024	1,431	1,838	2,451	1,047	/b	/b	/b	/b
Regular gasoline	25,648	25,709	24,380	24,909	25,206	27,083	29,048	30,855	33,199	39,005	43,023	45,308	46,733	52,463
Kerosene	52,497	51,778	48,224	45,213	43,954	43,618	43,352	44,664	46,601	49,472	50,573	53,850	54,242	56,110
Motor diesel	44,737	48,918	49,790	48,567	47,682	47,421	54,075	59,143	64,508	72,950	80,837	92,061	104,460	100,730
Industrial diesel	9,391	9,311	9,978	10,285	10,329	8,855	8,319	8,809	9,515	10,720	10,806	11,318	11,445	11,174
Fuel oil	17,587	19,341	21,149	23,625	22,863	18,004	19,054	18,097	18,329	24,847	28,899	29,313	30,154	25,456
Total	155,231	160,297	157,537	157,569	155,280	149,874	159,534	167,911	178,949	202,707	219,085	237,219	253,124	256,171

/a Excluding lubricating oil and similar products.
/b Discontinued.

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

Table 9.1

INDONESIA

COUNTRY ECONOMIC REPORT

Consumer Price Index, 1979 – 1994 /a /b
(April 1977 – March 1978 = 100)

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

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

Source: Central Bureau of Statistics.

Table 9.2

INDONESIA

COUNTRY ECONOMIC REPORT

Indonesia Wholesale Price Index, 1983–1994 /a
(1983 = 100)

Sectors /b	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Agriculture (44)	100	113	118	128	145	163	177	191	206	225	251	327
Mining & quarrying (6)	100	109	117	125	132	143	156	169	188	201	218	250
Manufacturing (140)	100	103	115	123	143	156	166	176	194	206	218	243
Imports (53)	100	113	119	129	158	164	178	191	201	208	211	219
Exports (38)	100	111	112	85	118	118	131	159	153	159	157	166
Excluding petroleum (34)	100	114	115	130	170	183	195	195	203	212	226	278
Petroleum (4)	100	112	113	73	103	99	112	148	139	143	137	133
General index (281)	100	111	116	116	142	149	162	178	187	197	204	226
General index excluding exports (243)	100	111	117	127	149	160	173	185	199	210	221	249
General index excluding exports of petroleum (224)	100	110	116	125	146	161	172	182	198	211	227	237

/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 9.3

INDONESIA

COUNTRY ECONOMIC REPORT

Domestic Prices of Petroleum Products, 1984 – 1994
(Rp./liter)

	1984 /a	1985 /b	1986	1987	1988	1989	1990 /c	1991 /d	1992	1993 /e	1994
Aviation gas	300	330	250	250	250	250	330	400	400	420	420
Aviation turbo	300	330	250	250	250	250	330	400	400	420	420
Premium gasoline	400	440	440	440	440	440	/f	/f	/f	/f	/f
Regular gasoline	350	385	385	385	385	385	450	550	550	700	700
Kerosene	150	165	165	165	165	165	190	220	220	280	280
Motor diesel	220	242	200	200	200	200	245	300	300	380	380
Industrial diesel	200	220	200	200	200	200	235	285	285	360	360
Fuel oil	200	220	200	200	200	200	220	220	220	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.
/e Discontinued.

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

Table 10.1

INDONESIA

COUNTRY ECONOMIC REPORT

Approved Foreign Investment by Sector, 1981 – 1994 /a
(US$ million)

Sector	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Agriculture	25	9	10	0	9	126	117	8	122	117	14	66	138	690
Forestry	115	32	7	0	0	0	5	26	4	20	1	138	22	0
Fishery	22	3	21	0	11	4	12	46	47	20	11	28	0	40
Mining & quarrying	29	0	0	0	0	0	0	0	0	116	0	2,312	0	0
Manufacturing	834	1,120	2,615	1,002	687	537	852	3,828	4,246	5,822	3,970	5,669	3,423	18,739
Food	41	6	83	77	6	34	54	231	223	99	382	213	141	1,235
Textiles & leather	139	26	12	1	7	9	118	213	581	1,094	532	591	419	396
Wood & wood products	124	5	13	0	0	32	45	104	106	218	62	34	50	68
Paper & paper products	49	0	722	0	25	47	109	1,506	211	730	822	686	202	5,120
Chemicals & rubber	236	317	183	96	338	294	209	1,544	2,512	1,991	923	2,342	1,171	7,743
Nonmetallic minerals	20	57	50	0	3	0	251	30	184	125	133	841	98	632
Basic metals	85	3	836	609	65	39	7	61	106	825	197	47	186	2,082
Metal products	141	706	716	210	244	82	57	129	292	460	856	863	1,114	1,423
Others	0	0	1	9	0	0	3	10	30	281	62	52	42	40
Construction	49	11	44	17	122	65	42	2	16	77	26	41	97	77
Trade & hotels	0	17	78	84	0	0	196	405	98	874	4,019	919	1,088	430
Wholesale trade	0	0	0	0	0	0	0	0	0	0	0	0	693	87
Hotels	0	17	78	84	0	0	196	405	98	874	4,019	919	394	344
Transport & communications	0	0	0	4	0	70	213	3	5	803	167	14	85	145
Real estate and business service	18	204	108	0	29	25	20	117	181	902	570	1,136	3,292	3,604
Total	1,091	1,397	2,882	1,107	859	826	1,457	4,435	4,719	8,750	8,778	10,323	8,144	23,724

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

Source: Investment Coordinating Board (BKPM).

Table 10.2

INDONESIA

COUNTRY ECONOMIC REPORT

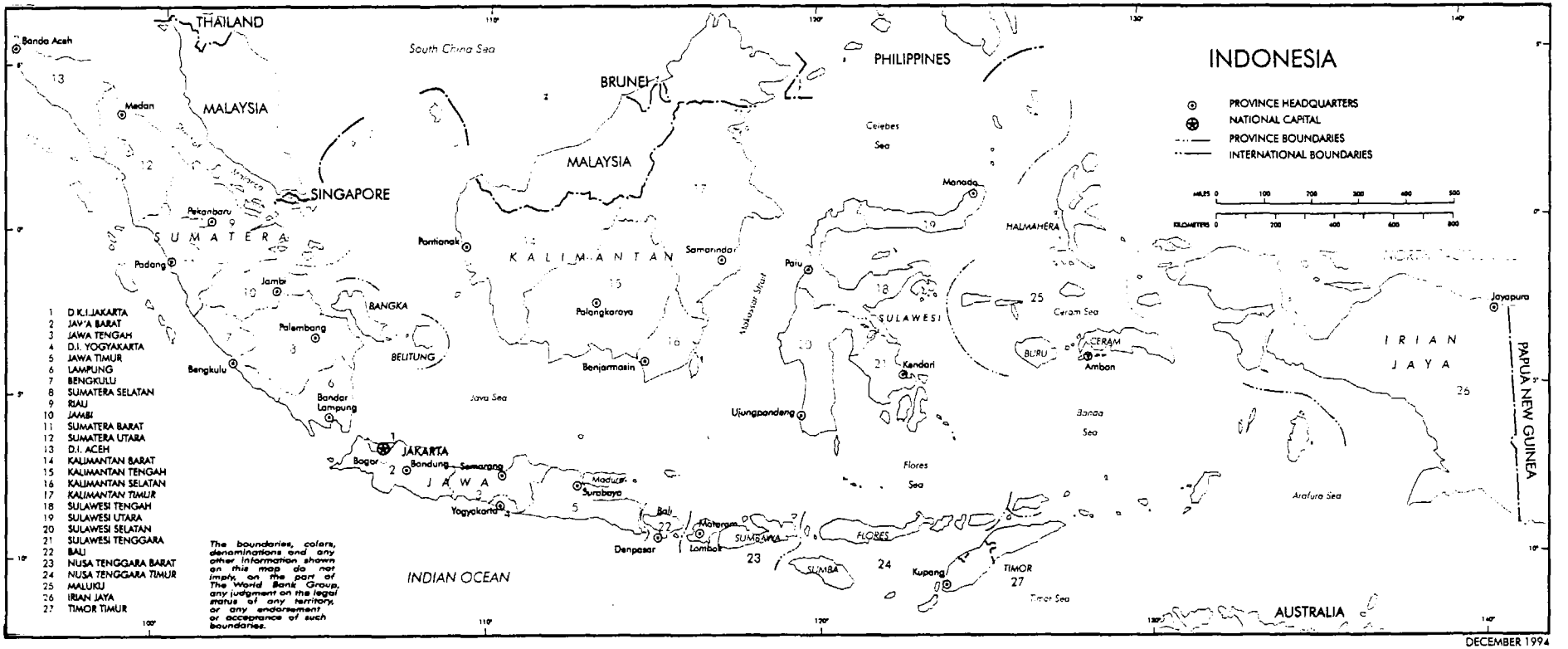
Approved Domestic Investment by Sector, 1981–1994 /a
(Rp billion)

Sector	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Agriculture, fisheries and livestock	60	62	681	277	899	1,879	2,885	2,698	3,418	6,442	3,468	1,952	2,835	7,140
Forestry	175	93	149	19	37	21	640	487	252	593	310	534	258	262
Mining	13	52	578	8	38	89	290	111	94	155	182	236	69	112
Manufacturing	1,306	1,419	3,792	1,332	1,632	1,842	5,518	9,747	12,931	39,850	27,624	19,079	24,037	31,933
Textiles	195	110	104	127	97	263	1,289	2,309	3,563	12,561	3,646	2,546	3,539	5,518
Chemicals	193	205	766	272	928	773	2,047	3,039	4,062	7,894	8,425	3,299	7,689	5,150
Electrical goods	0	0	0	0	0	0	0	0	0	0	0	0	5	12
Other manufacturing	918	1,104	2,922	933	607	806	2,183	4,399	5,307	19,395	15,553	13,235	12,804	21,253
Construction	8	16	195	67	270	74	50	31	146	87	275	215	187	731
Hotels	54	76	255	214	312	17	139	537	1,265	4,703	3,895	3,115	3,051	4,342
Real estate	5	74	204	31	267	169	174	846	936	1,783	2,633	536	3,049	3,336
Others /b	70	157	1,151	1	296	325	569	460	551	2,898	1,785	3,675	5,965	5,434
Total	1,691	1,949	7,005	1,949	3,750	4,417	10,265	14,916	19,594	56,511	41,078	29,342	39,450	53,289

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

Source: Investment Coordinating Board.

IBRD 26570



DECEMBER 1994

IMAGING

Report Date [illegible]
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