A STUDY ON INDUSTRIAL SUB-SECTOR DEVELOPMENT IN THE REPUBLIC OF INDONESIA

Part I
Review of Policies Related to Industrial Sub-Sector Development

FIRST YEAR FINAL REPORT

AUGUST 1990

JAPAN INTERNATIONAL COOPERATION AGENCY

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PREFACE

In response to a request from the government of the Republic of Indonesia, the Japanese government agreed to conduct a study on Industrial Sub-sector Development in Indonesia and entrusted the study to the Japan International Cooperation Agency (JICA).

For the periods from August 14 to October 27, 1989, and from January 21 to 30, 1990, JICA dispatched to Indonesia a study team headed by Mr. Fumio Inui of the Japan External Trade Organization.

The team held discussions with the Indonesian government officials concerned and conducted a field survey. After the team returned to Japan, further studies were completed and the following report was prepared.

I hope that this report will serve for the development of the industrial sectors concerned and that it will contribute to the promotion of friendly relations between our two countries.

I wish to express my deep appreciation to the officials of the government of the Republic of Indonesia for the close cooperation which they extended to the team.

August, 1990

Kensuke Yanagiya

Kensuke Yanagiya
President
Japan International Cooperation Agency

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1.1. Industrial Development Policy

(1) The Present Situation of Industrial Development

1) Overview of economic performance under Repelita IV

In the following, the performance of the various industrial sectors under Repelita IV has been summarized based on the Presidential Report of August 1989. The average annual rate of growth of industry as a whole has been 13.2 percent. While the total amount of the added value in 1983 was 9.89 trillion RP, the figure increased in 1988 to 18.33 trillion RP (in 1983 terms). The share of industry as a whole in the GDP increased from 12.7 percent in 1983 to 18.4 percent in 1988. The average annual rate of growth of non-oil/gas sectors was 12.4 percent. Exports and the number of industrial products produced increased a great deal. While exports of a total of 181 items amounted to US$3,209 million in 1983, the amount increased to US$9,387 million worth of 381 items in 1988. As a consequence, the share of industrial products among total exports increased from 15.2 percent in 1983 to 48.8 percent in 1988. In addition, the share of industrial products among non-oil/gas exports increased from 64.2 percent in 1983 to 81.4 percent in 1988.

The economic performance of the industrial sectors encompassing the sub-sectors dealt with in this report are summarized as following:

[1] Small-scale industry

The total number of SENTRA at the end of Repelita IV reached 6,092, consisting of 1,758 foodstuff firms, 1,171 textiles and leather, 1,147 chemical and building materials, 1,377 handicrafts and 639 metal products. A total of 4.48 trillion RP worth or 45.2 percent of the total output of small-scale industry was purchased by state-owned enterprises in 1988.

The Ministries of Industry, Cooperatives and Manpower are promoting the establishment of KOPINKRA handicraft cooperatives and their numbers had increased to 1,019 in 13 provinces by the end of Repelita IV. The number of firms and the number of people employed also increased during this period. While in 1983 about 1,55 million firms (unit usaha) employed about 4.42 million people, in 1988 about 1,77 million firms employed about 5.61 million people. This means that the number of employed persons increased by 1.2 million during the Repelita IV period.
The export performance of small-scale industry is described in Table 1-1-1.

Table 1-1-1: Export Performance of Small-scale Industry

	1983	1988 (tentative)	Annual growth rate
Foodstuffs			
quantity (ton)	7,118	550,200	138%
value (US$1,000)	11,579	100,942	54%
Textiles and Leather			
quality (ton)	9,282	25,372	22%
value (US$1,000)	55,486	254,410	35%
Chemicals and Building Materials			
quality (ton)	52,890	101,744	14%
value (US$1,000)	28,485	96,801	27%
Handicrafts			
quality (ton)	10,486	25,127	19%
value (US$1,000)	41,215	503,843	65%
Total			
quality (ton)	79,778	702,445	54%
value (US$1,000)	136,766	955,997	47%

Source: compiled from notes attached to the Presidential Report, 1989

It is notable that in the handicraft industry, exports increased 2.3 times in volume, and 12 times in value.

This means that the price per ton increased substantially.

Problems encountered in small-scale industry include insufficient production technology, ineffective marketing systems, shortage of capital, low competitiveness, and problems in material procurement.

[2]Miscellaneous industry

In the following, the performance of the chemical industry sector in the miscellaneous industry category has been reviewed because it is closely connected with the rubber products industry which has been dealt with in this report. Products which showed a great increase in production during the Repelita IV period were blank casette tapes, blank video tapes, rubber footwear, bath soap, matches, cardboard boxes, plastic bags, and printing inks. On the other hand, production of synthetic leathers decreased. Exports of chemical products increased 7.8 percent in volume and 14 percent in value. Production of crumb rubber at the end of Repelita III was 689,800 tons while that at the end of Repelita IV was 1,014,600 tons, up 47 percent.

[3]The electrical machinery industry

This industry did not see constant and stable growth during the Repelita IV period. The production of generators, motors, and transformers did not show a constant increase. For example, production of generators in 1983 amounted to 33,771 units but decreased to 6,570 units in 1988. Production of transformers and motors increased during the five-year period but never showed a straight-line increase. The production trends of these three items are summarized in Table 1-1-2.

Table 1-1-2: Production Trends in Electrical Products

	1983/84	84/85	85/86	86/87	87/88	88/89
Transformers	5,667	5,839	12,124	7,977	9,500	15,850
Generators	33,771	32,450	20,833	19,425	15,000	6,570
Motors	5,530	36,000	5,667	21,307	16,500	24,780

Source: Compiled from notes attached to the Presidential Report of 1989

The problem in this industry is that productivity in terms of value added is very low.

2) Industry as a whole

In advance of the review of the basic industrial development policies, an analysis of the present situation of the manufacturing industry and the selected industrial sub-sectors has been made.

Table 1-1-3 shows the development of industry (large and medium-scale firms) in the past 10-year and 5-year periods. The annual growth rates of the value of gross output and the added value for the past 10 years were 30 percent and 28 percent, respectively, while that of employment was 8.5 percent. The annual growth rates of the value of gross output and added value for the past five years were 28.7 percent and 26.6 percent, respectively. The annual growth rates for the past five years showed a declining tendency in comparison to those of the past 10 years.

Table 1-1-3: Development of the Manufacturing Industry (Large and Medium-scale Firms) (1977-1987)

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Employment (number of people)	791,659	1,067,017	1,788,325	8.5	10
Value of gross output (in bil. RP]	2,434	9,503	33,591	30	28.7
Added value (in bil. RP)	949	3,461	11,278	28	26.6

Source: Compiled from Statistics of Industry, BPS

Table 1-1-4 summarizes the changes in productivity in the manufacturing industry. The output value per employee increased by 19.8 percent per annum in the past 10 years but in the past five years it showed only a 16.1 percent increase per annum. The input to output ratio tended to increase slightly.

Table 1-1-4: Changes in the Productivity of the Manufacturing Industry

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Value of gross output per employee (in Mil. RP)	3.07	8.9	18.78	19.8	16.1
Added value per employee (in mil. RP)	1.19	3.2	6.30	18.1	14.5
Input to output ratio	0.61	0.63	0.66		

Source: BPS

3) The handicraft industry

The range of handicraft products is broad and no single industry code represents figures for the entire handicraft sector. Therefore, the analysis is based on the following three code numbers:

no.32113: bleaching, dyeing, printing and finishing fabrics
no.33140: manufacture of handicrafts and wood carvings
no.39010: manufacture of jewelry

The development of large and medium-scale handicraft manufacturers in the past 10 years and five years is summarized in Tables 1-1-5, 6 and 7. (Code no.39010 includes figures for the past five years only.) It can generally be said that in all indices, annual growth rates of individual handicraft firms were larger than those of the industry as a whole, with the exception of industry code no.32113. The share of the handicraft industry in the entire manufacturing industry is about 0.5 percent in all indices. (Reference Table 1-1-8)

The productivity of the handicraft industry is shown in Table 1-1-9. In comparison with the average productivity figures for the manufacturing industry, those for code nos.33140 (handicraft and wood carvings) and 39010 (jewelry) are particularly low. The added value per employee figures for industry code nos.33140 and 39010 in 1987 were one-fifth and one-fourth the average figure for the entire manufacturing industry respectively.

Table 1-1-5: Development of the Handicraft Industry Code No. 32113 (Large and Medium-scale Firms, 1977-1987)

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Employment (number of people)	6,876	5,529	8,138	1.7	8.0
Value of gross output (in bil. RP]	16	48.2	14.7	24.8	24.9
Added value (in bil. RP)	4	6.6	51	27.5	50.5

Source: BPS

Table 1-1-6: Development of the Handicraft Industry Code No. 33140 (Large and Medium-scale Firms, 1977-1987)

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Employment (number of people)	456	1,053	1,803	14.7	11.3
Value of gross output (in bil. RP]	0.12	0.85	3.3	39.2	31.1
Added value (in bil. RP)	0.09	0.7	2.3	38.7	26.8

Source: BPS

Table 1-1-7: Development of the Handicraft Industry Code No. 39010 (Large and Medium-scale Firms, 1982-1987)

	1982	1987	Growth rate per annum (%)
Employment (number of people)	293	703	19.1
Value of gross output (in bil. RP]	0.3	2.6	53.2
Added value (in bil. RP)	0.16	1.1	46.1

Source: BPS

Table 1-1-8: Share of the Handicraft Industry in the Entire Manufacturing Industry in 1987

	Handicraft (aggregate figures of code Nos.32113, 33140 and 39010)	Entire Industry	Share (%)
Employment (number of people)	10,644	1,788,325	0.59
Value of gross output (in bil. RP]	153.2	33,591	0.45
Added value (in bil. RP)	54.8	11,278	0.48

Source: BPS

Table 1-1-9: Changes in the Productivity of the Handicraft Industry

	Industry Code No.	1977	1982	1987	Annual Growth Rate for the past 10 years(%)	Annual Growth Rate for the past 5 years (%)
Value of gross output (in mil. RP) per employee	32113	2.4	8.70	18.10	22.3	15.7
	33140	0.25	0.80	1.84	22	18.1
	39010	NA	1.13	3.7	X	26.7
Added Value per employee (in mil. RP)	32113	0.65	1.19	6.31	25.5	39.6
	33140	0.19	0.64	1.3	21.2	15.2
	39010	NA	0.55	1.58	X	
Input to output ratio	32113	0.73	0.86	0.65		
	33140	0.24	0.19	0.29		
	39010	NA	0.51	0.57		

Source: BPS
NA = not available

4) The rubber-based product industry

The industry code number for rubber products is No.355 and this includes all kinds of rubber products such as tires, footwear, etc.

The rubber products discussed in this study are more precisely included under No.35590 (manufacture of rubber products not elsewhere classified).

The development of the rubber products industry under code No.35590 is shown in Table 1-1-10. The annual growth rate of this industry is very high in all indices relating to development. Furthermore, the growth rates for the past five years are higher than those for the past 10 years.

Table 1-1-10: Development of the Rubber-based Product Industry No. 35590
(Large and Medium-scale Firms, 1977-1987)

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Employment (number of people)	3,429	6,496	14,255	15.3	17.0
Value of gross output (in bil. RP]	5	16	158	41.2	58.0
Added value (in bil. RP)	1.5	5.5	51.5	42.4	56.4

Source: BPS

The share of the rubber products under No.35590 in the entire manufacturing industry is described in Table 1-1-11. The rubber products under this code number account for approximately 0.5 percent of the entire manufacturing industry output.

Table 1-1-11: Share of the Rubber-based Product Industry Code No 35590 in the Entire Manufacturing Industry in 1987

	Rubber products	Entire Industry	Share (%)
Employment (number of people)	14,255	1,788,325	0.79
Value of gross output (in bil. RP]	158	33,591	0.47
Added value (in bil. RP)	51	11,278	0.45

Source: BPS

The changes in productivity in this industry are shown in Table 1-1-12. In comparison with the figures for the entire manufacturing industry, the productivity of the rubber products industry under code No.35590 is very low. The value of gross output and the added value per employee of the rubber products industry under this code number in 1987 were 59 percent and 57 percent respectively, very low in comparison with the figures for the entire manufacturing industry. However, the growth rate of the rubber products industry under this code number is greater than that of the entire manufacturing industry.

Table 1-1-12: Changes in the Productivity of the Rubber-based Product Industry Code No.35590

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Value of gross output per employee (in million RP)	1.5	2.48	11.1	22	34.9
Added value per employee (in million RP)	0.44	0.85	3.6	23.3	33.4
Input to output ratio	0.71	0.65	0.67		

Source: BPS

For reference, the changes in the productivity of the entire rubber industry under the code number 355 are shown in Table 1-1-13. The rubber products industry as a whole showed a larger increase in the value of gross output in comparison with the entire manufacturing industry and the rubber products industry under code number 35590. However, the recent figures indicate that the growth of added value per employee is stagnant and the input to output ratio is worsening.

Table 1-1-13: Changes in the Productivity of the Rubber-based Product Industry Code No.355

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Value of gross output per employee (in mil. RP)	4.29	10.5	19.8	16.5	13.5
Added value per employee (in mil. RP)	2.19	2.66	3.8	5.6	7.39
Input to output ratio	0.49	0.75	0.81		

Source: BPS

5) The electrical machinery industry

The electrical machinery dealt with in this study are generators, motors and transformers. The industrial statistics on these items are included under industry code No.38330. The figures showing the past development of this industry are included in Table 1-1-14. The growth rates of the value of gross output and the added value of this industry were almost the same as those of the entire industry. However, the growth rate in the past five years shows a declining tendency in comparison with the preceding five years. The growth rate of the number of employees in the past five years is one-third that of the entire manufacturing industry.

Table 1-1-14: The Development of the Electrical Industry Code No.38330 (Large and Medium-scale Firms, 1977-1987)

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Employment (number of people)	9,298	15,129	17,786	6.7	3.2
Value of gross output (in bil. RP]	38	210	557	30	21.5
Added value (in bil. RP)	11	91	153	29.8	10.9

Source: BPS

The share of the electrical machinery industry under code number 38330 in 1987 in the entire manufacturing industry is shown in Table 1-1-15. The share of this industry in terms of the number of employees is about 1 percent and the shares in terms of gross output and added value are about 1.5 percent.

Table 1-1-15: The Share of the Electrical Machinery Industry Code No.38330 in the Entire Manufacturing Industry in 1987

	Rubber products	Entire Industry	Share (%)
Employment (Number of people)	17,786	1,788,325	0.99
Value of gross output (in bil. RP	557	33,591	1.65
Added value (in bil. RP)	153	11,278	1.35

Source: BPS

Changes in the productivity of this industry are shown in Table 1-1-16. The productivity of this industry is greater than that of the entire manufacturing industry. The gross output value and added value per employee are greater than the average of the manufacturing industry. However, the annual growth rate of productivity over the past five years has been declining and the input to output ratio is worse than that of the manufacturing industry as a whole.

Table 1-1-16: Changes in the Productivity of the Electrical Industry Code No.38330

	1977	1982	1987	Annual growth rate for the past 10 years (%)	Annual growth rate for the past 5 years (%)
Value of gross output per employee (in mil RP)	4.15	13.9	31.3	22.3	17.6
Added value per employee (in mil. RP)	1.2	6.0	8.6	21.7	7.4
Input to output ratio	0.7	0.56	0.72		

Source: BPS

(2) Objectives of the Industrial Development Policies

1) Primary objectives of industrial development under Repelita V

The priorities for industrial development during Repelita V are as follows:

[1] development of export-oriented industries and promotion of the diversification of the manufacturing industry

[2] building and strengthening of the industrial structure with particular emphasis on the promotion of inter-industry linkages

[3] development of small-scale industries for enhancement of business and employment opportunities

[4] expansion of the food processing industry for optimum utilization of the basic assets of the agriculture sector and other sectors

[5] development of national capability in plant design technology, engineering and manufacturing of machinery and equipment as well as the acquisition and development of main systems in the electronics industry

[6] development of professionals and entrepreneurs in terms of quantity and quality

For the purpose of achieving the above objectives, Repelita V sets several concrete targets for industrial development :

a. An average annual growth rate for the entire manufacturing sector of 8.5 percent and for the non-oil/gas manufacturing sector of 10 percent. It is expected that at the end of Repelita V, the share of the manufacturing industry in the GDP will be 16.9 percent while that of agriculture will be 21.6 percent.

b. An increase in the total employment in the manufacturing sector of 2.3 million.

c. The average annual growth rate of manufactured exports is expected to be 15 percent. Specifically, the miscellaneous industry category is expected to grow 13.8 percent, metal and machinery industries 10.9 percent, basic chemical industries 21.9 percent, and small-scale industry 21 percent. The share of manufactured goods in overall exports is forecast to be 59.7 percent by the end of Repelita V. The value of manufactured exports is projected at US$18 billion or more by the end of Repelita V.

The above objectives are expected to be achieved through the implementation of the basic policies and programs described below.

2) Basic policies

[1] Development of export-oriented industries

a. To support and secure the development of the industries which have successfully expanded exports during Repelita IV, and to make efforts to increase the competitive strength of such products in the international marketplace.
b. To diversify exports as well as to encourage the development of new manufacturing industries. The diversification of exports is aimed at increasing the added value of the export products.
c. To increase the competitive strength of the import substitution industries through the improvement of the effectiveness of the industries and to enhance such industries to increase exports.
d. To create a business climate that is conducive to investment by export-oriented industries.
e. To develop export-oriented industrial estates.

[2]Deepening and strengthening of the industrial structure

a. Priorities in structural improvement will be put on the industries which have a comparative advantage. Structural deepening is closely related to restructuring of the industries. This policy also aims at promotion of the industrialization of regions as well as the growth of small and medium-scale industries.
b. To promote the key or strategic industries effectively in consideration of national development priorities. Steps will also be taken to increase the efficiency and the productivity of state-owned enterprises.
c. For those industries which use raw materials which cannot be easily procured in the international market, the industrial structure will be deepened to secure the increase of production on a stable basis.

[3] Development of small-scale industries

a. The development of small-scale industries including handicrafts, family-run, and traditional industries will be done through the establishment of SENTRAS.
b. To promote the vertical expansion of these industries through the enhancement of their ability and self-reliance as well as through the enlargement of production scale and volume.
c. To develop regional small-scale industries
d. To make efforts to expand business opportunities through the development of production capability for export and through the linkage program and the program to the improve the business and investment climate.

[4] Development of agro-industry

a. To increase the efficiency and productivity of the existing agro-industry.
b. To strengthen the development of new products.
c. Development of agro-industry in the regional areas will be implemented in consideration of the distinct characteristics and comparative advantages of each region.
d. To make efforts to develop the labor intensive agro-industry.
e. To enhance the added value of the products and to increase the employment opportunities through the expansion of their products into consumer goods.
f. To promote the production of the machinery necessary for processing agricultural products.

[5] Acquisition and transfer of technology

a. Development of research and development facilities, laboratories, and industrial growth centers, enhancement of professionalism and specialization of research personnel, and increasing of the role of the private sector, especially that of large firms and state-owned firms in terms of R & D.
b. Acquisition of technology of manufacturing production processes, promotion of standardization, promotion of industrial standards and acquisition of advanced high technology.
c. Enhancement of industrial construction and engineering design technology in order to promote manufacturing factories, equipment, machinery and plant construction.
d. Promotion of effective transfer and dissemination of technology to decrease the distortion in the acquisition of the technology.

[6] Supporting policy measures

In order to support industrial development, government policies will be implemented and will include the development of industrial information systems, the establishment of a national industrial development plan, development of manpower, development of industry training and promotion of efficiency in the public sectors.

3) Programs

Industrial development programs consist of [1] the export-oriented industry development program, [2] the industrial structure deepening and strengthening program, [3] the agricultural product processing industry development program, [4] the industrial technology acquisition and dissemination program, and [5] the supporting measures program.

[1] Export-oriented industry development program

The growth of the export-oriented industries which successfully expanded exports during the Repelita IV period is to be maintained. Promotion of the diversification of export products is to be attained through the improvement of existing import substitution industries and also through the development of the new manufacturing industries. Efforts to create the appropriate investment and business climate for the balanced development of import substitution industries and export-oriented industries are to be continued. Promotion of the systematic integration of market and production information will be undertaken. A balance between export promotion and the satisfaction of domestic demand is to be secured. Improvement of production technology to assure adequate supply at an appropriate price and delivery time will be made. Preparation for the future expansion of exports of products with good export potential will be made. The targets for annual export growth by industry under Repelita V are as follows:

a.miscellaneous industry 13.8 percent
b.machinery, basic metal, electric and electronics 10.9 percent
c.basic chemicals 21.9 percent
d.small-scale industries 21.6 percent

[2] Industrial structure deepening and strengthening program

The objectives of the industrial structure deepening and strengthening program are to increase the added value of industries, to decrease the dependency of industries on imported products and to reinforce the industrial base. The priorities of this program are the industries which have close links with other industries or comparative advantages. These industries are expected to implement restructuring for production expansion, improvement of efficiency and strengthening of competitiveness. The purpose of restructuring is to secure the optimum utilization of natural resources, human resources, capital and technology. For the achievement of this, it is necessary to develop new manufacturing industries spanning from raw materials to intermediate products to capital goods which utilize natural resources and human resources effectively.

[3] Agricultural product processing industry development program

This program aims to increase the efficiency and productivity of production, to promote the diversification of products and also to improve the quality of the exportable products and to promote the standardization of products. To support the development of agricultural product processing industries, the development of appropriate processing machinery and factory equipment will be continued.

[4] Industrial technology acquisition and dissemination program

a.Enhancement of the capability of researchers and research facilities both in quality and in quantity will be pursued through the improvement of research facilities and equipment.
b.Promotion and improvement of manufacturing process technology, production technology, quality control, pollution preventive technology, recycling technology and high technology will be made.
c.Industrial training and education of technical engineers will be made to counter the shortage of such personnel, especially in small-scale industries.
d.Facilitation of access to data sources, both domestic and foreign, especially by small-scale industries, will be promoted so as to increase the possibility of the technological transfer from both domestic and foreign sources to small-scale industries.
e.Promotion of the standardization of manufacturing processes and of industrial standards will be implemented in accordance with the priorities described as follows:

For the purpose of promotion of industrial product exports, the standards of the products would be adjusted to meet the international standards or standards of importing countries.

For strengthening of the industrial structure and creation of linkage, promotion of the standardization of raw materials and intermediate products will be made in the acceptable range by up-stream and down-stream industry.

Promotion of the standardization of various products through the optimum utilization and unification of existing facilities.

Promotion of the utilization of domestically-manufactured products

For the purpose of the promotion of the machinery industry, standardization of raw materials, intermediate products and parts and components, and of the manufacturing process will be made so as to prevent excessive diversification and to decrease the production cost.

Promotion of the subcontracting system.

Improvement of efficiency in the utilization of raw materials
During the Repelita V period, establishment of 1,500 new industrial standards is foreseen.

f.Enhancement of design capability will be pursued. Transfer of design technology to domestic firms will be undertaken through the following steps:

Promotion of linkage between design firms and manufacturing firms and also promotion of the linkage among those firms which are already have design capability.

Promotion of the concentration of plant design and construction supervision to the manufacturing firms and design firms. The designing of machinery and equipment would be done by the machinery makers which have design capability.

Promotion of the manufacturing of machinery and equipment by the private and state-owned machinery manufacturers.

[5]Supporting measures program

a.Improvement of the efficiency of governmental organizations and state-owned enterprises will be pursued.
b.Good care will be taken for the maintenance and improvement of governmental facilities.
c.Prevention of environmental destruction, wasting of natural resources and pollution by industrial waste are being pursued.
d.Support the activities of WPPI.
e.Development of entrepreneurs and industrial professionals will be intensified.

4) Development programs for the industrial sub-sectors

In the following, the development programs for the industrial sub-sectors dealt with in this report are summarized.

[1] Miscellaneous industry

Among the agricultural, forestry and fishery products, priority is placed on palms, dates, tobacco, copra, etc. Among rubber products, priority is on latex, crumb rubber, rubber footwear, rubber gloves and automotive parts. Among foodstuffs, the development of canned fruits, bottled fruits, processed vegetables, livestock feed, etc., is given priority. During Repelita V, about 33 foodstuffs are expected to be exported. Among forestry products, plywood products and rattan products are given priority. Among non-metal mineral products, ceramics, glassware and marbles are given priority. Improvement of productivity in the textile product industry for strengthening export competitiveness is being pursued. Development of chemical products including rubber-based products and plastic products for export is also being pursued. Development of exportable electrical products will be undertaken. One hundred and forty-nine products from miscellaneous industries are also considered to be exportable.

[2] Machinery and basic metals industry

Industries belonging to this sector produce intermediate goods and capital goods. These industries play a great role in the development of manufacturing industries and in the increase of employment. The development programs are intended to enhance efficiency and competitive strength through the implementation of various restructuring steps such as the optimum utilization of production capacity, improvement of technology and betterment of the business environment. While these industries are currently regarded as import substitution industries, some of their products are already being exported. The promotion of exports from these industries will be implemented in consideration of the balance with domestic demand. During Repelita V, 91 products are considered to be exportable.

In particular, the development of electric generating machinery (turbines, generators, and boilers), transmitting machinery, transformer substations, (transformers, high voltage panels, etc.), power distribution apparatus (medium voltage panels, power distribution transformers, etc.), electrical machinery for industrial use (monitors, generators, welding machinery) and other machinery (KWH meters, MCB, cables) is given priority.

[3] Small-scale industry

Directions for the development of handicrafts, family-run and other small-scale industries including traditional industry are intended to improve technical skill and professional technology and to increase productivity. The above will be achieved through technological and managerial guidance including the provision of capital and credit and the dissemination of the information on research and development. It is expected that through the implementation of these development programs, employment and business opportunities will be increased, self-reliance will be strengthened and, finally, increases in exports and income will be attained.

In the development policy for small-scale industry, there are four important points, namely, enhancement of business ability, promotion of a linkage system, promotion of exports and enhancement of entrepreneurship.

a.Enhancement of business ability

The objectives of this program are to help small-scale industry develop self-reliance through the improvement of productivity and the quality of products they make, to improve the business environment and to strengthen the linkage. The improvement of productivity and quality will be achieved through improvement of working systems and methods, simplification of layout and composition of equipment and apparatus, improvement of the material procurement system, the practicing of total quality control, effective utilization of drawings and instructions, and so on. These programs are to be undertaken through technical guidance and training. For this purpose, UPT's activities will be reinforced. The improvement of the business environment is also being pursued. The procedures for obtaining business licences will be simplified. Import quotas and other facilities will be provided. Loan conditions and procedures will be simplified. Collaboration with technical research and development centers will be promoted.

b.Promotion of linkage system

Linkage between small-scale industry and large-scale industry, as well as linkage between the manufacturing industry and other industries will be promoted. The focus of the promotion of linkage between small-scale industry and large-scale industry is the promotion of production of parts and components in the subcontracting systems. Other measures will be taken to avoid unsound competition between large-scale industry and small-scale industry, to promote technology transfer and to promote cooperation based on the subcontracting systems such as the provision of financial assistance, provision of technical information, dispatch of technical personnel and so on. For those firms which participate in the linkage program by utilizing subcontractors, financial and tax incentives will be provided, especially for the production of products and components for export. The integration of marketing information, procurement of raw materials and sub-materials, payment systems, quality control systems, and assistance in loan provision procedures among small-scale industries will be strengthened. In this respect, the role of KOPINKRA is very important in the procurement of raw materials and marketing.

c.Promotion of exports

Priorities are given to the following products:

handicraft products
processed agricultural products
textiles and leather products

For the promotion of the export of these products, collaboration within subcontracting systems, and also among the governmental organizations, will be intensified. The target for annual growth of exports during Repelita V is 21.6 percent. Among 24 products which have high export potential, textiles, leather and precious metal products are expected to play important roles.

d.Enhancement of entrepreneurship

This program aims to enhance the ability of production management and marketing management, especially in the field of the development of production and design, development of markets, improvement of productivity and quality, enhancement of the capability to acquire technology and improvement of the capability to procure raw materials. For these purposes, professional and technical training and education and technical guidance will be provided to entrepreneurs and trainees.

Development of the work force will be implemented through SENTRA, for the purpose of cultivating professional and business skills.

The activities of SENTRA will be enhanced through the fulfillment of TPL and UPT, qualitatively and quantitatively. Collaboration with large-scale firms, state-owned firms, NGOs and government organizations and strengthening of the role of KOPINKRA are very important. SENTRA will continue ATM and EMD training. Development of professionals and independent consultants will be pursued. Improvement of safety and sanitary conditions will also be performed.

5) Major policies for industrial development adopted under Repelita IV

In the following, the focal points of the major policies undertaken during the Repelita IV period are summarized:

Year	Content
1984	Modification of tax laws; Reduction of income tax from 45 percent to 35 percent on the portion of annual taxable income over 50 million RP
1984 & 1985	Simplification of investment procedures; Reduction of the number of supporting documents needed Reduction of the time needed for obtaining investment approval from six months to six weeks
1985	Improvement of port procedures and the flow of goods; Smoothing and simplification of the flow of goods and port procedures
1986	Operational licenses can be extended for another 30 years Minimum investment amount may be less than US$1 million, if the project is small-scale and export-oriented PMA companies are allowed to invest in domestic companies Establishment of free bonded zone in Jakarta PMA companies may start business with 5 percent initial share held by Indonesian participant under certain conditions Relaxation of procedures for obtaining visas Export credit can be applied to PMA firms Modification of foreign currency SWAP system Introduction of drawback system for import duties on imported materials for export-oriented firms
1987	Definition of export company changed The percentage of production required for export reduced from 85 percent to 65 percent Simplification of export procedures Reduction of required initial share of Indonesian participants in PMA companies locating in bonded zone to 5 percent under certain conditions Import duty and value added tax exemption on capital goods and raw materials for export-oriented industries Import duty exemption on samples Reduction of import duty on machinery to produce jewelry from 15 percent to 5 percent Permission to establish joint venture firms with foreign firms in export trade business

1988	PMA company is allowed to be involved in distribution Deregulation of capital market, and liberalization of leasing
1989	Announcement of negative list on investment; Minimum investment requirement for a foreign investment project reduced from US$1 million to US$250,000

(3) The Directions and Focal Points for the Future Development of the Industrial Sub-Sectors

Based on the analysis in the preceding chapters, the fundamental directions for the development of the industrial sub-sectors are as follows:

1) The handicraft industry

Although the input to output ratio is low, the productivity of the handicraft industry is very low in comparison with the other manufacturing industries. It could be generally said that the increase of income, rather than cost reduction, is required for the improvement of productivity. For achieving this purpose, it is important that a sophisticated marketing strategy be formulated both in the domestic and foreign markets in order to achieve an increase in awareness of the advantages and attractiveness of traditional handicraft products. The development of new products to match the needs of the international market is also required. Furthermore, appropriate distribution strategies should be established. For this purpose, joint efforts among various government institutions for the realization of an international information center are essential.

2) The rubber-based product industry

The most important and urgent problem to be tackled concerning the rubber-based product industry code No.33590 is the improvement of low productivity. The share of this industry in manufacturing as a whole is about 0.5 percent and the number of people employed is small. For the development of this sector of the rubber industry, it is essential to establish the basic engineering technology of the industry. However, the development of the rubber-based product industry code No.35590 would require a minimum increase of input-output ratio. For this purpose, it is urgently required that the main raw materials be made domestically and procured in Indonesia.

3) Electrical industry No.38330

As previously mentioned, the productivity of this industry is higher than the average of the manufacturing industry as a whole. However, its growth rate is declining. The growth rate of employment is far below the average of the entire manufacturing industry. The input-output ratio is worse than the average for manufacturing as a whole. For the development of this sector of industry, it is important that an adequate local supply of high quality components at economical prices be secured and that the demand for the finished products be enlarged.

(4) The Social and Economic Effects of the Proposed Programs for the Development of the Industrial Sub-sectors

1) Problem areas of industrial development in Indonesia

The Indonesian Government considers the Repelita V period the preparatory stage for an industrial take-off and has set various target indices for industrial development during this period. The major targets are as follows:

a. The target for average annual growth of the industrial sector is 8.5 percent and that of the non-oil./gas sector 10 percent. The target of the share of the industrial sector in the GDP at the end of Repelita V is 16.9 percent.
b. The industrial sector is expected to create 2.3 million new jobs.
c. The target for average annual growth of industrial exports is 15 percent. The estimate for export value at the end of Repelita V is US$18 billion and the share of industrial exports among total exports is expected to increase to 59.7 percent.

While the expectation for industrial development is great, there are several important problems retarding the sound growth of the industry. In the following, the major problems prevalent in industry as a whole are summarized:

a. Inadequate business infrastructure
Shortage in the supply of utilities, inadequate communication system and facilities, insufficient transportation system and facilities and shortage of industrial estates equipped with adequate business infrastructure are major hindrances to the increase of industrial investment.

b. Shortage of technical support facilities
For the development of competitive products in the international market place, it is of the utmost importance to enhance the function and capability of the research and development facilities, both in quality and quantity. Promotion and establishment of industrial standards and of inspection facilities are also important. In addition, establishment of an industrial property protection system is necessary. These overall technical support facilities are urgently required.

c. Necessity of enhancement of managerial and technological capability
It is shown through the study that enhancement of the managerial and technological capabilities, especially in small-scale firms, is very much required.

d. Inadequate linkage among industrial sectors
Promotion of linkage between large-scale firms and medium and small-scale firms, between foreign-owned firms and domestically-owned firms, and among industry sectors is necessary. In particular, the promotion and strengthening of medium and small-scale firms are urgently required.

e. Insufficiency of domestic supply of the parts and components
Although natural resources are abundant in Indonesia, intermediate products such as parts and components are not adequately procured domestically due to the shortage of up-stream and mid-stream industry. This causes higher prices for the final products and delays in the procurement of parts and components.

f. Shortage of know-how and information regarding exports
In order to increase exports of non-oil/gas products, it is important to implement very sophisticated international marketing activities. For this purpose, product strategy and market entry strategy should be formulated and practiced, based on full understanding of the individual characteristics of the targeted markets. At the same

time, foreign importers should be appropriately furnished with the information they need regarding Indonesian manufacturers and products. Facilities which provide this sort of information are not adequately available but they are indispensable for the promotion of exports, especially of products from the small-scale industries. Cultivation of personnel who are very experienced in import/export trade is also urgently required.

2) Social and economic effects of the proposed programs for the development of the industrial sub-sectors

In evaluating the social and economic effects of the programs proposed in this report, the following factors have been taken into consideration:

a. What kind of contribution the programs will make to the export promotion activities of the enterprises.
b. How the proposed programs will be compatible with the fundamental development policies of Indonesian Government. What degree of significance they will have in the implementation of such policies.

Usually, international marketing strategies are conducted by individual firms at their own expense and risk. For the effective performance of such activities, overall marketing strategies including product planning, pricing, channel selection and promotion strategies should be appropriately integrated and practiced. In advance of the formulation of such strategies, adequate information about targeted markets must be obtained. Therefore, it is important to evaluate how the proposed programs support the international marketing activities of the enterprises. It is also important to evaluate how the programs support implementation of the development policies of the government described in Repelita V including:

a. development of export industry
b. deepening and strengthening of industry structure
c. acquisition and dissemination of technology
d. enhancement of management capability and development of manpower
e. promotion of small-scale industry
f. regional development

(1)Handicraft industry sector

For the development of this sector, the establishment of a Handicraft Development and Promotion Center, establishment of an MA company and restructuring and revitalization of the existing public supporting facilities are proposed as major programs.

The Handicraft Development and Promotion Center will help both foreign buyers and Indonesian suppliers in realizing business through the provision of necessary information about products and markets, and will also contribute to the enhancement of the expertise of personnel engaged in international trade. The center is expected to facilitate communication between the demand and supply sides. In addition, as the center could be utilized as the exhibition hall for all regional products, this would help increase exports of regional products and thus contribute to regional development. Expertise of international trade will be accumulated on national level.

The role of an MA company is indispensable in improving relations between buyers and suppliers as such enterprises convey detailed information on market requirements to suppliers which helps them in designing products to meet the demand of the market and in the distribution of the products, thus contributing to deepening and strengthening of industrial structure.

Restructuring and revitalization of the existing public support facilities would promote the improvement of the production process and development of design capability and also contribute to regional development through the dissemination of technical information to regional suppliers.

(2)Rubber-based product industry sector

For the development of this sector, short term and long term programs are proposed. Among the programs, establishment of a technical support facility is strongly recommended. The main objective of the facility is to promote the development of exportable products by fulfilling the requirements of foreign markets through the collection and dissemination of technical information including information on foreign industrial standards. The facility would also aim to enhance production technology and to cultivate manpower as well. From the viewpoint of the public development policies, establishment of the facility would contribute very much to regional development, to deepening and strengthening of industrial structure and to the development of small-scale industries through the dissemination of technical information. The above-mentioned objectives could be attained through restructuring and revitalization of the existing public facilities. All other programs would contribute to the promotion of exports of the rubber-based products.

(3)Electrical machinery industry sector

For the development of this sector, the establishment of an institute to authorize the qualification of engineers, reinforcement of testing and inspection facilities and the development of training programs for electrical engineers are proposed. The establishment of an institute to authorize the qualification of engineers would contribute to the enhancement of the quality of the engineers. The reinforcement of testing and inspection facilities would ensure the production of high quality products acceptable in the international market. These facilities could be utilized by the small-scale industries as well and would be expected to enhance the technological level of small-scale industry through the dissemination of information of international industrial standards. Training programs would enhance the technological and managerial capabilities of engineers and executive managers.

All the programs proposed are expected to contribute to the acquisition and dissemination of new technology, to deepening and strengthening of industrial structure, regional development, and cultivation and reinforcement of supporting and small-scale industries which are vital for the promotion of the electrical machinery industry in Indonesia.

1.2. Export and Investment Policies

(1) Review of Policies After May 6, 1986

1) Export promotion measures

Indonesia's export promotion measures were started during Repelita I (fiscal 1969 to 1973). First, in March 1970, a basic law on free trade zones and a law on establishment of a free port and free trade zone in Sabang were promulgated. In April 1970, the multiple exchange rate system was abolished and foreign currency acquired from exports was concentrated in the central bank. Further, the export commodity classification system was abolished and other means taken to streamline the export system. In April 1971, the Export Promotion Agency, known as the Badan Pengembangan Ekspor Nasional (BPEN), was established to promote exports.

Subsequently, in April 1975, the drawback system was introduced, but full scale export promotion measures were not established until 1976.

The comprehensive policies for promotion of non-oil type exports announced in April 1976 were as follows: (1) Abatement of export taxes and abolition of the export revenue stamp tax, (2) abolition of taxation of export products by local statutory bodies, (3) reduction of interest rates on export financing (from 15 percent to 12 percent) and raising of loan ceilings, reduction of port charges and establishment of export processing zones, (4) establishment of trade centers in New York and London, and (5) establishment of standards of quality for specific products.

Further, in 1978, as measures for changing the trade system along with the devaluation of the rupiah in November, the import duties on 1000 products were reduced 50 percent, the import duties and import sales taxes on materials required for the production of export products were waived or lowered, and the SE system (Sertifikat Ekspor (Export Certificate) was introduced. The SE system is an expanded, standardized version of the drawback system and established standard export prices (check prices) for each export product and standard prices for imported parts. Based on the same, the government established the amount of drawback for fixed values of exports of finished products, issuing export certificates (SE) for the same. The system proved effective for exports of textile products in particular, but was abolished in November 1986 after a complaint was raised by the U.S.

During Repelita III (fiscal 1979 to 1983), the government strengthened import restrictions with the aim of protecting domestic industries, but in January 1983 it announced a package of export promotion measures for the liberalization of holdings of foreign currency, an export guarantee system, and a CP (counter purchase) system. Further, in 1983, it established a standing committee (Pantjatap) for export promotion.

In the latter period of Repelita IV (fiscal 1984 to 1988), the government came out with a policy of fundamental structural reforms with the aim of promotion of non-oil exports and promotion of investment so as to rectify the high cost economy.

First, the government made major changes in import procedures (privatization of customs clearance work) based on a presidential order (Industruksi Presiden No. 4) of April 1985. The government subsequently came out with a package of policies in May 1986, devaluation of the rupiah on September 12, a new policy on October 25, and a series of measures for promotion of exports, particularly non-oil and gas products, in January 1987 and December 1987. On November 21, 1988, the government announced measures to ease restrictions in what may be called the cumulation of these measures.

Here, a look will be taken at the policies after the package of May 1986.

[1] Package of May 1986 (Paket 6 Mei)

a) Partial Easing of Obligation of Use of Domestic Products in the Case of Input Goods of Export Products
Companies exporting over 85 percent of their production were allowed to use imports, without regard to trade restrictions, as materials and intermediate goods for the production of their products. Companies exporting only less than 85 percent of their production had to use domestic products in the case where the domestic materials were lower in price than imports, but were allowed to use imports when domestic materials were higher in price.

b) Drawback of Import Duties Etc.
The tariffs and import taxes assessed on imported products used for production of export products were made available for drawback (taking place of import incentives abolished for goods on-loaded in 1986)

c) Tariff Exemption System
Export producers relying on imported materials for production of export goods were made exempt from import tariffs and import taxes.

d) Bonded Regions
Bonded regions were established in Jakarta, where establishment of bonded warehouses and bonded factories was allowed. In the bonded regions, the limitations on industries did not apply to investments.

[2] Package of October 1986 (Paket 25 Oktober)

The rupiah was devalued from US$1=134 rupiah to US$1=1644 rupiah, or 45 percent (31 percent by IMF system), with the aim of strengthening export competitiveness on September 12, 1986. The following trade measures were announced as follow-ups of this:

a) Reduction of Import Tariffs for Reduction of Production Costs

- Elimination of tariffs on 59 products (electronic components and other basic industrial goods etc. for which domestic production would be difficult due to economic or technical reasons), the old tariffs previously having been 5 to 30 percent.
- Reduction of tariffs on 94 products (computer components, machine tools, and other goods for which future domestic production was judged possible) from the old 10 to 40 percent to 5 percent.

b) Introduction of Tariff System

The old import distribution controls (monopolies, sole agent system,. quotas, etc.) established for the protection of domestic products were basically abolished. The products covered by the import distribution controls were subsequently to be controlled only by tariffs, tariffs plus surcharges, and special tariffs.

c) Augmentation of Export Financing System

To promote exports, PMA companies (companies established under Foreign Investment Law) were allowed to receive export financing for up to 85 percent (previously 70 percent) of their requisite operating funds in the same way as with PMDN companies (companies established under Domestic Investment Law). The interest rates on this export financing were previously 9.0 percent for primary products and 11.5 percent for nonprimary products, but these were raised to 14.0 percent and 14.5 percent in May 1989.

[3] Package of January 1987 (Paket 15 January)

As a follow-up to the measures of October 1986 and to strengthen the export competitiveness in the textile industry, ferrous metal industry, electrical machinery industry, and automobile industry, the following measures were taken to ease import restrictions on about 300 products.

a) Import taxes were waived for 103 products (of which, 92 textile products and 11 ferrous metal products)

b) 104 products which only designated import trading companies were allowed to handle were opened up for import by general registered importers and producer/importers (of which, 135 textile products (including raw cotton) and seven ferrous metal products)

c) Import taxes were reduced for 55 products.

Further, import tariffs were waived for materials used for the manufacture of automobile parts by an order of the Minister of Finance of February 3, 1987.

[4] Package of December 1987 (Paket 24 December)

a) Liberalization of Imports

Imports of 111 products, including 51 ferrous metal products, were liberalized and the number of monopolistic import companies was cut from 278 to 70.

b) Revision of Import Taxes

Import tariffs: The rates were lowered for 66 products and raised for 28.

Additional import tax: The tax was waived for 60 products and newly assessed on 39.

[5] Easing of Restrictions of 1988 (Paket 27 Oktober, Paket 21 November)

In October 1988, the Indonesian government announced major measures to ease restrictions. These measures meant far greater reforms than in the series of measures to ease restrictions up to 1987. The package of measures included:

a) Easing of restrictions on the financial sector
b) Easing of restrictions on the manufacturing industry and the trade and investment sectors
c) Reform of state-run companies

Among these, the easing of restrictions on the financial sector was announced on October 27, 1988 and the easing of restrictions on the manufacturing, trade, and investment sectors was announced on November 21, 1988. The reforms of the state-run companies were scheduled to be announced by the end of 1988, but the announcement has been delayed.

a) Policy of Easing Restrictions on the Financial Sector

Under this policy, restrictions on the financial sector were eased so as to increase employment opportunities and allow sufficient growth during the five-year plan (Repelita

V) beginning April 1989. This policy called for: (1) mobilization of private savings, (2) promotion of non-oil and gas exports, (3) streamlining of financial institutions, (4) improvement of fiscal policies, and (5) development of the capital market. Details are given below:

a. Mobilization of Private Savings

Indonesia's domestic banks were allowed to freely open new branches anywhere in the country.

Non-bank financial institutions (NBFI), further, were allowed to open branches in not only Jakarta, but also Bandung, Semarang, Surabaya, Medan, Ujung Pandang, and Denpasar.

The paid-in capital required for establishment of local small size financial and investment banks was made 50 million rupiah or more. Permission was waived for establishment of branches, with banks only having to report the same to the Bank Indonesia.

Issuance of CDs by the NBFIs was allowed. Permission was waived for this, and the NBFIs were allowed to issue them freely.

All banks were allowed to handle small size savings.

b. Promotion of Non-Oil and Gas Exports

The conditions for acquisition of permits for handling foreign exchange by banks were eased. Further, restrictions were eased on the establishment of joint ventures by foreign banks. Branches were previously only allowed in Jakarta, but were subsequently allowed also in Bandung, Semarang, Surabaya, Medan, Ujung Pandang, and Denpasar.

Foreign banks were further allowed to establish sub-branches under their branches in not only Jakarta, but also Bandung, Semarang, Surabaya, Medan, Ujung Pandang, and Denpasar.

The swap system was also improved, extending the maximum term from six months to three years. Premiums were also left to market forces. Further, the exchange permits, which previously had to be renewed every year, were made permanent.

c. Streamlining of Financial Institutions

State-run and public-run companies were allowed to maintain deposits in institutions other than state-run banks, the opening of branches was liberalized, and the loan restrictions were eased.

d. Improvement of Fiscal Policies

The deposit reserve rate was lowered from 15 percent to 2 percent and central bank securities were introduced for open market operations.

e. Development of Capital Market

Taxes were assessed on interests from time deposits so as to promote the securities market and permission was given for banks and NBFIs to raise capital through the capital market.

b) Easing of Restrictions in Manufacturing, Trade, and Investment Sectors

The easing of restrictions was meant to (1) promote the formation of a non-oil based economy through improvement of productivity in the non-oil sectors, (2) introduce private sector vitality through establishment of a sound economic environment, and (3) increase employment opportunities. The package included numerous measures such as elimination of the import restrictions on plastics, easing of restrictions on imports of ferrous metals, and other measures to ease restrictions in the central purchasing system and liberalization of entry into the distribution sector by foreign capital joint ventures. It covered a far broader range than the previous reforms.

a. Easing of Import Restrictions

Import restrictions on 318 products were eased and import restrictions on plastics were totally scrapped. Restrictions on imports of ferrous metals were eased 83 percent

b. Easing of Restrictions in Distribution Sector

Entry of foreign capital joint ventures into the wholesale sector, banned since 1977, was liberalized, enabling foreign capital affiliated manufacturers to try to reduce distribution cost on their own. Further, restrictions were eased on warehousing so as to streamline the physical distribution process.

c. Easing of Restrictions on Shipping Sector

Issuance of new licenses in the shipping sector, stopped in 1976, was resumed and streamlined and entry of foreign capital affiliates in the domestic shipping sector was liberalized.

2) Investment Policies

The policies regarding foreign investment under the Suharto regime may be summarized as follows:

First, after the inception of the Suharto regime, the Foreign Investment Law (Law No. 1 of 1967) was established in 1967 and the Domestic Investment Law (Law No. 6 of 1968) was established in the following year, 1968, with the aim of stimulation of economic activity and encouragement of domestic and foreign private investment. After the establishment of these two investment laws, the first five-year plan was formulated and work began on long term economic development. In the Foreign Investment Law, six principles were given for areas in which foreign investment was to be welcomed and, further, taxes were reduced or waived for foreign investors.

A look at the investments made from the establishment of the Foreign Investment Law to 1969 shows the total investment reached US$1.9 billion, of which US$1.5 billion, or 79.5 percent, was in the forestry industry and mining. In other words the investment leaned toward exploitation of resources rather than the originally intended industrialization. The opinion grew that the Foreign Investment Law had lost touch with reality, so on August 7, 1970, the Foreign Investment Law, Corporate Tax Law, and Domestic Investment Law were amended and the incentives for foreign investment, which had previously been granted indiscriminately, were changed so as to be more selective. (The BKPM was established in June 1973.)

However, after the 1970 amendments, various problems surfaced, such as pressure on the traditional local industries, criticism of foreign investment with overseas Chinese companies as partners, the lack of Pribumi capital, the failure of foreign aid and foreign investment to contribute to a fair distribution of income, soaring commodity prices, etc. Faced with these problems, the government announced a new basic stance toward domestic and foreign investment in January 1974, in which it indicated that the policy of the government was to promote participation of Bumiputra capital in both domestic and foreign investment and to protect and foster the same, thus becoming much tougher in "Indonesiazation" Further, it reduced the number of fields open to foreign investment (expanding the negative list), slashed incentives, and made the joint venture format obligatory.

With its increasingly tougher stance toward "Indonesiazation", the government abolished the preferential tax system for investments - an action seen as signifying a retreat from the previous foreign investment policy. That is, in the tax reforms of January 1, 1984, the Indonesian government reduced the maximum rate of corporate taxes from 45 percent to 35 percent and shortened the depreciation term, but abolished the various preferential tax incentives for investment. Specifically, it abolished (1) tax holidays (maximum six years), (2) deductions for investment (four years of deduction of 5 percent of the investment in fixed assets from the assessed income tax, with a limit of 20 percent), and (3) capital whitening (waiver of taxes on interest income on time deposits and savings type deposits and waiver of tax audits on sources of deposits).

After the tax reforms, foreign investment, which had been rising since 1982, plummeted.

In response to this, the government took positive action to again promote investment in August of the same year by revising the tax system again (so as to (1) expand the range of application of the accelerated depreciation rate (25 percent) and (2) restore capital whitening).

Aside from the tax system, the government streamlined procedures for permits for employment of foreign workers in September of that year and made the BKPM the sole channel for permits for investment and employment. In April 1985, it abolished the charge for obligatory education and training in force since 1974 and took a more flexible stance toward "Indonesiazation" of the labor force. Further, it streamlined procedures for application of investment permits twice in April and October 1985. In particular, the April 1985 measures were extensive, slashing the number of documents required for application from the old 36 to just 13 and otherwise streamlining the approval process.

[1] Recent Easings of Restrictions

In the structural reforms made in the latter part of Repelita IV, a package of measures was announced for the promotion of non-oil exports. These export promotion measures overlap the investment policies in many areas, so the investment policies will be explained below.

a) Package of Policies of May 1986

To promote investment, special provisions were provided for drawback of tariffs assessed on raw materials, intermediate goods, and capital goods used by manufacturers of capital goods, allowance of reinvestment by joint venture companies, and application of equal treatment as with domestic companies to joint ventures with local majority shares.

b) Easing of Restrictions of October 1986

The government reduced import tariffs, eliminated part of the system of designation of importers, allowed foreign investment in existing domestic companies, and increased investment by the foreign side in existing joint ventures.

c) Package of Policies of December 1987

The government established joint ventures for the purpose of exports, liberalized employment of foreigners, and extended the deadline for conversion of PMA companies to local majority shares (10 years to 15 years). It also eased the restrictions on the equity ratio for export oriented PMAs.

[2] Easing of Restrictions of May 1989

Before this, priority investment fields for foreign investment in Indonesia had been indicated in the Daftar Skala Prioritas (DSP), the latest version of which was issued in 1987, but after Presidential Order No. 21 of May 5, 1989, this was changed to a negative list, the Daftar Negatif Investasi (DNI), wherein fields closed to new investment were shown.

At the same time, the closed fields were drastically reduced. The 273 fields closed to investment in the DSP'87 were cut to 75 and of the 75, 20 were closed only to foreign investment. Fifty-five fields were closed to entry of all new projects including not only foreign investments but domestic investments as well. Note that even in these closed fields, existing companies were free to expand. Further, certain fields were specified as being openable depending on the export ratio of the products (two categories - ratios of 65 percent up and 100 percent). The main negative fields were as follows:

a) Fields Closed to Foreign and Domestic Investment (55)

Processing of coconut and palm oil, flour, alcoholic beverages, cloves, tobacco, lumber and plywood (except Irian Java), processing of rattan wood and semifinished products of same, gas lighters, ethyl alcohol, nitrogen fertilizers, cold rolled iron plate, galvanized iron plate, gasoline and diesel engines, motorcycles, heavy machinery, trucks, passenger cars, commercial vans, multipurpose vehicles, automobile engines, clutches, propeller shafts, transmissions, brakes, aircraft, etc.

b) Fields Closed Only to Foreign Investment (20)

Finished products of rattan (not allowed even in case of 100 percent exports), medium distance passenger transport, taxis, ferries, short distance shipping, air transport, retailing, advertising, construction, radio and television broadcasting, etc.

Apart from the negative lists, as a measure for protection of small size industry, 35 fields were indicated as being reserved for domestic small-scale industry (with investments of within 200 million rupiah).

Further, BKPM Directorial Order No. 09/SK/1989 (dated May 5) lowered the minimum value of foreign investment from the previous US$1 million to US$250,000.

[3] Current Foreign Investment Policies

As seen above, major changes have been made to the investment policies of Indonesia since the latter period of Repelita IV. The measures in effect as of the end of 1989 are summarized below:

<General Provisions>

(a) Investment permits are valid for 30 years from the establishment of the company.

(b) If additional investment is made during the period of the investment so as to strengthen production, the validity of the permits may be extended to 30 years from the date of authorization of the additional investment.

(c) Investments are allowed only in the form of joint ventures with Indonesian companies or Indonesia nationals. The equity ratio of the Indonesian side at the time of establishment of the company must be at least 20 percent.

(d) PMA satisfying the following conditions are allowed to have equity ratios of the Indonesian side at the time of establishment of as low as 5 percent. (However, ratio must be raised to 20 percent within 10 years from the start of commercial production.)
-- Capitals of US$10 million or more
-- Investment in remote areas (10 provinces being designated as remote areas)
-- Export of 65 percent or more of the products

(e) Foreign partners must pass over the majority of the equity (51 percent or more) to the Indonesian side within 15 years from the start of commercial production. At that time, if the Indonesian side does not meet the requisite conditions, it must either find other Indonesian partners or raise capital through financial institutions or capital markets.
If the equity cannot be transferred even through the above measures, resolution must be sought with the BKPM.

(f) When PMAs satisfy the following conditions, they may be treated as equal with PMDNs: (However, the status as PMA does not change.)
- The Indonesian side holds over 51 percent of the shares
- Over 20 percent of the shares are made public and over 45 percent of the shares (including public shares) are held by the Indonesian side.

(g) PMA companies may use their profits to augment their businesses or to reinvest in other companies, both new and existing.

(h) Foreign investors in PMA companies may raise their equity ratio up to 95 percent when raising funds for export of products or increasing exports in the cases where the Indonesia partners are not able to increase their equity participation. However, there is the condition that the equity ratio must be returned to its original level within five years from the authorization of the BKPM and further the majority of the equity must be transferred to the Indonesian side within 10 years of the same.

(i) The minimum investment is made US$250,000. "Investment" means the total cost of the project including loans. The BKPM guideline calls for at least 25 percent of the total project costs to be met by owned capital.

(j) Trading companies specializing in export of manufactured products may be established as PMA companies.

<Incentives>

(a) Abatement of import tariffs on machinery and spare parts
(b) Abatement of import tariffs on production materials (two years)
(c) Abatement of first ship registration revenue stamp tax in Indonesia
(d) Grace period for payment of added value tax on imports of capital goods required for production and services and having durable lives of at least one year
(e) Exemption of withheld corporate taxes for imports of capital goods and materials at time of establishment of company (one year). However, this must be applied for before the start of commercial production.

(f) The above incentives are not available for imports of machinery mentioned in the negative list of imports of capital goods. This, however, does not apply in the case of 100 percent export of production.

(g) When purchasing capital goods from within Indonesia, a refund may be obtained of the import tariffs which were assessed on the imported equipment and materials used for the manufacture of the same.

(2) Position of Export and Investment Policies in Economic Development Plans

1) Export Policy in Repelita V

In the fifth five-year plan, covering fiscal 1989 to 1993, great hopes have been placed on the promotion of exports of non-oil and gas products.

That is, Indonesia is working to diversify its exports of oil and gas products and to diversify its foreign markets for crude oil, LNG, and LPG. The price of oil on the international market, however, is unstable. Indonesia expects the share of oil and gas in exports will fall from the 40.0 percent of fiscal 1988 to 27.2 percent in fiscal 1993.

For this reason, Indonesia considers it important to increase exports of non-oil and gas products, especially, to promote exports of industrial goods. Indonesia is targeting at increasing non-oil and gas exports an average annual 15.6 percent during the period of Repelita V.

To achieve this, the government has come out with the following measures in a comprehensive program of export promotion for Repelita V:

(1) Measures for Increasing Exports
- Strengthening of cooperation among related government organizations and between government organizations and private sector companies
- Diversification of export products
- Diversification of export markets
- Strengthening of bilateral and multilateral cooperation
- Stronger implementation of export promotion measures

(2) Measures for Strengthening Competitiveness
- Strengthening of quality control
- Rationalization of commodity markets and domestic settlement methods and streamlining of collection and distribution of export products
- Strengthening of cooperation between commercial sector and other sectors

(3) Measures for Collection and Provision of Overseas Market Information
- Strengthening of information services to private sector companies
- Provision of information on potential overseas export markets
- Preparation of profiles of exporters and importers
- Provision of information relating to import procedures of other countries
- Effort to establish export prices through commodity markets

(4) Promotion of Policies
- Strengthening of industrial organizations and promotion of export efforts through monitoring of implementation of export policies
- Strengthening of activities of commodity markets
- Strengthening of position of exporters through resolution of claims through trade arbitration organizations

(5) Others

- Strengthening of role of foreign trade promotion organizations
- Organization and establishment of "Indonesia Trade Center" and other support organizations
- Strengthening of cooperation among companies, including cooperation of medium size companies and small size companies with state-run companies and Koperasi
- Sponsoring of exhibitions, development of laboratories for quality control, and streamlining of information services

2) Investment Policies

The sources of the investment for supporting economic growth in Repelita V may be classified as foreign investment and domestic investment. These may be further broken down as follows:

- Investment
  - Domestic investment
    - Government funds
    - Private sector funds (1)
  - Foreign investment
    - Loans
    - Grants.
    - Direct investment (2)

Of the above, (1) and (2) constitute the total private sector investment. In Repelita IV, 45 percent of the total development investment came from private sector investment, but in Repelita V this is planned to be raised to 55 percent.

	Repelita IV	Repelita V
Development investment	145	239.1 (trillion Rp)
Of which, private investment	65.3 (45%)	131.5 (55%)

In this way, the government has placed great hopes on private sector investment during the plan. In May of 1989, the first year of the plan, the government changed from the old positive list of investment fields to a negative list and also drastically reduced the number of closed fields.

Private sector investment is expected to play the following roles:

(1) Promotion of industrialization
(2) Maximum utilization of natural and human resources
(3) Promotion of exports of non-oil and gas products
(4) Expansion of employment (creation of 2 million new jobs a year)
(5) Transfer of technology
(6) Promotion of investment in areas other than Java
(7) Conservation of environment

The roles of foreign investment are supposed to be the securing of investment funds and the introduction of advanced technology.

(3) Export and Investment Policies Relating to Development of Sub-sectors

Since the package of policies of May 1986, the government has announced a succession of measures to promote exports of non-oil products, but these do not specify individual products. On the other hand, in Repelita V, as mentioned in the foregoing (2), the government is targeting at an average annual 15.7 percent growth in exports of industrial products as a whole and further has merely grouped measures for promotion of exports of industrial products under certain subheadings. There is not sufficient information for discussing measures for promotion of specific individual industries or products from the viewpoints of exports and investment. Therefore, in this section, the discussion will be limited to the measures for promotion of trade and investment of the three sub-sectors covered by the present survey.

1) Handicraft Industry

<Exports>

Exports of handicrafts are being promoted by the Handicraft Center of the Export Promotion Agency (BPEN). The main measures used are the collection of overseas information and the supply of the same to companies, handling of inquiries, monitoring of samples in overseas markets, dispatch of export promotion missions, invitations to purchasing missions, sponsoring of exhibitions and business meetings, sponsoring of seminars in guidance in designs, etc.

<Investment>

Presidential Order No. 21 of May 1989 included a list of fields of possible investment, but almost all handicraft products are produced by small scale industries, so handicrafts have been designated as a "reserved" field. Therefore, this field is not open to foreign investment.

2) Rubber Product Industry

<Exports>

The promotion of exports of rubber products is considered to have the same goals as the promotion of exports of plastics and other chemicals in the various industrial sectors of the development program. There are no policies specific to rubber. However, the export plans of Repelita V establish the export targets shown in Table 17. In particular, the government will be concentrating on rubber tires and rubber sports shoes and hopes that exports of the two will more than double from the US$84 million of 1988 to US$174 million by the end of the five-year plan.

As specific measures for promoting exports, the Industrial Product Center of the Export Promotion Agency (BPEN) will take the lead and collect and disseminate overseas information, dispatch missions overseas, receive missions from abroad, and hold seminars in Indonesia.

Table 1-2-1: Export Targets for Rubber Products

(Unit: US$1000)

Products	Performance	Export targets					Annual growth
	1988	1989	1990	1991	1992	1993	(%)
Rubber gloves	960	1,110	1,284	1,485	1,718	1,987	15.7
Tires	45,000	52,065	60,239	60,239	69,696	93,298	15.7
Sports shoes	39,000	39,000	45,123	52,207	60,403	69,886	15.7
Condoms	55	63	72	83	96	111	15.7
Others (V-belts, pipes, rollers)	1,490	1,724	1,994	2,307	2,669	3,088	15.7

Source: CBS and MOI

<Investment>

There are no restrictions on investments in the rubber product industry. Investment by foreign companies is possible in the framework of the current Foreign Investment Law. Foreign investment in rubber products has increased in recent years, with there in particular having been a remarkable number of investments in sports shoes during Repelita IV. The state of investment by key countries from 1985 to 1988 is given below (all new investment permits):

Japan:	1985 - 1 tire project, 1987 - 1 belt project and 1 motorcycle tire project, 1988 - 1 V-belt project
South Korea:	1987 - 1 sports shoe project, 1988 - 7 sports shoe projects and 1 surgical glove project
Hong Kong:	1988 - 3 sports shoe projects

Of the above, the motorcycle tire project had a target export ratio of 85 percent and the sports shoe projects ratios of over 65 percent, so these investments were exported oriented.

3) Electrical Machinery Industry

<Exports>

Electrical machinery is one of the sectors covered by the import substitution industrialization plan (deletion program) introduced during Repelita IV. This program remains in effect even today.

On the other hand, electrical machinery is covered under the export industry promotion program of Repelita V as well.

In Repelita V, five targets have been set for the development of export oriented industries (see 1.1.(2).2) Basic Policies). In these, the government indicated that it wishes to raise the competitiveness of the import substitution industries by raising the efficiency in those industries and placing them on an export footing. In this way, the government will be promoting the growth of electrical machinery from import substitution to an export orientation as well. At the present time, however, no specific measures have been announced for this. The government has only set export targets for Repelita V as shown below in Table 18.

Table 1-2-2: Export Targets for Electrical Machinery

(Unit: US$1000)

Products	Performance	Repelita V					Annual growth
	1988	1989	1990	1991	1992	1993	(%)
Generators	975	1,069	1,173	1,287	1,412	1,549	9.7
Transformers	366	402	442	487	536	589	10.0
Motors	N/A	N/A	N/A	N/A	N/A	N/A	

Source: CBS and MOI

<Investment>

In the current Foreign Investment Law, electrical machinery (including parts and components) are not mentioned in the negative lists and thus there are not special institutional obstructions to investment. For the state of investment by foreign companies, see III. Electrical Machinery, 4.3.(3), Table 4-3-9.

(4) Comments on Problems in Implementation of Policies Relating to Sub-sector Promotion and Development and Countermeasures

1) First, the structural reforms made since 1983 may be summarized as follows according to time:

March 31, 1983	Devaluation of rupiah (from US$1=702 rupiah to US$1=970 rupiah)
April 1983	Reevaluation of projects (suspension, shelving, and privatization of about 200 large scale foreign-currency expending type projects)
January 1984	Introduction of new tax system (income tax, prime cost depreciation, etc. Added value tax instituted from April 1985)
April 1985	Major streamlining of import procedures - introduction of SGS inspection system (privatization of customs clearance work)
September 13, 1986	Devaluation of rupiah (from US$1=1134 rupiah to US$1=1644 rupiah)
January 1987	Package of policies (reduction of tariffs and easing of import restrictions)
June 1987	Streamlining and easing of system of permits for industrial activities
December 1987	Package of policies (export promotion, easing of import restrictions, promotion of investment, liberalization of capital market, promotion of tourism)
October 1988	Easing of restrictions in financial sector
November 1988	Package of policies (easing of restrictions in manufacturing, trade, and investment sectors and easing of restrictions in warehousing and shipping)
December 1988	Easing of restrictions for financial institutions other than banks
January 1990	Reforms of financial system (streamlining and consolidation of institutional financing and insurement of loans for small and medium size companies)

2) Indonesia has takes a series of steps to ease restrictions from the April 1985 "policy for smoothing physical distribution (privatization of customs clearance work)" to the November 1988 "package of policies" in an effort to wean the economy from its excessive dependence on oil. That is, it has been attempting to escape from the high cost economy, escape from the dependence on oil, and promote domestic and foreign investment in the private sector through the series of eased restrictions. It is a very sound idea to ease restrictions so as to adjust the economic structure and make the economy more efficient. The extent to which these policies are implemented will prove to be the key to the success of the structural adjustment of the Indonesian economy.

Structural adjustments are in progress, such as with the continuation of fiscal austerity, tougher management of investments by state-run companies, tax reforms, liberalization of financing, promotion of the private sector, preferential treatment to the export industries, elimination of irrational special privileges, correct of strained price relationships, and easing of government restrictions. These will probably continue in so far as there is no tremendous rise in the price of oil.

3) The devaluation of the rupiah in March 1983 and September 1986 eliminated the barriers to export and brought the cost factors, such as wages, back to a realistic level through the reduction of prices, when viewed on a dollar basis. Monopolies over imports are being reduced too, as seen with the elimination of the monopolies over plastic materials in November 1988. The liberalization of imports of materials for production of export goods under the package of policies of May 6, 1986 eased the burden of the high cost economy. The easing of restrictions on foreign investment for promotion of private sector investment further greatly improved the investment environment.

Clear effects of the structure adjustments are beginning to appear in the area of promotion of export industries.

4) Exports of non-oil and gas products are continuing to grow. In particular, rapid growth began in exports of non-oil and gas products in the latter half of 1987 and continued up to 1988. In 1987, exports of non-oil and gas products reached US$8.58 billion, accounting for 50.3 percent of all exports and over the amount of exports of oil and gas for the first time since 1972. Exports further increased in strength in 1988, when exports of non-oil and gas products rose 34.5 percent over the previous year (with exports as a whole rising 12.2 percent) to US$13.2 billion, for a 60 percent share.

In the exports of non-oil and gas products, industrial products accounted for US$6.67 billion, or a 78 percent share, in 1987 and US$9.2 billion, or an 80 percent share, in 1988. The growth rate over the two years was 38.3 percent.

This favorable export performance was primarily due, first, to the rectification of the exchange rate by the devaluation of the rupiah in September 1986, which brought prices down to levels acceptable in the international market, and, second, to the export drive resulting from the slump in domestic demand caused by the fiscal austerity of the government. However, due credit must be given to the institutional changes for their ability of immediately promoting export growth.

The interest in exports by entrepreneurs and the accumulation of experience in the same also proved effective, but elimination of the systems inhibiting export may be considered to have been of greater impact.

A look at the industrial sectors covered by this survey shows that exports of handicrafts (plaiting, wooden products, hand weaves, etc.) grew almost four-fold from US$93 million to US$325 million from 1984 to 1988. Among exports of non-oil products, the leaders were textiles, plywood, and natural rubber, but handicrafts came in at ninth place and thus are becoming important export items.

Most of the exports of rubber have been of natural rubber materials such as latex, sheet rubber, crepe rubber, and crumb rubber. Only a small amount of rubber products has been exported. Exports of natural rubber materials fell from 1984 to 1986, but returned to US$960 million, the 1984 level, in 1987 and increased 28.8 percent in 1988 to US$1,168 million. On a volume basis, there was a slight increase to 1.1 million tons.

Exports of electrical machinery were at a low level of US$1.34 million in 1988. US$370,000 worth of motors (including parts) and US$970,000 worth of transformers were exported. No generators were exported.

5) Foreign investment may be considered as most clearly reflecting the economic opportunities in Indonesia. Foreign investors have a broader selection of investment opportunities open to them than domestic private companies and would not bother applying for investment unless there were good chances of making profits. Behind their decisions to invest are their judgements that there would be good business opportunities if certain conditions were met.

Most of the investments up to the early 1980s were of an import substitution type or resource development type, but the recent new and additional investments being made are shifting to an emphasis on export production or at least the production of products with international competitiveness. This reflects the change in direction in the Indonesian economy and follows the restoration of the market function by the structural adjustments being made to the economy.

In particular, the liberalization of imports of materials by the export industries in 1986 and the correction of the exchange rate have been tremendously effective. The relative superiority Indonesia's low labor costs may be judged to be properly functioning at the present time. The investment incentives offered by Indonesia are still inferior to those of the other ASEAN countries and there are still restrictive conditions such as the joint venture rule and fade-out rule, but interest in investing by foreign companies is reviving. This conversely shows the magnitude of the anticipated potential of Indonesia.

6) In 1989, there were a total of 294 foreign investment projects approved, worth US$4,718.8 billion. This was double the number of projects and 58 percent more the value of the 145 projects of US$2,989.8 billion of 1988. As a result, foreign investment in Indonesia has broken new records for the second straight year, counted from the establishment of the Foreign Investment Law in 1967, in both the numbers and value of the investments. Investment in Indonesia is finally booming.

Of particular note regarding the investor countries is the continued dominance of South Korea, which has been investing since 1988. Sixty-four of the investment projects were South Korean, more than even those of Japan. Investment from that country rose by 91 percent. There were also 50 investment projects from Taiwan (worth US$1,564 million), which had only made small investments up to 1988. The foreign investment in Indonesia is therefore being lead by Japan, South Korea, and Taiwan, the three accounting for 27.7 percent of the investments on a value basis and 60.2 percent on a numerical basis. Note that Japan accounted for 21.4 percent of the investment projects and 13.3 percent of the investment value.

1.3 Financial Policies

(1) Financial Structure of Indonesia

1) Outlook

The financial system of Indonesia is composed of bank and non-bank financial institutions, insurance companies, leasing companies and so on.

As of September 1989, there were 97 commercial banks (five of them state owned), 29 development bank (one state owned, 27 regional, one private), three savings banks (one state owned, two private), and over 5,000 non-depository rural banks. Besides banks, there are 14 non-bank financial institutions (NBFIs), of which nine are investment banks, three are development finance companies, and one is a housing finance institution. Also, there are leasing companies (83 companies) and insurance companies (118 companies).

2) Banking system

a. Bank Indonesia (BI)

In Indonesia, the banking sector is regulated and supervised by Bank Indonesia, the central bank.

Bank Indonesia has many functions. Besides handling banking administration, BI is the sole issuer of currency (Indonesian rupiah) and formulates monetary policy, controls money supply by open market operation, participates in the foreign exchange market and provides credit for the government, government enterprises and private enterprises. However, its activities as a commercial bank such as direct financing of enterprises are decreasing in importance.

b. Commercial banks

As of September 1989, there were 97 commercial banks in Indonesia including foreign bank branches and joint venture banks. Among them, the state owned banks, five of which are commercial banks, take a very large part: about 60 percent of deposits and an estimated 70 percent share of the amount of outstanding loans in the banking sector.

Fig. 1-3-1: Financial Institutions in Indonesia

- Financial Institutions
  - Other Financial Institutions
    - Pawn Shops
  - Non Bank Financial Institutions
    - Development Finance Companies (3)
    - Investment Finance Companies (9)
    - Housing Finance Institutions (1)
    - Insurance Companies (118)
    - Leasing Companies (83)
  - Banks
    - Central Bank (1)
    - Commercial Banks (97)
      - State Owned (5)
      - Private (92)
    - Development Banks (29)
      - State Owned (1)
      - Regional (27)
      - Private (1)
    - Savings Banks (3)
      - State Owned (1)
      - Private (2)
    - Rural Credit Banks
      - Village Banks
      - Paddy Banks
      - Petty Traders' Banks
      - Employees' Banks

* ( ) is number of institutions

Table 1-3-1: Bank Credit by Type of Bank

(Billion Rp)

	1986 Mar 31	1987 Mar 31	1988 Mar 31	1989 Mar 31
State Banks	15,240 (71.1%)	18,902 (70.9%)	22,894 (68.1%)	30,270 (67.3%)
Private National Banks	4,487 (2-.9%)	5,772 (21.6%)	8,210 (24.4%)	11,441 (25.5%)
Regional Development Banks	633 (3.0%)	786 (2.9%)	994 (3.0%)	1,238 (2.8%)
Foreign Banks	1,072 (5.0%)	1,219 (4.6%)	1,520 (4.5%)	1,994 (4.4%)
Total	21,432 (100%)	26,679 (100%)	33,618 (100%)	44,943 (100%)

Source: Bank Indonesia

Table 1-3-2: Time Deposits by Type of Bank

(Billion Rp)

	1986 Mar 31	1987 Mar 31	1988 Mar 31	1989 Mar 31
State Banks	7,609 (60.4%)	9,249 (62.0%)	12,213 (59.1%)	15,553 58.7%)
Private National Banks	3,380 (26.9%)	4,066 (27.3%)	6,649 (32.2%)	8,856 (33.5%)
Regional Development Banks	131 (1.0%)	178 (1.2%)	228 (1.1%)	276 (1.0%)
Foreign Banks	1,470 (11.7%)	1,419 (9.5%)	1,564 (7.6%)	1,790 (6.8%)
Total	12.590 (100%)	14,912 (100%)	20,654 (100%)	26,475 (100%)

Source: Bank Indonesia

Table 1-3-3: Comparison of Private Banks by Total Assets 1987 Dec.

(US$ Million)

Rank	Indonesia	Malaysia	Thailand	Singapore	Japan
1	Bank Central Asia	Bank Bumiput Ra Malaysia	Bangkok Bank	Development Bank of Singapore	Fuji Bank
	938	6,628	12,115	8,160	309,334
2	Bank Niaga	Malayan Bank	Krung Tai Bank	United Over-seas Bank	Daiichi-Kangyo Bank
	478	6,135	5,853	6,290	301,376
3	Bank Umum National	United Malayan Banking Co.	Thai Farmers Bank	Overseas Chinese Banking Co.	Sumitomo Bank
	285	2,642	5,208	5,203	281,686
4	Bank Duta	Public Bank	Siam Commercial Bank	Overseas Union Bank	Mitsubishi Bank
	276	2,085	3,475	4,034	270,126
5	Bank Bali	Development & Commercial Bank	Thai Military Bank	Tat Lee Bank	Sanwa Bank
	174	1,591	2,250	1,690	260,046

Source: Bankers Handbook 1989
Conversion rate : Average Rate of 1987
1US$=1643.9RP.
=2.5196M$
=25.723B
=2.160S$
=144.64¥ Source:IFS

Note: Assets of State Banks are as follows (US$ Million)

BNI 1946	7,210
BBD	5,675
BRI	4,752
BDN	4,623
BEII	3,101
Bapindo	1,372

Each state owned commercial bank was established to develop a specific economic sector and, as a result, they still have some advantages in specific economic sectors such as,

Bank Negara Indonesia 1946 for the manufacturing sector,
Bank Rakyat Indonesia for the agriculture sector,
Bank Bumi Daya for the forestry and plantation sector,
Bank Dagang Negara for the mining sector, and
Bank Export Import for foreign trade transactions

In Indonesia there are 76 private commercial banks. They are small in scale not only compared with state owned banks, but also compared with commercial banks in neighboring countries. (Even Bank Central Asia, the largest private commercial bank, is smaller in total assets than any of the top five banks in ASEAN countries.) Nevertheless, because of a series of deregulation policy packages in the banking sector such as PACTO PACDES, the share of private commercial banks in the banking sector is growing steadily. Among private commercial banks, there are several banks which are owned by groups of enterprises. Formerly, these banks gave loans mainly to their own group companies, but since PACTO Bank Indonesia set a limit on financing to group companies, this tendency is changing.

c. Development banks

Development banks in Indonesia are BAPINDO, the state owned development bank, the regional development banks in 27 provinces and PDFCI, a private development bank. So there are 29 development banks in Indonesia.
Development banks are almost the sole distributors of long-term funds, which are provided at terms of up to 10-15 years.

On the other hand, bank deposits in Indonesia are for a maximum of two years and most bank deposits are time deposits of less than one year. As a result, if the development banks depended on deposits for their banking funds, there would be a big discrepancy between the procurement and the provision of funds.

In BAPINDO's case, the largest funds supplier is Bank Indonesia. On January 29, 1990, Bank Indonesia announced another policy package including the removal of many liquidity credit schemes. However, liquidity to development banks was maintained.

d. Non-Bank Financial Institutions (NBFIs)

Non-bank financial institutions such as investment banks and leasing companies are growing very rapidly. After a series of deregulation policy packages, NBFI are now permitted to issue CDs (Certificates of Deposit). This is one reason for the rapid growth of NBFIs. In the policy package of January 29, 1990, Bank Indonesia set a guideline stating that not less than 20 percent of loans should be given to small-scale industries, not only for banks but also NBFIs. Before this regulation was announced, NBFIs usually did not deal with small enterprises and thus this regulation may be having some influence on the growth of NBFIs.

3) Capital market

The capital market in Indonesia remained small before the December 1988 policy package (PACDES) which enabled the establishment of a stock exchange outside Jakarta and private stock exchanges. There was also a relaxation of listing standards. As a result of this package, in 1989 there was a rush of listings and the stock market has been growing very rapidly.

Even now, the stock market of Indonesia is small compared with those in other ASEAN or NIEs countries and not only in terms of the number of stocks. Many of the listed companies are foreign joint-venture companies and the rest are large businesses. For most Indonesian companies, therefore, bank loans are still the most practical method of fundraising.

Table 1-3-4: Number of Companies Issuing Stocks & Market Value

(Us$ 100 Million)

	1985	1986	1987	1988	1989/10
Indonesia (No. of Co.)	24	24	24	24	39
(Market Value)	1	1	1	3	N.A.
Malaysia	284	288	291	295	300
	240	248	296	364	509
Thailand	97	93	109	136	158
	19	29	55	89	184
Philippines	138	130	138	141	142
	7	20	30	43	119
Singapore	316	317	321	327	329
	336	325	427	518	704
Hong Kong	279	253	276	304	294
	345	538	840	743	752
R. of Korea	342	355	389	502	589
	74	139	330	943	1323
Taiwan	127	130	141	163	172
	104	154	485	1201	2551
Japan	1829	1866	1912	1967	1988
	9787	18418	27984	38781	41745

Source: Nikko Research Center

(2). Monetary & Credit Policy in Indonesia

1) Basic policy

Indonesia's monetary policy is based on prudent control of money supply aimed at avoiding inflation and maintaining confidence in the Indonesian rupiah. As a result, interest rates in Indonesia are fairly high both in nominal and real terms.
To achieve Repelita V, 293,1 trillion rupiah in investment is required. The government will supply only 45 percent of the funds and thus the current issue is how to develop the banking sector and the capital market to raise the remaining 65 percent of the funds required.

2) Banking policy

Indonesia's basic banking policy is deregulation to promote competition in the banking sector. By competition, the Indonesian government expects to increase the efficiency and improve the constitution of the banking sector.

a. Banking policy

The government of Indonesia has enforced a series of deregulation policy packages on the banking sector. Thus, in Indonesia, there is no regulation on interest rates (deposit/loan) and there are no foreign exchange regulations. Banks can open new sub-branches just by reporting to Bank Indonesia, the central bank. Meanwhile, in Japan, approval of the Ministry of Finance is needed.
(An outline of the deregulation policy package will be given later.)

b. Sector development policy

Institutional lending schemes which provide funds preferentially or under special conditions to certain sectors would impede the optimum distribution of resources through free market mechanisms. As a result, the Indonesian government has taken a policy of minimizing the number of such institutional lending schemes and abolishing or integrating most of the institutional lending schemes by deregulation policy packages. Now the only economic sector which has a special institutional lending scheme is the "Food & Sugar Procurement" sector.

c. Policy on small & medium-scale industry development

In Indonesia, Bank Indonesia, the central bank, also has the responsibility for economic development and since 1978 it has enforced small business development programs called SEDP (Small Enterprises Development Project) and SMIEP (Small & Medium Industrial Enterprise Project), a successor program to SEDP.

SMIEP is aimed at developing the non oil/gas sector, spurring economic growth and increasing jobs, extending economic growth to all parts of the country, leveling income distribution and providing support to small and medium enterprises in both a financial sense (Financial Assistance: FA) and a technical sense (Technical Assistance: TA). The outline of SMIEP is as follows.

a) Target enterprises

Medium-scale enterprise
Total assets of over 300 million and not more than 600 million Rp.
Small-scale enterprise
Total assets of not more than 300 million Rp.

b) Financial assistance (FA)
Preparation of institutional lending schemes favorable to small and medium-scale industries.

*for medium-scale industries, there was KE for investment and KMK for working capital (the interest rate for both was 15 percent p.a.)

*for small-scale industries, there was KIK for investment and KMKP for working capital (the interest rate for both was 12 percent p.a.).

However, these institutional lending schemes were abolished by the policy package of January 29, 1990.

c). Technical assistance (TA)

Technical assistance means to enhance the ability of small and medium-scale enterprises through non-financial support such as management consultation so that small and medium-scale enterprises can raise funds more easily.

TA is enforced through RPMU (Regional Project Management Units) which are set up in Bank Indonesia's 13 branch offices. At each RPMU, three consultants (Agriculture, Industry, and Finance) provide assistance services for clients.

(3)Institutional Lending Schemes for Development of Industry and Exports

At the time of this research, there were several institutional lending schemes in Indonesia which could be used for industrial development or export promotion. However, with the policy package of January 29, 1990, these schemes were all abolished and no new loans will be given under these schemes. Nevertheless, the part which these schemes played in the development of industry and exports was very important and is still worth studying.

1) Institutional lending schemes for industrial development

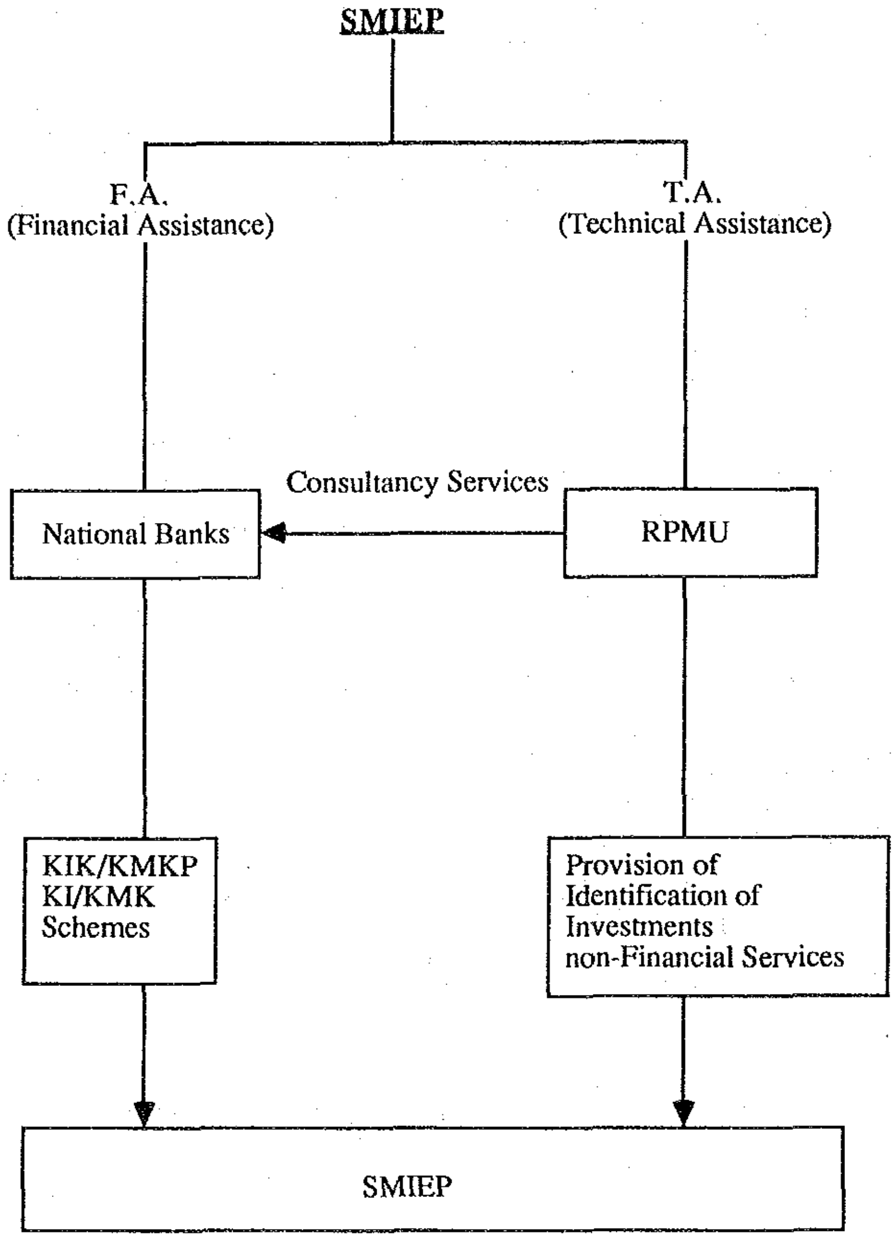
a. KUPEDES (General Rural Credit)

KUPEDES was one of the institutional lending schemes called liquidity credit under which Bank Indonesia and the World Bank provided part of the funds to Bank Rakyat Indonesia, which has the largest branch network in Indonesia.

KUPEDES was handled in both branches and sub-branches, while KIK & KMKP were handled only by branches.
The lending conditions were:

Maximum Loan	from 25,000 rupiah up to 10 million rupiah	
Maximum Term	Working Capital	2 years
	Investment	3 years
Lending rate	Working Capital	1.5 percent per month (Flat)
	Investment	1 percent per month (Flat)
Collateral	The project, but sometimes borrowers offered additional collateral	
Risk Sharing	Government 100 percent	

Fig. 1-3-2. Outline of SMIEP



Bank Rakyat Indonesia has nearly 4,000 branches including sub-branches and thus, in the case of KUPEDES, enterprises in rural areas could also utilize the scheme.

b.KIK / KMKP

[1] KIK/KMKP was one part of the liquidity credit system for small-scale enterprises. KIK was for investment and KMKP was for working capital.

KIK/KMKP started as a lending scheme of Bank Indonesia but now the World Bank furnishes 25 percent of the funds, KIK/KMKP played the most important role in financing small-scale business.
The lending conditions were:

Target companies	Total assets of not more than 300 million rupiah (excluding residence).	
Maximum loan	15 million rupiah. Nevertheless, the credit ceiling was flexible when the total of all loans was under 30 million.	
Interest rate	12 percent per annum	
Maximum term	KIK eight years	
	KMKP five years	
Source of funds	Bank Indonesia	55 percent
	World Bank	25 percent
	Handling bank	20 percent
Interest rate of BI's funds:	3 percent (after blending with WB's funds, 5.2 percent)	
	Automatically insured by	
	P.T. ASKRINDO	70 percent
	Handling bank	30 percent
Insurance premium	6 percent of the loan amount (covers the entire loan period)	
Collateral	The project, however, sometimes the handling bank required additional collateral.	

KIK/KMKP was handled by state owned commercial banks, private national banks and development banks. KIK/KMKP was handled in branch offices only, not in sub-branches.

Table 1-3-5: KIK/KMKP by Economic Sector

(1989)

(Clients: 1000 Amount: Billion Rp)

	KIK		KMKP	
	No. of Clients	Amount	No. of Clients	Amount
Agriculture	70.4 (23.8%)	157.2 (12.4%)	237.1 (10.4%)	273.4 (7.2%)
Industry	36.1 (12.2%)	163.8 (12.9%)	237.7 (10.4%)	413.7 (11.0%)
Trading	94.7 (32.1%)	444.1 (35.0%)	1,611.7 (70.8%)	2,591.7 (68.5%)
Communication	56 (19.0%)	272.8 (21.5%)	15.4 (0.7%)	28.0 (0.7%)
Others	38.1 (12.9%)	231.5 (18.2%)	175.8 (7.7%)	474.6 (12.6%)
Total	295.3 (100%)	1,269.4 (100%)	2,277.7 (100%)	3,781.1 (100%)

Source: Bank Indonesia

Thus, the number of offices which could handle KIK/KMKP was 1,305, smaller than the number handling KUPEDES.

Among the offices handling KIK/KMKP, over 50 percent (778 offices) are state owned (state owned commercial banks and BAPINDO), while private banks with head offices in Jakarta accounted for 268 offices (42 banks), private banks with head offices outside Jakarta, 45 offices (14 banks) and regional development banks 214 offices (26 banks).

Offices handling KIK/KMKP are mainly located in provinces which have large cities, such as DKI Jakarta 57, East Java 40, Central Java 36, West Java 32, and North Sumatra 30. In Kalimantan and the eastern part of Indonesia, the number of handling offices is rather small.

[2].Outstanding loans of KIK/KMKP by economic sector

For both KIK and KMKP, the commerce sector was the largest borrower. In the case of KMKP, about 70 percent of the loans (by number or by amount) were to the commerce sector. The percentage of loans to the industry sector was about 10 percent for both KIK and KMKP.

[3] Problem areas in KIK / KMKP

High percentage of bad loans

As KIK/KMKP was an institutional loan scheme prepared for quite small-scale enterprises, the percentage of bad loans was very high. According to P.T. ASKRINDO, there was a time when nearly 8 to 10 percent of the loans was in default.

There is another reason for the non-payment of loans. There was a time when the government requested that the banks give more KIK/KMKP loans, but it was hard for the banks to find good customers. In addition, the management and collection of small loans is technically very difficult and costly.

The percentage of bad loans is quite different depending on the province. For example, in Bali there are few unpaid loans. It is said that the religious belief of the Balinese that those who do not repay their loans cannot go to heaven has some relation to this phenomenon.

Heavy burden on the government

The interest rate on Bank Indonesia funds to handling banks was only 3 percent p.a., which is about 10 percent lower than the market rate. There was also a 1 percent subsidy from the Ministry of Finance to the handling bank and the government paid the insurance premium to P.T. ASKRINDO. Thus, KIK/KMKP was a heavy burden on the government.

It seems that reduction of the fiscal burden, in addition to the application of market mechanism policies to small-scale finance, was one of the reasons for the abrogation of KIK/KMKP.

Burden on the handling banks

The target firms of KIK/KMKP were very small and usually they could not prepare even a balance sheet or a profit/loss statement. Usually a loan officer from the handling bank had to help with the application form and in some cases the loan officer had to prepare the document. For this reason, KIK/KMKP's procedures were a burden for loan officers.

As the KIK/KMKP loan amounts were small and the percentage of bad loans was high, KIK/KMKP was not very profitable for the banks handling it even through they could receive liquidity from Bank Indonesia at low cost.

The problem of improper use

KIK/KMKP's interest rate was only 12 percent p.a. which was much lower than that of bank time deposits. It is said that in some cases the KIK/KMKP borrowers used the money not for investment or working capital, but for deposits or to buy stocks. It is also said that in some areas there were cases where the money was used for funeral expenses.

c.KI/KMK

[1]Outline

KI/KMK was the institutional lending scheme for medium-scale enterprises with total assets of not more than 600 million rupiah, while KIK/KMKP was for those with total assets of not more than 300 million. KI/KMK was also based on SMIEP (the successor project to SEDP). KI furnished the money for investment, and KMK for working capital.

The lending conditions were:

Target companies	Total assets over 300 million rupiah but not more than 600 million Rp.
Maximum term	KI 10 years KMK one year
Interest rate	15 percent p.a.
Interest rate on BI Funds	3 percent p.a.

Risk sharing	with KI, loans were automatically insured by P.T.ASKRINDO P.T. ASKRINDO 70 percent Handling bank 30 percent with KMK, insurance by P.T. ASKRINDO was also available but the loans were not automatically insured.
Insurance premium	2 percent p.a.
Collateral	The project but it is said that the handling banks demanded additional collateral in some cases.
Others	At least 10 percent self-financing was required
Handling bank	Same as KIK/KMKP (bank branches only)

[2] Comparison of KI/KMK and KIK/KMKP

The targets of KI/KMK were larger than those of KIK/KMKP so the percentage of bad loans was much lower than that of KIK/KMK. According to P.T. ASKRINDO it was under 2 percent.

Nevertheless, the insurance premium was 2 percent p.a. for the entire loan period.

KI/KMK's maximum loan amount was 150 million rupiah. This is a fairly good amount for use by light industries (for example, one can buy more than 500 hand weaving machines for 150 million Rp).

2)Institutional lending scheme for export promotion

a.Export credit

[1] Outline

Target companies	Exporters Manufacturers of export commodities or raw materials for export. (domestic L/C was needed)
Maximum loan	85 percent of the export target
Interest rate	14 percent (primary goods) 14.5 percent (non-primary goods)
Maximum term	five months (except for several commodities such as tobacco)
Source of funds	Primary goods Bank Indonesia (BI) 40 percent Handling bank (HB) 60 percent Non-primary goods BI 37 percent HB 63 percent
Interest rate on BI funds	4 percent p.a. Automatically insured by P.T. ASEI, state owned insurance company
Insurance premium	0.5 percent
Collateral	Export goods, no other collateral required

Handling bank	All foreign exchange banks

[2]Problem areas in export credit

a)Relationship with the United States

In the beginning the interest rate for export credit was 9 percent but the United States claimed that this scheme was an export subsidy which was prohibited by GATT. The government considered the importance of its relationship with the United States and raised interest rates both for the customers and for BI funds and reduced the portion of BI funds. As a result, the scheme was not as profitable for either the handling banks or exporters.

b)Limited P.T. ASEI Capital

Some handling banks point out that P.T.ASEI is too small to insure all export credit.

c)Feasibility for handling banks

Since the portion of BI funds was reduced (from 50 percent to 37 percent) and the interest on BI funds was raised (from 3 percent to 4 percent) while final lending rates were fixed at a rather low level, this scheme was not as feasible for the handling banks as it had been and thus they were not eager to use the scheme.

Table 1-3-6: List of Major Institutional Financing Schemes for Small Scale Industrial Development

Name of Schemes	The use of \Credit	Maximum Loan (RP.1000)	Lending Rate % p.a.	Maxmum Maturity	Handling Bank (HB)	Source of Fund	Collateral Requirement	Insurance Premium	Risk Sharing	note
1.KUPEDES (General Rural Credit)	Investment Working Capital	5,000	Inv. 12%FLAT WC 18%FLAT	Inv.3yrs. WC2yrs.	BRI	BI BRI World Bank	The Project	---	Gov. 100%	Commence-ment Feb 1984
2.KIK (Small Investment Credit KMKP (Permanent Working Capital Credit	Investment (KIK) Working Capital (KMKP)	Total 30,000	12%	KIK *yrs. KMKP 5yrs.	National Banks	BI 55% WB 25% HB 20%	The Project	6% paid BI 4.5% HB 1.5%	P.T. ASKRINDO 70% HB 3-%	Commence-ment Jan 1974
3.KI (Investment Credit) up to 75 million Rp. KMK (Working Capital Credit)	Investment (KI) Working Capital	Total 150,000	15%	KI 10yrs. KMK 1yrs.	National Banks	BI 70% HB 30%	The Project	>1yr. 2% p.a. Paid by BI & HB equally (KMK is not automatically insured	P.T. ASKRINDO 70% HB 30%	Commence-ment Jun 1983 May 1984
4.KMK Keppres (Working Capital Credit Under Presidential Degree 29/1984)	Working Capital	200,000	15%	1yr.						
5.Credit for Cooperative member (One of the Cooperative credit)	Working Capital	15,000	12%	1yr.	National Banks	BI 90% HB 10%	Project	---	---	Commencement Jun 1983
6.Export Credit	Working Capital	85% X T TO T=Export Target to=Turn Over	Primary 14% non Primary 14.5%	5months except some commodities such as Tabacco	all Foreign Exchange banks including Joint Venture Banks	Primary BI140% HB 60% non Primary BI 37% HB 63	Exported products	Paid Equally by BI & HB 0.5%	P.T.ASEI 85% BI 7.5% BH 7.5%	Commencement Jan 1982 Jan 1982

b. Two Step loan from World Bank

For investment purposes and in the cases where over 40 percent of the products are exported, the World Bank offers its two-step loan.

With this loan, the final lending rate is determined by the handling bank based on the market rate. Loans under this system are for projects which have passed World Bank screening. The cost of funds is a little bit lower than that of time deposits and loan amounts are larger.
Therefore, actual interest rates are a little lower than market rates, around 18 percent.

(4) Outline of the Policy Packages of October and December 1988

The outlines of the October and December 1988 deregulation policy packages are as follows.

1)The objectives of deregulation policy

A series of policy packages starting from PACTO announced on October 27, 1988 had the following objectives:

1 Mobilization of funds
2 Promotion of non oil/gas exports
3 Developing the efficiency of the banking sector
4 Developing the effectiveness of monetary policy
5 Developing the capital market

2) Policies for mobilization of funds

[1] Deregulation of new branch opening

Banks such as commercial banks and development banks were allowed to open new branches all over the country.

Banks could open sub-branches simply by reporting to Bank Indonesia, whereas a license for each sub-branch had been required previously.

[2]Deregulation on opening NBFI branches

NBFIs which were recognized as "sound" for at least two years, could open branches in seven major cities (Jakarta, Bandung, Semaran, Surabaya, Medan, Ujung Pandang, Dempasar).

[3]Establishment of new banks

Establishment of new banks was allowed

Rural banks were allowed to change and become commercial or development banks

To become a commercial or development bank, at least 10 billion rupiah of paid up capital was needed.

[4] Approval for NBFIs to issue CDs (Certificates of Deposit)

[5] Expansion of banks which handle savings deposits

All banks were now allowed to handle savings deposits such as TABANAS.

3) Policies to promote non oil/gas exports

[1] Deregulation of foreign exchange bank licensing

Banks which were recognized as "sound" for the previous two years and which had total assets over 100 billion rupiah were allowed to obtain foreign exchange bank licenses.

[2] Deregulation of foreign exchange branch licensing

Foreign exchange banks were allowed to change their branches to foreign exchange branches by simply reporting to Bank Indonesia.

[3] Approval of foreign joint-venture banks

Foreign banks could establish joint venture banks under these conditions:

The Indonesian partner bank must have operated as a "sound" bank for at least 20 months.

The foreign bank already had a representative office in Indonesia.

The foreign bank should be ranked highly in its own country.

The home country of the foreign bank adopts reciprocity.

Paid up capital of the joint venture bank is not less than 50 billion rupiah.

After 12 months, over 50 percent of the loans outstanding should be provided for export credit.

Under these conditions, a joint venture bank could be established in one of the seven major cities (Jakarta, Bandung, Semaran, Surabaya, Medan, Ujung Pandang, Dempasar).

[4] Abolishment of "Outside Jakarta" regulation

By abolishment of the "Outside Jakarta" regulation, foreign banks were now allowed to lend their money to customers outside Jakarta.

[5] Approval of foreign bank branches

"Sound" foreign banks were allowed to open sub-branches in the seven major cities. These sub-branches were also required to lend over 50 percent of their loans outstanding for export credit.

[6] Extension of SWAP period of Bank Indonesia

Bank Indonesia's SWAP period for foreign currency was extended from six months to three years.

4) Policies to promote the efficiency of the banking sector

To promote the efficiency of the banking sector by liberalization and to stimulate the competition between banks, Bank Indonesia announced these policies.

1 Liberalization of fund management of state owned companies

State owned companies were allowed to deposit 50 percent of their liquidity in banks not owned by the state.

2 Stimulation of competition between banks

Competition between banks was stimulated by deregulation of branch opening, establishment of new banks and joint venture banks, and so on.

3 Legal lending limit

To avoid excessive amounts of loans to group companies, a legal lending limit was set for banks and NBFIs.

To a certain company	20 percent of own capital
To a certain group of companies	50 percent of own capital
Member of board and his company	5 percent of own capital
Member of board and his group companies	15 percent of own capital
Shareholder	10 percent of share
Shareholder and his group company	25 percent of share amount

5) Policies to promote the effectiveness of monetary policy

1 Reduction of deposit reserve ratio

The reserve rate to Bank Indonesia was reduced from 15 percent to 2 percent

2 Setting reserve ratio for NBFIs.

NBFIs were required to reserve deposits with Bank Indonesia.

3 Open market operations

The terms of SBI & SBPU were extended from seven days to six months and the variety of measures to open market operation was increased.

6) Policies to develop the capital market

1 A 15 % withholding tax was imposed upon interest of deposit.

2 Permission for banks to raise funds in the capital market

Banks and NBFIs were allowed to go public.

7) The effect of financial reform

It seems that financial reform through a series of deregulation policy packages such as PACDES has had these effects.

[1] Stimulation of competition between banks

The deregulation policies led to the establishment of a number of new banks and joint venture banks and that made the competition between banks keener. (The number of commercial banks was 97 in September 1989, while in March it was only 79).

[2] Mobilization of private funds

Through the increase of bank branches and the new deposit system such as TAHAPAN, mobilization of funds was advanced.

[3] Drop of interest rates

The interest rate in Indonesia has been very high compared with neighboring countries in terms of both the nominal rate and the actual rate. With the reduction of the reserve ratio, fund mobilization and increased competition among banks, the lending rate is gradually falling.

[4] Increase of non oil/gas exports

It is very difficult to gauge the actual effect of financial reforms, but non oil/gas exports are increasing and deregulation of foreign exchange branches and joint venture banks has obviously played a great part in this.

Table 1-3-7: Banking Funds

(Billion Rp.)

	1987 Sept.	1988 Mar.	1988 Sept.	1989 Mar.
Demand Deposits	8,213	8,481	9,223	10,543
Rp.	6,911	7,184	7,949	9,101
Other Currency	1,302	1,292	1,274	1,442
Time Deposits	17,905	20,654	24,603	26,475
Rp.	14,491	16,656	19,907	20,984
Other Currency	3,414	3,989	4,696	5,491
Savings Deposits	1,419	1,835	1,860	2,485
Tabanas, Taska	1,176	1,402	1,415	1,646
Others	243	433	445	839
Total	27,537	30,970	35,686	39,503

Source: Bank Indonesia

(5) Outline of the January 29, 1990 Policy Package

A new banking policy package was announced on January 29, 1990. It included the abolishment of most liquidity credits.

1) The background of the policy package

Indonesia had suffered from a lack of liquidity for a long time but after a series of banking deregulation policies such as PACTO were announced in October 1988, the situation was improving.

After the third quarter of 1989, direct investment from Asian countries increased remarkably and this caused a rapid increase in the money supply.

The interest rate on liquidity credit was very low compared with the market rate (in the case of KIK/KMKP 12 percent). In addition, there were some companies which used the funds improperly for such things as time deposits or buying stock instead of for investment or working capital.

The burden on Bank Indonesia was getting heavy due to the growth in outstanding liquidity credit. (In November 1983, the amount of liquidity credit outstanding was 6.6 trillion Rp. By November 1989, it had increased to 16.7 trillion Rp.)

2) The objectives of the policy package

1.To reduce the financial burden on Bank Indonesia
2.To promote the mobilization of private funds through the banking system
3.To develop appropriate measures of financing

3) Outline of the policy package

[1].The liquidity credit schemes of Bank Indonesia were abolished except for the following four schemes.

a) Credit for Farm Business: KUT
Bank Indonesia furnishes 100 percent of the funds.
Interest rate on BI funds is 3 percent.
Financial lending rate is 16 percent p.a.
Lending through Cooperative Village Units

Table 1-3-8: Money Supply & Call Money Rate

(10BILLIONS Rp)

End of period		Total	Money supply Change (%) Monthly	Annual	Call money rate (Average)
1982		712		9.8	17.3%
1983		757		6.3	12.9%
1984		858		13.4	19.4%
1985		1,010		17.8	10.0%
1986		1,168		15.6	14.0%
1987		1,269		8.6	14.5%
1988					
	MAR	1,263	0.9	9.8	14.5%
	JUN	1,305	2.3	12.6	14.1%
	SEPT	1,314	1.4	9.3	15.1%
	DEC	1,439	6.8	13.5	14.7%
1989					
	MAR	1,501	6.5	18.8	13.7%
	JUN	1,592	7.4	22.0	11.8%
	SEPT	1,716	9.2	30.6	12.0%

Source: Bank Indonesia

b) Credit for Cooperatives

Bank Indonesia furnishes 75 percent of the funds
Interest rate on BI funds is 12 percent.
Final lending rate is 16 percent.
Lending through Primary Cooperatives or Cooperative Village Units

c) Credit for Food & Sugar Procurement

Bank Indonesia furnishes 100 percent of the funds
Bank Rakyat Indonesia is in charge of credit for food procurement.
Bank Bumi Daya is in charge of credit for sugar procurement.

d) Investment Credit

Bank Indonesia furnishes 50 percent (in the western part of Indonesia 40 percent) of funds for three types of investment credit.

estate credit
investment credit through development banks
housing loans through BTN

The interest rate is the market rate.

Accordingly, KIK/KMKP, which had played very important roles in the institutional lending schemes, stopped giving new loans and small and medium-scale enterprises had to raise funds in the free market through the banking system. In addition, the automatic insurance coverage of P.T. ASKRINDO was abolished and ASKRINDO now checks each case before giving insurance.

2.Provide 20 percent of credits for the economically weak

With the exception of foreign joint-venture banks, the banks are required to provide 20 percent of their credit to the economically weak.

This requirement has no sanctions but those banks which cannot achieve 20 percent are not recognized as "sound" banks. Since "soundness" is the most important criterion for receiving the benefits of the deregulation policies, banks are obligated to meet this requirement.

Here, credits for the economically weak (KUK) means loans of not more than 200 million rupiah to borrowers who do not have more than 600 million rupiah in total assets. (The condition of borrowers is the same as under KIK/KMKP and KI/KMK but the amount has been increased by 50 million rupiah.)

KUK is not necessarily lent directly to the customers. Loans through secondary banks are also counted as KUK.

4) The effects of the policy package of January, 1990

The application of this policy is not yet clear and thus it is difficult to say just what effect it will have. However, as far as can be determined, this policy package will likely have the following effects.

1.Influence on small and medium-scale financing

The problem of funds

Before this policy package, the percentage of loans to the economically weak was slightly less than 20 percent. If all banks provide 20 percent of credits to the economically weak, funds for that group will not decrease as a whole. In addition, the maximum loan is 200 million rupiah, which is larger than that under KI/KMK by 50 million rupiah.

On the other hand, "economically weak" enterprises must raise funds in the market, so those enterprises that are not active or do not have enough collateral such as land or buildings may face some difficulties in raising funds.

The problem of lending conditions

The prime rate in Indonesia is coming down and it is now under 20 percent p.a. but that is still higher than that of KIK/KMKP (12 percent), or KI/KMK (15 percent). Furthermore, the market rate on loans to small businesses is still over 20 percent.

Thus, as a result of the abolishment of liquidity credits, the cost of funds to these enterprises will rise.

Because the automatic insurance system of P.T. ASKRINDO has also been abolished, the collateral requirements will be more severe than before.

2.Influence on the banking sector

The problem of screening by banks

Most of the commercial banks including state owned banks have very little experience in lending to small scale industries, with the exception of the liquidity credit schemes. In other words, the banks do not yet have enough know-how in handling small-scale loans.

On the other hand, those banks which have established screening systems and loan management systems for small loans will have good opportunities because the interest rates on small loans have been liberalized with the abolishment of the liquidity credit schemes.

The problem of staff

All of the banks surveyed face problems in terms of the number of skilled loan officers. As a result of this policy package, banks will need even more loan officers and the problem will become more serious.

3.Influence on the policy for development of small and medium-scale enterprises

The importance of technical assistance will increase

The requirement that 20 percent of each bank's credit line go to the economically weak aside, small companies must raise funds under the competition of the free market. As a result, the lending conditions will change according to the management ability of the borrowers. However, the management capability of small enterprises is usually at such a low level that most of them cannot prepare even B/S or P/L.

Table 1-3-9: Various Credit Schemes for the Economically Weak

(BILLION Rp.)

	1987 March 31	%	1988 March 31	%	1989 March 31	%
KIK	311	1.2	312	0.9	439	1.0
KMKP	879	3.3	946	2.8	1,127	2.5
KIK/KMKP	1,190	4.5	1,258	3.7	1,566	3.5
KI75JUTA	143	0.5	208	0.6	372	0.8
KMK75JUTA	181	0.7	317	0.9	625	1.4
KI/KMK	324	1.2	525	1.6	997	2.2
KUPEDES	383	1.4	462	1.4	607	1.4
INVESTMENT	15	0.1	16	0.0	31	0.1
WORKING CAPITAL	368	1.4	446	1.3	576	1.3
COOPERATIVE CREDIT	275	1.0	340	1.0	405	0.9
INVESTMENT	71	0.3	74	0.2	54	0.1
WORKING CAPITAL	204	0.8	266	0.8	351	0.8
KCK	14	0.1	14	0.0	15	0.0
KPR*	1,459	5.5	1,745	5.2	2,414	5.4
OTHERS	1,189	4.5	1,521	4.5	1,545	3.4
CREDITS FOR THE ECONIMI-CALLY WEAK TOTAL	4,834	18.1	5,865	17.4	7,549	16.8
BANK CREDIT TOTAL	26,679	100.0	33,618	100.0	44,943	100.0

* HOUSE OWNERSHIP CREDIT, INCLUDING KPR BY BTN AND PT Papan Sejahatera
SOURCE: BANK INDONESIA

Therefore, many small enterprises may lose their ability to raise funds if they do not improve their management level. Technical assistance is assistance for small and medium-scale enterprises to improve their management ability. The importance of technical assistance in the policy for the development of small and medium-scale enterprises will increase.

(6) Problem Areas in Fund Raising in Each Industrial Sub-sector (From Questionnaire)

1) Lending Organ Used

In Indonesia, indirect financing such as loans from banks is the main method of fund raising. This questionnaire also shows that most of the enterprises in all sub-sectors use bank loans. In the rubber-based product & handicraft sectors, the percentage of bank loans reaches 80 percent.

1.Electrical machinery sector

Five out of eight enterprises which responded to the questions regarding fund raising used bank loans, two used loans from NBFIs, and one borrowed from a manager and his relatives. The electrical machinery sector requires more funds compared with the other two sectors, so some enterprises use leased equipment.

2.Rubber-based products

Seventeen enterprises out of 21 used bank loans, three borrowed from NBFIs and one borrowed from a manager and his relatives.

3.Handicraft products

Eighty-seven out of 107 enterprises which returned answers borrowed from banks. Three enterprises borrowed from NBFIs, seven from cooperatives, seven from informal lending schemes and 11 from managers and relatives.

In the case of the handicraft sector, the percentage of loans from the non-banking sector such as managers and relatives or informal lending schemes was remarkable.

This is because handicraft enterprises are usually very small and there are many enterprises too small to borrow from banks or NBFIs. In addition, handicraft enterprises are usually located in rural areas where access to banks is not good. These reasons also explain why the percentage of bank loans is low compared with other sectors.

According to the questionnaire answers, loans from the non-banking sector are particularly noticeable among small business and in districts where access to banks is not good, such as in South Sulawesi. This confirms the reasons mentioned above.

2) Lending schemes used

The present situation of utilization of institutional loans for export promotion and development of small and medium-scale enterprises is as follows.

In the case of the handicraft sector, in which most of the enterprises are small, 62 firms out of 184 enterprises are using KMKP, 42 firms are using KIK, two are using KUPEDES, and one is using KCK. Thus, utilization of institutional lending schemes prepared for small business is notable in the handicraft sector.

In the rubber products sector, only one enterprise uses KUPEDES and KMKP. Among electrical machinery enterprises, none of the enterprises use any of the institutional lending schemes. This is because KIK/KMKP's 300 million rupiah limit on total assets is too small for these sectors.

Among the enterprises which answered the questionnaire, 12 handicraft and eight rubber goods enterprises are using export credit. However, none of the electrical machinery enterprises use export credit.

Table 1-3-10: Present Source of Borrowing by Area & Scale

(MULTIPLE ANSWER)

	Total	Bank	NBFIs	Cooperatives	Informal lender	Managers & relatives
AREA						
Jakarta area	11	10		1		2
	(100%)	(90.9%)	---	(9.1%)	---	(18.2%)
Yogyakarta area	18	16	1	1		
	(100%)	(88.9%)	(5.6%)	(5.6%)	---	---
Bali area		29	27	1	4	
	(100%)	(93.1%)	(3.4%)	(13.8%)	---	---
North Sumatra area (mainly Medan & lake Toba area)	20	15			2	3
	(100%)	(75.0%)	---	---	(10.0%)	(15.0%)
South Sulawesi area (mainly Traja area)	8	3			5	
	(100%)	(37.5%)	---	---	(62.5%)	---
West Java area (mainly Bandung area)	21	16	1	1	5	1
	(100%)	(76.2%)	(4.8%)	(4.8%)	(23.8%)	(4.8%)
Total	107	87	3	7	7	11
	(100%)	(81.3%)	(2.8%)	(6.5%)	(6.5%)	(10.3%)
SCALE						
Under 20 employees	35	15	1	3	3	9
	(100%)	(68.6%)	(2.9%)	(8.6%)	(8.6%)	(25.7%)
20-99 employees	49	42	2	3	4	1
	(100%)	(85.7%)	(4.1%)	(6.1%)	(8.2%)	(2.0%)
100 or more employees	23	21		1		1
	(100%)	(91.3%)	---	(4.3%)	--	(4.3%)
Total	107	87	3	7	7	11
	(100%)	(81.3%)	(2.8%)	(6.5%)	(6.5%)	(10.3%)

SOURCE: QUESTIONNAIRE

3) Problem areas in fund raising

The following are problem areas in fund raising.

1.Electrical machinery sector

Seven out of the eight enterprises which returned answers regarding fund raising said that interest rates were too high. Two of them referred to the complexity of loan procedures. One enterprise indicated that there are too many conditions on loans. This shows that interest rates are the most serious problem in the case of fund raising.

2.Rubber-based product sector

Seventeen out of 21 enterprises said that interest rates are too high. Two of them mentioned that the credit ceiling is too low, the loan period is too short and there are too many conditions on loans. Only one of them indicated the complexity of loan procedures. This also shows great concern about interest rates.

3.Handicraft sector

Conditions in the handicraft sector are slightly different from those in the other two sectors. Out of 123 enterprises, 66 firms said the collateral requirement is too strict and 53 enterprises mention the high number of conditions on the loan. Forty-one enterprises said the loan procedures are too complex and 40 firms stated that the loan period is too short. The number of enterprises which indicated that interest rates are too high was 50. For handicraft enterprises, interest rates are not the matter of greatest concern.

This is because most handicraft enterprises are very small and thus they can use liquidity credits such as KIK/KMKP (interest rate 12 percent) and KI/KMK (interest rate 15 percent). Out of 61 handicraft enterprises which do not use KIK/KMKP, 50 firms say that interest rates are too high.

In the case of handicraft enterprises, the problem areas differ according to the scale of the enterprise.

(7) Problem Areas in Fund Raising from Interviews with Enterprises

1) Problem Areas from the Viewpoint of Enterprises

1.Problem areas of large-scale enterprises

Enterprises with total assets of more than 600 million rupiah cannot use any priority credit scheme and thus they must raise funds in the market and pay high interest rates. This is the largest problem area in fund raising for large-scale enterprises.

Of course they can raise funds in foreign money markets and convert the funds to rupiah using Bank Indonesia's SWAP facility. However, the number of enterprises which can raise funds in these ways is quite low at the moment.

Being forced to pay the high lending rate is partly a result of the capabilities of the enterprises. According to one company visited, it is not difficult to borrow money at 2 or 3 percent lower than market rates if they can prepare accurate financial statements and clear plans for investment and repayment of the loan.

Incidentally, concerning export credit, several enterprises pointed out that handling banks require a Letter of Credit but in cases where the shipping period is short, the L/C usually arrives too late to collect the exported goods.

2.Problem areas for small and medium-scale enterprises.

Liquidity credit schemes for small and medium-scale enterprises are well known as determined through research in East and West Java and Bali. Among the enterprises surveyed, several actually used KIK/KMKP.

The enterprises which used KIK/KMKP were all satisfied with the interest rate (12 percent), especially in Bali where the average lending rate for small businesses was 3 percent per month.

Regarding the credit ceiling, handicraft enterprises were generally satisfied with the amount. However, electrical machinery enterprises complained that 30 million rupiah is too small to buy good machines made in Japan.

Under the policy package of January 29, 1990, almost all liquidity credits were abolished. Thus, the problem areas of small and medium-scale enterprises will change.

2) Problem Areas from the Viewpoint of Banks

1.Problems with large-scale enterprises.

The situation is getting better but still many enterprises do not want to disclose their real financial status. Some enterprises prepare several types of financial statements such as those for the taxation office, for banks, for shareholders, etc.

2.Problems with small and medium-scale enterprises.

Small and medium-scale enterprises can seldom make their own financial statements such as B/S or P/L statements. Therefore, when banks lent under KIK/KMKP to such enterprises, it often happened that the loan officer of the handling bank had to prepare financial statements and other documents required on behalf of the customer. Thus, institutional lending schemes for small and medium-scale enterprises are not profitable for the banks because of the effort involved.

In addition, small and medium-scale enterprises usually lack knowledge of export activities. Some of them do not even know that discrepancies will cause payment to be withheld.

3.Problem with the banking sector

Financial statements do not always show the real financial situation and only a small number of enterprises can show clear repayment plans. Therefore, in screening loans, banks cannot judge creditworthiness by the forecast profitability and risk of the project. This is why banks tend to rely upon collateral.

If loan officers rely on collateral, their skill in areas such as financial analysis will not improve. There are other problems with collateral as well. For example, because of the imperfect registration system, it sometimes happens that two or three certificates are issued on the same land. In addition, it takes too much time to realize a mortgage.

The lending funds of private banks come mainly from three-month time deposits and to avoid mismatching assets and liabilities, credit terms must be short.

In general, the repayment period for the industry sector is longer than that of the commerce sector. So the industry sector has a disadvantage compared to the commerce sector in terms of access to bank funds.

Loans to small and medium-scale enterprises including liquidity credits are not profitable because of the high risk and high cost of management.

Experience in exporting is insufficient among both customers and the banking sector. In some cases, nonpayment occurs because of a lack of knowledge of export activities.

Export credit is automatically insured by P.T.ASEI but conditions for repayment are very strict and thus most of the cases are not fully covered by insurance. On the other hand, banks are prohibited from asking customers for additional collateral. As a result, export credits are very high risk loans for the banks handling them.

(8) Problem Areas in Financing for Industrial Sub-sector Development

1) Handicraft Sub-sector

1.Problem areas at the time of this research in Indonesia

Most of the handicraft enterprises are very small - 152 out of the 182 enterprises studied had less than 100 employees. According to the questionnaire, almost all of these enterprises are classified as small enterprises by the definitions of both the Department of Industry and Bank Indonesia.

Thus, almost all of the enterprises could utilize KIK/KMPK or KI/KMK if they could gain access to the branch offices of banks. The interest rates were very low (KIK/KMKP 12 percent, KI/KMK 15 percent, which is even lower than that of time deposits), and collateral is the project itself with no additional collateral required. The lending limit was 150 million rupiah in the case of KI/KMK and it seemed to be enough for small-scale enterprises. (According to the definition of the Ministry of Industry, small-scale industry is not more than 70 million rupiah in terms of the amount of equipment.)

The problem was additional conditions (for example, the requirement of additional collateral), and complicated loan procedures. Small enterprises usually have a very low business management ability. For example, most small enterprises do not make financial statements such as B/S or P/L statements and they seldom make repayment plans when they invest. For these reasons, banks cannot judge the credit risk accurately. This is why banks impose additional conditions and demand high interest rates on loans, except for liquidity credit schemes for which the lending rate is fixed by regulation.

The most important issue for handicraft enterprises was improvement of management ability. Another important issue was to make the methods of fund raising available to enterprises in rural area because KIK/KMKP and KI/KMK were handled only by branches of banks and not by sub branches.

2.Effects of the policy package of January 29, 1990

As most of the handicraft enterprises are small and medium-scale enterprises which can use liquidity credit, the effects of the policy change will likely be most noticeable in the handicraft sector.

With the abolishment of liquidity credits, small enterprises must raise funds on the market. Market interest rates for small-scale enterprises are higher than interest rates for large-scale enterprises because the credit risk is greater. Thus, whereas before small-scale enterprises could raise funds at low cost by using liquidity credit schemes, they will now have to pay high interest rates .

KIK/KMKP and KI were insured automatically by P.T.ASKRINDO. As a result of this policy package, loans will no longer be automatically insured. For some enterprises this means the loss of one method of fund raising.

On the other hand, owing to this policy package, promising small-scale enterprises have the opportunity to borrow more money from the banking sector due to the guideline that 20 percent of each bank's credit line should be provided for KUK (credit for the economically weak). In addition, enterprises located in rural areas will have more opportunities to raise funds because while KIK/KMPK and KI/KMK were handled only by branches, KUK can be lent not only at sub branches but also through secondary banks.

Therefore, under this policy package, promising small-scale enterprises will have more opportunity to raise funds. For other enterprises, however, this policy package means higher interest rates and the loss of one method of fund raising.

Accordingly, the most important issue for handicraft enterprises is the improvement of their business. But only a small number of enterprises are aware of this point. This means that without the assistance of the government, most handicraft enterprises will face difficulties in fund raising.

2) Rubber-based products sub-sector

The rubber-based product industry includes many types of enterprises ranging from the most advanced joint venture companies to very small enterprises in rural areas. Not surprisingly, the problem areas vary according to the scale of the enterprise.

The problems for large-scale enterprises such as joint venture companies are high interest rates and the lack of long term loans. Enterprises which have good credit ratings overseas can raise funds in dollars on markets in foreign countries such as Singapore. That money can then be converted into rupiah by the SWAP facility of Bank Indonesia. However, the maximum SWAP period is three years and thus for projects which will take more than three years for recovery, this type of fund raising is not suitable. In the case of loans or subscription from the parent company, there is always exchange rate risk. The only method of raising long-term funds at low interest rates is to borrow the money in a foreign currency and repay it through proceeds exports. At the moment, this is very difficult because the Indonesian rubber industry has not yet established a presence in the international market.

For the small-scale rubber product enterprises, the problems are basically the same as those in the handicraft sub-sector. With the abolishment of liquidity credits, small enterprises can no longer raise funds at special interest rates. Because of their low management ability, loans to these enterprises are considered high risk. Thus, the interest rate will be higher than that for large-scale enterprises and sometimes banks will refuse loan applications.

While the Indonesian handicraft industry is competitive both in technique and price, the small-scale rubber-based product industry is not competitive in the international market because of out-dated equipment and raw materials. To increase competitiveness, the introduction of new equipment is indispensable. Furthermore, most of these enterprises are requested to improve working conditions from the viewpoints of safety and pollution.

At the same time, most of the small rubber enterprises produce only when they have orders and they are not eager to expand their business.

3) Electrical machinery sub-sector

Most of the enterprises in the electrical machinery sub-sector in Indonesia are very large in scale (seven out of the 16 visited are joint ventures and one is state owned). Problem areas are the same as those for large-scale rubber enterprises, i.e. high interest rates and a lack of long term credit.

High interest rates decrease the incentive for investment. Among the enterprises visited, there was one company which did not want to borrow money at high interest rates so the manager was making equipment instead of buying it.

During the course of this study, almost all of the electrical machinery enterprises were visited and the expected amount of investment in the next two years (7760 million rupiah) is too small compared with production. (557 billion rupiah in 1987: Industrial Statistics)

According to our research, the average amount of total investment is US$1.65 million in the case of generators and transformers and US$2.37 million in the case of motors. If the average depreciation period is assumed to be 10 years, every year each enterprise will need equipment and the total amount required will be US$2.87 million.

This amount (about 5 billion rupiah) is much bigger than the expected amount of investment in the questionnaire. It shows that the enterprises in the electrical machinery sub-sector are not eager to expand their business and the increase of electrical machinery production must rely on new investment.

Foreign joint venture companies faced a particular problem in that they could not borrow from state owned banks and export credit had been dissolved by the deregulation policy.

(9) Directions for Solutions

In Indonesia, problem areas in fund raising differ not by economic sector but by the scale of the enterprise. Accordingly, solutions should be examined based on the scale of the enterprise.

1) Medium and large-scale enterprises (total assets of more than 600 million rupiah)

The problem areas for medium and large-scale enterprises in fund raising are high interest rates (nominal and real), and the lack of long term credit.

To support certain industrial sub-sectors financially, it is usual to prepare a low interest credit scheme for the sub-sectors in question. However, since Indonesia basically has a deregulated and free market banking policy, it is difficult to adopt a new credit scheme for only certain sub-sectors.

In light of this situation, there are two ways to reduce interest rates.

1.Introduction of foreign financial resources

Introduction of long-term foreign loans at low interest rates will enable the enterprises to raise low-cost funds. If a large amount of capital is introduced, it will effect the money market of Indonesia and reduce interest rates.

There are two main ways to introduce foreign funds. One is the promotion of foreign investment in Indonesia and the other is long-term loans from overseas.

Promotion of investment is referred to in another chapter and thus here we examine mainly loans from foreign countries.

There are two ways to introduce loans from overseas. One is private loans and the other is government loans. For private loans, borrowers must have a sufficient credit rating in the foreign money market. However, of the enterprises of the three sub-sectors targeted in this study, very few have such credit ratings, with the exception of several joint venture enterprises.

Therefore, in introducing foreign capital government loans, the so-called two-step loans will be the main focus. Generally speaking, borrowing via governmental loans raises the debt-service ratio. However, in cases where the final borrowers are in the exporting sector, this will not happen because it will increase exports and thus foreign exchange earnings. Consequently, this type of loan will not conflict with REPELITA-V. In the case of the two-step loan, handling banks can reduce final lending rates if the cost of foreign funds is lower than the market rate and thus it is necessary introduce funds at the lowest possible interest rates.

2.Reinforcement of assistance system for management and finance in the target sub-sectors

One of the reasons for the high interest rates in Indonesia is the result of actions on the part of borrowers. For example, financial disclosure is insufficient, the purpose of the funds and the repayment plan are not clear, etc. These are pointed out not only by lenders but by borrowers as well.

In cases where the borrower can present a clear repayment plan, the lending rate can be reduced by 2 or 3 percent by reducing the spread of the government.

2) Small-scale enterprises (total assets of not more than 600 million rupiah)

For small-scale enterprises, the largest problem was additional conditions imposed by financial institutions. They impose additional conditions mainly because of the nature of the borrowers, who, for instance, can rarely prepare financial statements.

With the policy package of January 29, 1990, special credit schemes for small enterprises were abolished and only a guideline stating that over 20 percent of each bank's credit line should be provided for KUK (loans to small business) remains. Thus, improvement of the management system of small business increased in importance.

Under SMIEP, the assistance program for small business, technical assistance is provided through RPMUs (Regional Project Management Unit) which have been established in 13 branches of Bank Indonesia and financial assistance is provided by KIK/KMKP.

Each RPMU has three consultants (banking, industry, agriculture) and provides assistance to small enterprises, training to bank officers and research on local industries. Formerly, there was also a marketing consultant who made many reports on local industries and this was very useful in analyzing customers and credit. However, for financial reasons, this system has been abolished. The reports were made by the team of consultants at each RPMU and bank loan officers. The system produced useful reports and was also a good chance for training young bank loan officers.

Strengthening the function of RPMUs by establishing them in all provinces and enriching their budget will be one of the solutions to problems for small enterprises.

Because of the policy package of January 29, 1990, the importance of training loan officers is increasing. (The automatic insurance by P.T.ASKRINDO was abolished but the number of branch offices which can deal with small loans increased by allowing KUK to be handled through secondary banks.) However, most of the banks do not have in-house training programs for loan officers. Therefore, in this aspect also, the reinforcement of RPMU is important.

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