

**Country Study for Development Assistance
to the Republic of Indonesia**

"Basic Strategy for Development Assistance"

January 1990

Country Study Group

**for Development Assistance to the Republic of Indonesia
organized by the Japan International Cooperation Agency**

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This paper is based on the discussions and findings of the Country Study Group for Development Assistance to the Republic of Indonesia organized by the Japan International Cooperation Agency (JICA). The views expressed in the paper are those of the members of the Study Group and do not necessarily reflect those of JICA.

Additional copies of this report are available upon written request from
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PREFACE

As Japan's official development assistance (ODA) has been expanding every year and as development needs of the developing countries diversify, it is becoming increasingly important that development assistance be provided in a systematic and effective way.

The Japan International Cooperation Agency (JICA), in view of the steady expansion of international cooperation, has established the Country Study Group on Indonesia in order to work out the basic strategy of development assistance, by drawing on knowledge and experience of specialists and intellectuals in various fields.

The Study Group was established in December 1988 with Dr. Shinichi Ichimura, Vice-Chancellor of Osaka International University, as chairman of a nine-member panel. The Study Group was assisted by task force formed simultaneously, whose members include development specialists as well as staff members of JICA. This report is the English translated version of the main part of the report made originally in Japanese by the Study Group.

JICA sincerely hopes that various important recommendations in the report will be referred to frequently in implementing economic and technical cooperation for Indonesia. This report shall be widely distributed to organizations in Japan and overseas which are concerned with development assistance in the hope that it will be of use to them.

January 1990

President : Kensuke Yanagiya
Japan International Cooperation Agency

FOREWORD

Japan's relationship with Indonesia has evolved under generally favorable conditions after Indonesia's independence. The economic relationship between these two countries has been particularly close in terms of trade and investments. Besides, Indonesia is the largest recipient alongside China of Japan's official development assistance (ODA). Japan has become the world's largest donor of development assistance to Indonesia, overtaking even the World Bank since 1988.

As such, Japan's economic conditions have very significant effects on Indonesia. Japan's ODA, which currently accounts for more than 10% of Indonesia's budget, could have direct and indirect bearing on policy measures of the Indonesian Government. Indonesia's economy has shown remarkable achievements in the past 20 odd years. Indonesia is earnestly seeking to become a middle-income economy by realizing an economic takeoff by the end of this century as is mentioned in its Fifth Five-Year Plan. It seems high time that the basic strategy of Japanese assistance should be examined and worked out from a middle-term and long-term viewpoint.

The Study Group was commissioned by the President of the Japan International Cooperation Agency (JICA) in December 1988, and since then, eight meetings, including a public discussion meeting, have been held to discuss the present state of Indonesia's socio-economic development and to hammer out a basic strategy for Japan's ODA to Indonesia. In addition to these meetings, field surveys in Indonesia, including discussions with Indonesian officials, were also carried out. It should be noted in particular that there was close cooperation from the

Ministry of Foreign Affairs and the task force made up of JICA staff members and development specialists, in addition to earnest efforts by the members of the Study Group in facilitating the study and the discussions and in formulating the report.

This report is the fruit of such joint efforts. I am afraid that mistakes might have been made in it because of my lack of caution and knowledge. Nonetheless, in view of the importance of the issue, I sincerely hope that this report will justify the efforts of the above-mentioned persons by drawing earnest attention of those involved in development assistance and by contributing to further promotion of genuine friendship between Japan and Indonesia.

December 1989

To

President : Kensuke Yanagiya
Japan International Cooperation Agency

Chairman : Shinichi Ichimura
Country Study Group on Indonesia

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I. BASIC STRATEGY

1. Development Assistance to Indonesia - Issues for Consideration

1.1 Objectives of assistance

Of the ASEAN nations, Indonesia has the largest population and the greatest national strength. Friendly ties with Indonesia form the basis of Japan's policy for all of Southeast Asia. Indonesia, along with China, is the largest recipient of Japanese assistance and this is no doubt the result of the government's recognition of the importance of the aforementioned facts. Assistance to Indonesia, therefore, must be assessed not only with respect to its effect on Indonesia but also with regard to its influence on Southeast Asia as a whole. Assistance to Indonesia should serve the following objectives.

- 1) Contributing to stable economic and social development of Indonesia.
- 2) Promoting mutual understanding and friendship between the Japanese public and the people of Indonesia.
- 3) Promoting good relations with other countries of Southeast Asia.

Japan must fulfill its international obligation to contribute to the peace of the world and particularly that of the Pacific Rim region by meeting these objectives.

1.2 Comprehensive viewpoints of the issues

Development assistance to Indonesia has largely been centered on separate individual projects (project aid) and evaluations have been made of these individual projects. While this type of evaluation is important, what we are attempting to do here is to investigate the issue of whether aid to Indonesia as a whole is appropriate to the objectives noted above from a comprehensive standpoint. That is, whether the priorities of assistance have been properly sorted out, whether or not there are important fields in which assistance has not been implemented -- in other words, an assessment of aid to Indonesia in its entirety from a macroeconomic viewpoint.

Japan is the largest donor country of development assistance to Indonesia. Official development assistance (ODA) to Indonesia totaled 1,245 million U.S. dollars in net disbursements in 1987, 91% of which was bilateral aid. Japan accounted for 62% of total bilateral aid to Indonesia; the Netherlands for 12%; the FRG for 5%, and the U.S., for only 3%. For this reason, the form of Japanese aid is a subject of close attention for other donor countries and international financial institutions, such as the World Bank and the Asian Development Bank, due to its great influence on Indonesian development. For Japan, too, this represents a crucial opportunity to exercise international leadership. Given this condition, along with the question of expanding the scope of such assistance, it is necessary to re-evaluate the methods and fields in which assistance has been provided up to now, to strive to open up new fields of assistance and to provide assistance more effectively.

At the same time, the current and future economic conditions in Indonesia must be carefully weighed. How shall the next targets be set for the agriculture sector, now that rice self-sufficiency has been achieved? Will exports of non-oil/gas products continue to increase at a steady pace? At what pace shall Indonesia's external debt of 41.3 billion dollars be reduced? Japan has announced aid of 1.4 billion dollars in 1988 and 1.2 billion dollars in 1989, but what effects will Indonesia's fiscal situation have on repayment of these debts? With these questions in clear view, it will be necessary in the future to determine aid policy based on investigation and research of social and economic conditions in Indonesia to a greater extent than in the past. Japan must also make greater efforts to extend a helping hand in research and development and in the drawing up of development plans, the so-called "software" aspect.

For a donor country to contribute to the economic and social development of a recipient country, it is necessary to carefully consider the economic and social situation in the recipient country at the time that the assistance is provided. Thus it is necessary to examine development assistance to Indonesia as a whole from these viewpoints.

1.3 Personnel and facilities for assistance

Assistance, of course, does not consist of money alone, but is, rather, a complex entity composed of personnel, money, commodities, technology, and information. Most developing countries need all of these forms of assistance. Japan, however, as the donor country, is

unable to meet all of these needs appropriately. Japanese technical specialists, for example, excel in their field of specialization but often lack sufficient language skills. It is also necessary to expand facilities in Japan for foreign trainees and students. The amount of aid has been increasing, but this trend and the content of aid will be constrained by the conditions of facilities, the availability of personnel, and the system for providing aid itself. Therefore, it is essential for Japan to examine the possibilities for strengthening both personnel and material capabilities with regard to the issue of assistance.

1.4 Assistance implementation methods and administrative structure

Assistance in the past has been extended in the response to a request for assistance from the recipient nation. Aid which is imposed on and not exactly suited to the recipient country will not be appreciated. It also contradicts the precept of development assistance for helping achieve self-reliance. However, to find and formulate effective projects for assistance, closer dialogue and cooperation between Japan and Indonesia is required. While the policy of providing assistance in response to requests will be continued, consideration should also be given to offering development projects based on the results of closer dialogue with the Indonesian government officials concerned on a case-by-case basis. As described above, this way of making decisions concerning assistance projects which satisfy the desires of both countries will be most beneficial.

Another issue is whether or not the present administrative system of assistance is adequate. As the amount of assistance gradually increases and the period of cooperation becomes longer, the level of specialized knowledge required becomes higher. Further, if the donor country lacks correct knowledge of overall circumstances in the recipient country, cases in which assistance is not provided in the appropriate manner at the appropriate time will increase. If the number of development projects grows larger, the system for their management must be reinforced. It is necessary to re-examine the staffing and administrative structure for assistance. These issues will be discussed in Chapter 3.

2. Priorities in Development Assistance

2.1 Cooperation for the stable growth of Indonesia

While the objective of assistance is to support the promotion of social and economic growth in a stable environment, the premier goal is economic development. We will consider here, first of all, the issue of economic development as "cooperation for development efforts aimed at an economic takeoff." The success of economic growth may sometimes lead to social distortions. In the implementation of assistance from Japan, it is necessary to give full attention to the issue of social equity. Therefore, the next issue that will be examined is "cooperation for eliminating poverty and reducing the disparity in incomes," The third issue that will be considered is "cooperation for the repayment of accumulated debt," which is related to the huge increase in accumulated debt arising primarily from steady increases in the value of the yen.

2.1.1 Cooperation for development efforts aimed at an economic takeoff

At present, Indonesia has just begun its Fifth Five-Year Development Plan (1989/90 ~ 1993/94). In the period of Fourth Five-Year Development Plan (1984/85 ~ 1988/89), fiscal revenues declined sharply and debt accumulated at a rapid pace due to the sharp decline in petroleum prices. Although the current five-year development plan is based on expectations of stable petroleum prices, a large increase in the volume of production cannot be expected. In this regard, an important point of development policy

is that priority be given to the development of agriculture focused on self-sufficiency in foodstuffs and the diversification of agricultural products, to the development of non-oil/gas sectors, especially development of manufacturing industry such as agro-industry and machinery industry, and to the promotion of exports (non-traditional products). For these reasons, rationalization of economy and enhancement of productivity in both the agricultural and industrial sectors are being given top priority. The government of Indonesia expects that the period of coming Sixth Five-Year Development Plan (1994/95 ~ 1998/99) will be the one in which the takeoff of the Indonesian economy begins, and the five-year period starting in 1989 is viewed as the period of preparation for this "takeoff." The term "takeoff" refers to the constant increase in per capita income resulting from the accumulation of investment capital from domestic savings. Realizing this "takeoff" in the 20th century is the goal of the Indonesian Government. Support for this "takeoff" is precisely the long-term goal of Japanese assistance.

In the past, the focal point of Japanese economic cooperation for the development of Indonesia has been on efforts for this type of economic development, that is, financial assistance for investments in the infrastructure. This type of assistance should also be the main part of Japanese assistance in the future. However, finding a more appropriate way of allocating financial assistance for infrastructural developments is necessary.

The first aspect of this issue is the distribution of investments for rehabilitating existing basic facilities and for building new infrastructural facilities. From the standpoint of assistance, while

considering the rehabilitation of existing infrastructural facilities to a greater extent than in the past, it becomes important to examine whether emphasis should be placed on more infrastructural development or on rehabilitation. The second aspect of the issue is that the budget allocated for the transportation and communications sectors in Indonesia is less than that in other countries. Further, the trend in recent years has been toward reducing allocations for these sectors even more, despite the fact that the transportation and communications networks in Indonesia have not yet been adequately constructed. The status of roadway diffusion is worse in Indonesia than in the Philippines, Thailand, and Malaysia. The construction of harbors and railways is also behind. Further, although the infrastructural investment for electronic communications is largely concentrated in the cities, telephone service in the cities is still poor. The demand for telephone service in regional cities is also very high. The construction and improvement of these types of infrastructural facilities in transportation (land, sea, and air) and communications (telephone and telex) must be promoted by maintaining a balance with the agricultural and manufacturing sectors for the unification of economies in Indonesia, a country having a huge land area. Further, the uneven distribution toward the island of Java, with its large population, must be corrected. It is also necessary to target the growth of the tourism industry. It is appropriate that Japanese assistance be focused on these important points.

The third aspect of the issue is that this type of infrastructural investment has been centered on projects controlled by the government's Ministry of Public Works or by national enterprises. Shifting priority to investments with immediate effect on the

development of private-sector enterprises is also necessary. As will be described later, from the viewpoint of reducing the differences between regions and in consideration of the development of underdeveloped areas outside Java Island, special priority must be given to the development of areas on the periphery of regional growth centers. In the implementation of this assistance, it is necessary not only to provide financial cooperation but to combine it with technical cooperation and strive to make effective and proper use of assistance.

The fourth aspect of the issue concerns the relationship between assistance and construction work -- that is, the question of tied aid. In extending official development assistance from the Japanese Government, Japanese specialists and consulting companies are used to a great extent, and there are those who say that orders for construction work are being placed with Japanese construction companies at a high ratio. However, in general, in the case of grant aid, tied assistance is the common practice by aid donors.

In extending Japanese technical cooperation (development studies), non-Japanese consultants are allowed to be used for one-fourth of all consulting work (man / months). On the other hand, for Japan's ODA loans, the ratios of general untied assistance and LDC untied assistance, on the basis of Exchange of Notes, are 77.4% and 22.6%, respectively. Viewed from the standpoint of procurement ratio of goods, this tying status is certainly not more than that of the European and North American countries. At the stages of orders for engineering services and construction work, the ratio of receiving

orders of Japanese firms is rather high. However, this ratio, too, has been gradually declining in recent years.

It is not easy to answer foreign criticisms promptly, but the general impression is that Japan's reaction has been quite slow. There should be no disparity between Indonesia and other Southeast Asian countries in the use of foreign consulting business for ODA projects. Untying of Japanese assistance to an extent even greater than the present level is vital for flexible and prompt response to these criticisms.

For the rationalization of infrastructural investment, securing human resources for planning and carrying out the investment activities is crucially important. In the case of Indonesia, such human resources are insufficient, so it is vital that assistance be undertaken from the viewpoint of long-term development of these human resources. Along with the increase in Japanese assistance, the relative weight of projects other than those involved with infrastructural development must also be increased. It is important to strive to find these other important development projects. Several priorities in this regard will be discussed in Chapter 2.3.

2.1.2 Cooperation for the elimination of poverty and reducing the disparity in incomes

The disposable income of Indonesian households showed a marked increase until the year 1982. Real per capita income was increasing at a rate of 4.8% per annum. However, the situation became worse after 1982 and during the period 1982 - 1986 annual per capita

income fell by 1% yearly. According to the forecast of the World Bank, real per capita income will remain stagnant until 1989. The distribution of incomes was improved somewhat during the period 1978-1984. However, the disparities in incomes still remain large. Also, the disparities in incomes between social classes, between regions such as the island of Java and outlying regions, and between large-sized and small-sized enterprises, including public corporations, remains quite significant.

With the increase in the population, the number of unemployed in both rural and urban districts is also increasing. In Indonesia, it is estimated that there are currently more than 10 million peoples who are either unemployed or underemployed and this number continues to increase. People, including the unemployed, who are living without the benefit of basic human needs (BHN), namely, food, housing, education, and medical care, are numerous in both the rural and urban districts. Moreover, deforestation, soil erosion, water pollution, and air pollution are all showing a tendency to further deteriorate and the quality of the living environment is on the decline. That these factors are having a deep impact on the poor classes is not difficult to imagine.

Indonesia, since its founding as a nation, has upheld the principle of Pancasila, which stands for its national cause, and places high priority on a fair distribution of the fruits of development. Also, since the Second Five-Year Development Plan, "Just Distribution, Just Participation" has been the basic aim of its development policy. This principle is also reflected in the Fifth Five-Year Development Plan. The priorities involved in how the fruits of development assistance

will be afforded to the impoverished and how assistance will relieve the victims of unemployment and environmental destruction are crucial matters to consider in solving the essential problems of national development and social justice.

Therefore, if Japan works to provide assistance directly or indirectly to the most impoverished social classes or regions on the basis of humane considerations, it will serve to inform both Indonesia and the rest of the world that the basic principle of Japanese assistance is humanitarian, and the broadest social spectrum of the Indonesian public will correctly understand the objectives of Japanese assistance. This will also serve as a pillar supporting the bonds of long-term friendship between Japan and Indonesia.

The contents of assistance for this purpose should include construction of healthy living environments, provision of sufficient food for production activities and improvement of facilities for education and medical care. Increasing assistance so that poor people can enjoy the minimum necessities of life and broadening the strata of the Indonesian public which enjoys the minimum necessities of clothing, food, and shelter will contribute to stabilizing public life and to making practical and effective use of the country's human resources.

For correcting the economic gap between Java Island along with the nearby islands and the outlying areas, not only should BHN-related assistance be undertaken in the outlying areas, it is crucial to extend assistance to support the economic development of the less-developed areas in the outlying regions. In the same sense,

assistance for medium- and small-sized labor-intensive enterprises is also important. In this regard, it would be effective to strengthen occupational training, to make flexible provision of two-step loans, and to give priority to small-scale projects.

In the implementation of this assistance, in addition to normal cooperation with the central government, support for the activities of charitable organizations in both Japan and Indonesia and of other non-governmental organizations (NGOs) extending direct cooperation with the state governments, or for grassroots activities, is considered quite effective. Since fiscal year 1989, 300 million yen in small-scale grant aid was to be provided to local NGOs, and Japan established a fund system that focuses on providing subsidies to Japanese NGOs. These efforts will support the activities of the NGOs in both countries. A significant increase in these forms of assistance is expected for the future and it would be desirable for the public to become involved in these assistance activities.

2.1.3 Cooperation related to the repayment of accumulated debt

The total balance of the public external debt of Indonesia stood at approximately 41.3 billion dollars at the end of 1987, according to the World Development Report issued by the World Bank in 1989. Along with this, there is a private sector debt of 4.11 billion dollars and a debt obligation of 0.72 billion dollars to the International Monetary Fund, 6.47 billion dollars in short-term obligations, adding up to a total debt obligation of 52.6 billion dollars. The total long-term debt obligation of 45.389 billion dollars amounts to 68.8 % of the nation's GNP. Moreover, the debt service ratio for public debt

obligations is 32.2%. Government and private-sector debt repayments in 1987 reached 6.7 billion dollars and are expected to surpass 9 billion dollars in 1988. The share of debt repayment costs in relation to government revenues has been the largest item of expenditure since 1986. This reached approximately 40% of total outlays in 1987 and was just less than 50% in fiscal year 1988. As a result, Indonesia's overall debt service ratio was 34.7% in fiscal year 1987 and approximately 40% in 1988.

Indonesia's debt obligation has increased immensely in recent years primarily due to the rise in the value of the yen. A policy of long-term countermeasures is required to solve this problem. Now that the Baker Plan has been applied as a new debt obligation strategy in Mexico, it is hoped that the Southeast Asian countries, which are conscientiously continuing to repay their debts, will not be treated disadvantageously in comparison to Mexico and the Philippines. In particular, an international framework is necessary to support this effort for Indonesia, which is grappling with the task of economic reconstruction.

In the past few years, the weight of program assistance in the overall amount of Japanese assistance to Indonesia has increased considerably. However, the factors behind the rapid increase in this assistance have been essentially short-term measures of an emergency nature, not lasting countermeasures. In the long term, efforts must also be made on assistance which will help boost Indonesia's exports. In order to reduce the debt service ratio from 40% in 1988 to 25% in 1995, an average annual expansion of export revenues of 10% each year is required. Therefore, under present

circumstances, wherein a rapid increase in oil export prices cannot be expected, Indonesia's non-oil and non-gas exports must be expanded. This means that expansion of industrial product exports and diversification of export products (other than textiles, plywood, and rubber) are vital. At the same time, Japan, for its part, must import products from countries having large accumulated debts, such as Indonesia. Special preferential measures to achieve this would be beneficial.

In order to repay the accumulated debt, while also increasing non-oil and non-gas exports, an increase in general tax revenues must be achieved. This increase must be allotted to repaying external debt. Such countermeasures covering fiscal revenues are very important because even if foreign currency revenues are generated by exports, it does not mean that the money will automatically become public fiscal revenues. This fiscal issue will be discussed later in this report.

In addition, for the purpose of developing the export industry, it is necessary to expand government investment, to increase investment resources available to the private sector, to continue the policy of deregulation of economic activities, and to make the activation of private-sector corporations and the utilization of resources more effective. In terms of the monetary and financial policy, it is necessary for this purpose to make financial institutions more effective, to stabilize prices, and to gradually lower interest rates from their present level, which is over 20 percent.

From these considerations, it is clear that Japan, from a long-term viewpoint, must give priority to assistance which is targeted at

bolstering economic development and exports, and at strengthening Indonesia's repayment ability. Greater efforts must be made to expand non-oil/gas exports, to diversify export products, to expand private-sector investment resources, and to contribute to sound fiscal and financial policies. In addition, organizational and management capabilities on the fiscal, financial, and tax sides which are necessary to implement these improvements must be enhanced.

The IGGI (Inter-Governmental Group on Indonesia) is considered particularly important in this connection. Some criticize that the IGGI has up to now been lacking in determining the medium and long-term outlooks on assistance. Now that the amount of Japanese assistance has reached the top position, surpassing even that of the World Bank, it is important for Japan to exercise leadership in the IGGI by, for example, expressing Japan's views on the long-term perspective for Indonesia's debt obligation. For this purpose, it is essential to correctly understand the prospects for Indonesia's trade balance and fiscal budget balance. Japan should not depend on the World Bank, the IMF, or the U.S. for this understanding. Rather, the Japanese government or a committee of experts should examine the issues and make proposals. The possibilities with this type of response should be carefully examined.

2.2 The promotion of mutual understanding and friendly relations between Japan and Indonesia

Economic and technical cooperation from Japan to Indonesia has been steadily expanding ever since Japan's participation in the

Colombo Plan in 1954. The cumulative total of bilateral assistance between the two countries in the past has reached the number one position among all donor countries. Looking at this issue from the Indonesian side, Japan is not only the largest donor country in terms of aid; it has been the top donor among all international organizations since 1988.

It goes without saying that Japanese official development assistance not only promotes the economic and social development of Indonesia, it also helps to bind friendly relations between our two countries. In Indonesia, on the one hand, there are those who view the objective of Japanese official development assistance as "support for social and economic development." On the other hand, there are those who see Japan's objective as "expanding the sphere of Japanese business." It is imperative that Japan in the future exert much greater effort to ensure that the fact of Japan's huge assistance be known and correctly understood by every group and class in Indonesian society, particularly the intelligentsia.

Further, Japan is Indonesia's largest partner in both exports and imports, and Japan has long been the country with the greatest amount of cumulative investment in the non-oil/gas sectors of Indonesia. While Japan is Indonesia's largest market for exports, Japanese-made products can be seen everywhere on the streets in Indonesia and the number of Japanese tourists to Indonesia continues to increase every year. Also, through the avenues of technical cooperation and on-the-job training afforded by joint-venture corporations, there is a continuing exchange of people and goods, and thus of knowledge between Japan and Indonesia.

However, to enhance further mutual understanding and friendly relations between the peoples of the two countries, still greater efforts are required.

To achieve this purpose, the following measures should be undertaken.

- a. First and foremost, Japan must redouble its effort to provide information to the mass media of Indonesia regarding the basic aims of Japanese assistance and the results achieved up to now in a way that gives a lasting impression of the true facts.
- b. Meetings for dialogues and consultations between the end beneficiaries of assistance and the Japanese and Indonesian authorities involved in the assistance program should be increased. In response to requests, every effort should be made to ensure there is no room whatsoever for dissatisfaction or misunderstandings.
- c. Japanese assistance should go beyond supporting the economy and be broadly expanded to cover cultural exchange in such areas as education, culture, and the arts. For greater mutual understanding between the peoples of the two countries, it is essential that feelings of mutual trust be fostered and nurtured. In doing so, it is vital to give adequate consideration to promoting respect for Indonesia's history, culture, and values based on its national traditions.
- d. It is also necessary to inform Indonesians about Japan's culture and Japanese lifestyles in as much diversity and in as great a volume as possible. Japan should quickly and actively respond to all Indonesian efforts made to study and research not only the

Japanese language but also modern Japanese politics, economy, society, and culture.

In particular, a start should be made to upgrade the facilities that have already been established for this purpose. First, the "Japan Cultural Center, Jakarta", part of the Japan Foundation, which has already been set up, should be drastically expanded and strengthened as a place where the latest information in many fields concerning Japan can be obtained. Besides academic information, other knowledge and information sought by the Indonesian public, such as movies and music, must be provided. Ideally, this should be a place where people can catch for themselves the real atmosphere of Japan.

Next, as part of the plan for promoting Japanese studies at Indonesian universities and research institutes, if there is any request for assistance in the establishment of a "Japan Research Center" at the University of Indonesia for instance, Japan should make a prompt and positive response to this request.

Third, the Foreign Ministry and the Ministry of Posts and Telecommunications are currently involved jointly in a "Study for Foreign Distribution of Television Programs" to introduce Japan via the mass media, particularly television. It would be effective to produce programs that provide a correct understanding of Japan, dub these programs into the Indonesian language, and provide them at no cost on the basis of the Study's recommendations. Likewise, educational programs should also be jointly produced.

Fourth, Japan should build an " Indonesian Culture Center" in Japan in consultation with the Indonesian side. Reports and publications concerning Indonesia cannot be said to be in abundance in Japan. The number of Indonesian visitors here is quite low. In other words, the pipeline for people-to-people exchange between the Japanese and the Indonesians is still very narrow. Providing the Japanese people with correct and abundant information about the Indonesian people and their culture will become ever more important in the future. Therefore, this center should become a place for exchange between Japan and Indonesia. This type of center should be established not just for Indonesia. In consultation with the other countries of Southeast Asia, construction of a Southeast Asia Hall, as a form of ASEAN Center, would be even more worthwhile.

Finally, support for Japanese researchers and university research institutes involved in research of economic development in developing countries and of economic cooperation has been approved as official development assistance. However, it is also necessary to investigate the utilization of official development assistance for regional studies of the society and culture of developing countries, in addition to economic issues. For such research studies, Japan could be expected to offer development cooperation with more detailed knowledge of the situation in Asia than any other donor country.

Relations between Japan and Indonesia have grown steadily deeper since the end of World War II.

The relations, based on mutual understanding, should extend further to cover not only economic but also cultural exchanges.

2.3 Other priorities in development assistance

The major part of Japanese assistance now and in the future should be directed toward the development of industrial infrastructure. That issue was briefly discussed in Chapter 2. Other priorities in Japanese assistance should be as follows.

2.3.1 Human resources development

Many people who have worked in Indonesia must have noticed the lack of skilled personnel, and also recognized that building up human resources is the most urgent task which Indonesia is facing. According to a study commissioned by the Ministry of Foreign Affairs, the people of Indonesia themselves admit that the assistance most urgently needed in Indonesia is for human resources development through education, vocational training, and the development of skilled personnel. The lag in education in this country is very serious and is a major obstacle to industrialization and economic development. While the spread of elementary education and the improvement in the literacy rate have been very evident, less than 1% of the workforce has received any university education.

For the future economic development of this country, steady strengthening of its education system must be a fundamental policy. Although the Pancasila spirit is emphasized in elementary and secondary education, it is also essential to increase basic academic abilities. The most urgent item required to increase basic academic abilities is the improvement of teachers. To improve the quality of elementary and middle school education, priority must be given to

the following points and the cooperation necessary to achieve them must be implemented.

- 1) Enrichment of course curricula for the teaching profession to improve the quality of teachers and foster more and better qualified teachers.
- 2) Reinforcement of education facilities and equipment, broadcast of educational programs, and extensive application of such programs.
- 3) Reinforcement of science education, improvement of the quality of teachers, establishment of a science education research center and of science education facilities, and the reinforcement of science education equipment.

However, to implement this type of policy in a country as immense as Indonesia over the entire nation at the same time would be very difficult due to insufficient financial and human resources. Therefore, one proposal to be made to the Indonesian Government is the establishment of "Model Education Districts" for elementary and middle schools in a number of areas throughout the country. Model education programs should then be implemented in these districts with the provision of adequate budgets. It is believed that this would be a very effective measure.

In the field of higher education, the system must foster human resources in demand by the industrial sector. In Indonesia, graduates in the fields of applied chemistry, engineering, communications technology, political analysis, and business

administration are urgently needed for modernization and industrialization of the country but they are very few. In the future, it is expected that graduates in the fields of science and technology, political analysis, and accounting will be in much more demand than those in the liberal arts. The current distribution of academic departments in Indonesian universities does not seem to meet these demands. Also, plans to establish institutions of higher learning and to send students abroad in large numbers require adequate scrutiny from the standpoint of costs and benefits, and usefulness. The capability of formulating comprehensive plans for the establishment and accreditation of schools of higher learning is also required. In this respect, Japan can provide assistance based on its experience up to the present.

The dropout rate from schools is also high. The number of graduates with bachelor's degrees amounted to only 10% of the number who matriculated at schools of higher learning in 1987. The average number of years required for graduation with such a degree was 6 ~ 8 years. Economic reasons are, of course, the greatest factor of this problem. Improvements cannot be expected overnight. Many of the problems inherent in the education system are due to a lack of capacity for planned, system-wide management. Therefore, in the medium-term, planning and policy proposal functions for education administration should be strengthened, and education should be molded to respond to the needs for development of an economic society. For the long-term, participation in the education decision-making process by the education sector and efforts to link education planning to workforce demands are required. In other words, in addition to basic education, technical education, skills training, and

vocational training must be reinforced. In these areas, Japan can make an important contribution by providing expert knowledge and skills.

One proposal in this field is for the establishment of an international university in Indonesia as a sort of "ASEAN University," similar to the Asian Institute of Technology that has been set up in the suburbs of Bangkok. This would raise the standard of higher education in Indonesia and provide an opportunity to enhance the integration of higher education. If the proposal is accepted, Japan should play a major role in the establishment of this international university and dispatch of scholars to it.

To stimulate private-sector enterprises, it is essential to foster entrepreneurs and to reinforce vocational training and corporate in-house training. Japanese corporations, in comparison with those of Europe and North America have made effective and appropriate utilization of corporate in-house training and have succeeded in attaining higher productivity by this means. A serious study should be made of the possibility of using this experience and supporting Indonesia's efforts to foster skilled human resources. For this purpose, training centers have already been established by the private sector and they are pursuing very active programs. The "Pacific Resources Exchange Center," which was established recently in Osaka, is a good example. Actively supporting these centers is one method of further enhancing their effectiveness. Moreover, in the case of Indonesia, consideration should be given to assistance in supporting governmental training organizations (the Training Institute of the Ministry of Finance and the Statistical Training and

Education Center of the Central Bureau of Statistics, for example), to strengthening similar private-sector organizations, and to reinforcing public organizations for the purpose of assisting corporate in-house vocational training.

For strengthening and enhancing the effectiveness of Indonesian bureaucratic organizations, it is no exaggeration to say that the key lies in eliminating the scarcity of well-trained, middle-level bureaucrats. For Indonesia to achieve an economic "takeoff" in the near future, the efficiency of bureaucratic organizations must be enhanced in parallel with that of private-sector corporations. An important item for Japanese assistance for enhancing bureaucratic organizations is support for the cultivation and retraining of middle-level government officials within this framework. In Indonesia, there is no organ comparable to the National Personnel Authority in Japan. It would be very significant if cooperation could be offered for the establishment of such an agency. One measure that should be examined is the planned invitation of Indonesian students to the course in Public Administration established at Saitama University in Japan.

Another matter which should be examined in this connection is financial assistance for foreign students from the World Bank and the Overseas Economic Cooperation Fund. The amount from the latter is already 6 billion yen. The intent and ideal of this assistance is excellent from a long-term perspective and future requests should be examined favorably, however a careful comparison of the costs and public benefits of this program with those of alternative proposals should also be made.

2.3.2 Countermeasures for increasing population and unemployment

The new workforce that will be created during the period of Fifth Five-Year Development Plan is estimated to be 11.9 million workers, at 2.4 million per year. The government forecasts that the number of new workplaces that will be required for new employment will reach 11.5 million (4 million in agriculture, 2.7 million in commerce, 2.3 million in industry, and 2.5 million in other sectors). As of 1988 however, 54% of the total workforce was already employed in the agricultural sector and for the success of this plan, further development of the agricultural sector would be required. In fact, vitalization of the agro-industry would be essential. Moreover, a large expansion of employment opportunities in the commercial and industrial sectors would also be mandatory.

According to the Ministry of Labor, the total number of unemployed was estimated to be 2.2 million at the end of the Fourth Five-Year Development Plan (1988). While the rate of those totally unemployed was low, only 2.7%, the rate of unemployment was high in the cities (5 ~ 7%) and among the young and those with higher education. Thus, the unemployment rates for urban youth (20 ~ 24 years old) were 19.2% for men and 17.5% for women. Among these groups, the new workforce, which will have higher levels of education than in the past (approximately 20 million over the next 10 years), will seek employment in urban areas, where incomes and other employment conditions are more favorable. For this reason, the employment problem in the cities will become even more serious. Among middle and high school graduates, the rate of those totally unemployed is very high. According to the 1986 census, more than 60% of middle

school graduates seek work. It is vital to provide employment opportunities to these people in order to avoid social instability.

Under these conditions, the fundamental subject that must be examined is control of the population growth rate. Indonesia must make greater efforts in family planning to reduce the rate of population growth, just as the newly industrializing economies (NIEs) such as Korea, Taiwan, and Singapore have done. Japan can make greater contributions in this area than it has in the past.

In implementating the development plans, further scrutiny must be given to these problems from the standpoint of employment, and particular attention must be paid to regional distribution. It is essential to develop a plan that provides for fair regional distribution by clearly distinguishing the businesses that should be developed around metropolitan areas, the businesses that should be developed around regional cities, and the businesses that should be developed in rural areas and areas outside Java Island. In this regard, the Japanese national land utilization plans, including the recent Fourth Comprehensive National Development Plan, are based on rich experience in diverse regional developments. Therefore, cooperation in this respect should be extended in the future and greater support should be provided for regional development in Indonesia.

Partial unemployment (less than 35 hours per week), on the other hand, has traditionally been high, in Indonesia at around 30 - 40%. This problem is particularly acute among the youth, the elderly, women, and rural area residents. Incorporation of women into the

workforce will also increase due to the reduction of load in infant care as a result of family planning, the necessity for additional household income, and the desire of women to participate in economic activities. Women are forecasted to make up 41.8% of the total workforce by 1993. In considering the employment problem, it is particularly important to include employment of the female workforce. With respect to this point, Japan underwent many very similar experiences and has many specialists in this field. In this respect as well, it would be desirable in the future to strengthen assistance.

Unemployment, of course, is caused by excessively low levels of employment resulting from rather slow development. However, low standards of education and poor levels of training are also causes of low productivity by the labor force. Seventy-eight percent of the labor force of 74.5 million in 1988 had no higher academic training than elementary school graduation or even less. Even if the economy develops, workers with this educational background cannot be guaranteed employment opportunities in the future. In developing countries, an overabundance of unskilled labor coexists with a shortage of skilled and semi-skilled workers, and Indonesia is no exception. Measures for employment, therefore, must focus on efforts to create employment opportunities via a policy of boosting industry and commerce, and, at the same time, must not neglect retraining of workers and provision of basic education to the labor force. The Indonesian Government has been striving vigorously to enhance vocational education and training. It is imperative, however, that such education and training be further expanded to enhance productivity and promote employment. Japan should strengthen

assistance for construction and augmentation of facilities based on her experience in occupational education and training, as well as step up technical cooperation.

The expansion of employment opportunities in rural areas is important to alleviate the excessive flow of the agricultural labor force to urban areas. As in the case of agricultural development, vitalizing the agro-industry and providing incentives for building plants in rural areas are very important for absorbing the labor force. These points are discussed in the section below.

2.3.3 Agricultural development

The share of GDP taken up by the agricultural sector dropped to 24% in 1985, down from 56% in 1965. From 1985 on the share has been approximately the same. Further, the ratio of agricultural workers in proportion to all workers fell from 71% in 1965 to 55% in 1985. On the island of Java, where 60% of the population lives, the amount of agricultural land per household in terms of area is very small, 0.55 hectares in 1983. In fact, the distinguishing characteristic of this region is the existence of many agricultural families totally without land. Indonesian agriculture suffers from both low productivity and low incomes. However, this sector provides food to the people and a means of acquiring valuable foreign exchange. In this regard, agriculture is the sector which provides the largest source of employment for the country and the vast pool of under-employed workers. The development of the agricultural sector has been given top priority by the government in previous development plans up to

the present. As a result, Indonesia has been self-sufficient in rice since 1984.

Indonesian agriculture, which has achieved the major goal of rice self-sufficiency, is now seeking new objectives. However, rice production, the staple of the agricultural sector, is subject to severe fluctuations due to weather condition and the outbreak of virulent pests. A government policy for distribution of main foodstuffs should be carefully implemented, since the sharp drop in the price of rice in 1985 affected the livelihood of so many people. On parts of Java Island, however, there are shortages of workers during the busy periods of the season. In addition to improving the productivity of labor, the agricultural sector has reached the stage where it is necessary to diversify agricultural products and to expand in new directions that include cultivation of the agricultural product processing industry. Many cautiously advocate adopting the latest planting and harvesting machines. The mechanization of agriculture must be carefully implemented, so as not to lead to a rapid worsening of the employment problem in rural villages. It is also important that care be exercised so as not to wastefully use a small amount of investment resources. In this respect, the cooperation of Japanese specialists would be extremely effective and should be increased to a higher level than in the past.

To maintain rice self-sufficiency, it is necessary to enhance productivity further. For this, it is important that construction of the irrigation infrastructure be further promoted and that organizations for maintenance and management be strengthened. In addition, the entire system for storage, processing, transport, and consumption of

agricultural products after harvesting must be made more efficient. The cooperation of Japanese specialists in the field of post-harvest processing could make a large contribution, thereby reducing the quantity of rice lost after harvesting.

In the future, agricultural production can be diversified by increasing the production of not only rice but also field crops (*palawija*) such as soy beans, potatoes, corn, and cassava and by expanding animal industry. By diversifying this way, the living standards of the Indonesian people can be raised and a greater variety in foods can be provided. The "Major Foodcrop Production Program" (1986 - 1990), the so-called umbrella-type cooperation, which is currently being supported by Japan, is aimed at increasing the production of various crops such as soy beans, potatoes, and rice. This program covers the entire national territory, and is being vigorously promoted in an integrated fashion. Along with enhancing productivity and expanding production of commercial crops such as rubber, palm oil, lumber, and raw starch, the agro-industry should be boosted and agricultural products with greater value-added prices should be exported in order to increase foreign exchange earnings. It is also important to provide means for under-employed workers to increase their non-agricultural incomes within rural areas. The other vital point is the planned expansion of afforestation and development of the forestry industry in a way that is consistent with environmental protection policies.

Besides the agricultural sector, another field which lags behind is fisheries. The poverty of fishermen is even greater than that of farmers. Fisheries should be further developed on the grounds that

aquatic products are an important source of protein for the Indonesian people. The fish processing industry, including that for fish meal, should be expanded further and the distribution system, including quality control of fishery products, should be improved. The development of fisheries, along with the revitalization of fish culture and the development of potential marine resources, should also be boosted in the future. In this area, Japan holds lots of accumulated experience and knowledge which can be shared with Indonesia.

In addition to putting efforts into areas in which Japan is very experienced and has many high-level experts, participation by foreign experts in fields where there are few Japanese experts, such as plantation farming, should be vastly expanded and active cooperation by Japan with these other experts should be advanced.

2.3.4 Stimulating export industries

The policy of the Indonesian government for industrialization began with efforts to build up industries which produce items to substitute for imports by using investment funds gained from expanding petroleum revenues. In terms of type of industry, in addition to light industries such as the food processing industry and the textile and clothing industries, capital-intensive industries in which capital resources are closely bound, such as the machinery and basic chemical industries, are also given priority in the country's development effort. The promotion of industrialization and nationalization for import substitutes, coupled with restrictions on purchasing of industrial raw materials, brought about a high-cost

economy. In terms of industrial organizations, a large disparity developed between the small number of national enterprises, foreign-owned businesses, or businesses owned by ethnic Chinese, on the one hand, and the very large number of small business groups.

At present, while petroleum and gas prices are weak, the necessity of switching to an industrial policy which is export-oriented and which develops and revitalizes industries that make products with high value-added prices, particularly non-oil/gas products, is clear. To accomplish this, it is necessary to overcome the difficulties outlined above and to foster export industries which have genuine international competitive strength. Enhancing the productivity of the entire manufacturing industry sector is the first step in achieving this goal. For this purpose, very close cooperation between industries, based upon free business competition, will be required.

To this end, what is most urgent in Indonesia at present is further relaxation of controls, which affects every aspect of production, trade, investment and financing from abroad. As will be described below, the Indonesian government warrants high marks for its effort in recent years to implement a considerable degree of economic deregulation and liberalization of trade. However, it is important to institute still further economic deregulation. For example, by studying the example of liberalization policy and successes in Thailand, which has been enjoying outstanding growth in recent years, Indonesia should formulate a liberalization policy based on real conditions in the country. The main liberalization policies and deregulation policies which have recently been implemented in Indonesia are set forth below.

- 1983, March 28% devaluation of the rupiah (IMF formula)
- 1983, June Liberalization of financial controls :
liberalization of interest rates : removal of controls on lending
- 1984, January Tax reform
- 1985, April Policy of streamlining the distribution system for the support of economic activities : removal of most customs inspection requirements
- 1986, May Announcement of the May 6, 1986 package
— Comprehensive Economic Policy
- (a) Exemption from and refunds of customs duties on raw materials imported for the manufacture of export products
 - (b) Decision to decontrol investments
 - (c) Beginning of environmental work for boosting exports of non-oil/gas products and --- for stimulating overseas and domestic private-sector investment
- 1986, September 31% devaluation of the rupiah
- 1986, October Announcement to of follow-up devaluation of the rupiah
- (a) Relaxation of import controls
 - (b) Reduction of customs duties
 - (c) Relaxation of investment controls for foreign investment, decision to liberalize the swap facility to avoid foreign exchange risks
- 1987, January Further lowering of customs duties, relaxation of import controls on steel and textiles

- 1987, August Major simplification of the system for granting permission to firms for new investment and expanded investment
- 1987, December Announcement of the December 27, 1987 package: relaxation of controls to promote exports and investment
- 1988, October Announcement of major reforms of the currency and financial system as part 1 of the "New Policy Round," re-opening of the way for foreign banks to participate in the Indonesian economy
- 1988, November Announcement of a major relaxation of import controls and streamlining of license controls for distribution and water transportation as part 2 of the "New Policy Round"
- 1988, December Announcement of a new policy for the capital markets and for non-banking financial institutions, and reconvening of license issues for the lease industry as part 3 of the "New Policy Round"
- 1989, May Switch from a positive to a negative system of control for foreign investments and reduction of the minimum scale of investment from one million U.S. dollars to US\$250,000.

Since these coordinated measures represent a very dramatic shift in direction for the country's industrial policy, it is likely that they will make a major contribution to enhancing the efficiency of the domestic economy and to revitalizing business activities. As a result of such changes, it is expected that the focus of efforts will move from an import-substitution to an export-promotion economic policy.

However, in Indonesia, several further stages of economic deregulation are required, including policies to promote additional foreign investment, which is vital to nurturing small- and medium-sized businesses. This is because foreign investors will invest only after making a comparative examination of conditions in Thailand, Malaysia, and the Philippines, and the pace of economic deregulation in Thailand and other countries in the past few years has been extremely fast.

The second important concern is not to make any errors in selecting the export industries to be supported. The export industries which will be important to Indonesia in the future are labor-intensive industries which will absorb a considerable portion of the workforce and industries that make active use of domestic resources, rather than capital-intensive industries. No doubt some preinvestments are also necessary for such long-term targets as the cultivation of more engineers. However, resources which are in limited supply should be employed in the most effective way. When vast amounts of human and material resources are introduced to certain specific industrial sectors, an accurate cost-benefit analysis must be performed. To increase Indonesia's industrial strength, it is necessary to build up the intermediate goods and parts industries (small and medium-sized suppliers). This point will be discussed in the next section.

The third vital concern is the build-up of industrial infrastructure, consisting of roads, harbors and ports, communications, and industrial zones, around the areas where export industries can be sited. Compared to Thailand and Malaysia, there are many areas in

Indonesia which still need to be developed. This topic was discussed fully in Chapter 2 and will not be repeated here.

The fourth major concern is the urgent implementation of policies for preferential treatment in terms of the administrative and tax system in order to strengthen the export orientation of domestic enterprises. For example, systems such as that of bonded manufacturing factories in Japan should be applied more flexibly, and efforts should be made to allow these factories to market a portion of their output domestically. To attract further overseas investment, it is necessary to build and maintain the distribution and financial system in parallel with legal reforms so as to contribute to the revitalization of exports. It is not sufficient that matters only be stipulated by law. For the long-term, stable management of enterprises, it is important that the interpretation and application of these laws be carried out correctly.

For Japan to cooperate with Indonesia, it is critical to make full use of its experience in implementing an export boosting policy that brought very dramatic results. Japan should strengthen cooperation so as to utilize Japanese practical expertise and tactics on administrative guidance, fiscal and financial support policies, product quality control and marketing. Japan must aim at a combination of both technical and financial cooperation, providing unified assistance which effectively links these two elements in building and improving an infrastructure of ports, harbors, roads and other facilities linked to exports.