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SURVEY OF RECENT DEVELOPMENTS

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SUMMARY

Monthly inflation fell to around zero in October 1998, while the rupiah strengthened considerably. Some recovery of share prices and significant declines in interest rates have given cause for optimism, and early estimates of increases in both poverty and unemployment now appear unjustifiably pessimistic. Although non-oil exports have been growing reasonably well, the plunge in imports reflects the severely depressed economy, and there is little to suggest that recovery is imminent. The private sector is waiting until the political outlook becomes clearer, and continuing outbreaks of violence have further eroded its confidence. The new bankruptcy laws are not working effectively and so a *de facto* debt moratorium prevails. Consequently, banks are unwilling to provide the new finance needed if firms are to re-employ workers and boost output.

Neither the foreign debt restructuring agency, INDRA, nor the Jakarta Initiative has contributed significantly to resolving the debt bottleneck. The bank rehabilitation program appears mired in confusion, and there is opposition to it from both bank owners and the parliament. Privatisation is moving far more slowly than planned and, although the budget for 1999/2000 has been reasonably well received, it appears to be contractionary. The emergence of populist economic policies can be seen in the MPR Decree on Economic Democracy, the proliferation of cheap credit programs, proposals for transferring the assets of failed banks to cooperatives and small and medium enterprises, and the introduction of an anti-monopoly law.

POLITICAL AND SOCIAL DEVELOPMENTS

After the optimism about '*reformasi*' and democratisation that prevailed in the early months of the Habibie government, the political atmosphere became tense towards the end of 1998. There were violent clashes between the military and student demonstrators during the November meeting of the MPR (People's Consultative Assembly), summoned to decide on new 'broad guidelines of state policy'. Political uncertainty and party rivalry are bound to continue until the national elections in early June 1999 and a further MPR meeting to elect a President in November. It is probably too much to hope that a strong and capable government with decisive economic policies will emerge before then—or even afterwards, perhaps. On the other hand, a surprising feature of the last four months is that economic conditions have not worsened appreciably, despite the political and social turmoil, with economic policy proceeding more or less in accordance with the third IMF plan negotiated in mid 1998 (Johnson 1998: 32).

President Habibie is not in a strong position at the head of an uninspiring and essentially transitional government, although both have been performing better than critics expected. Despite rumours of power struggles involving Habibie, Armed Forces (ABRI) Chief General Wiranto, Minister of Cooperatives and Small Enterprises Adi Sasono, and Coordinating Minister for Economics Ginandjar Kartasasmita, it is fairly clear that none of them is in a position to move against the others before the elections. What may happen afterwards is quite unpredictable.

Sporadic rioting and violence occurred throughout Indonesia during the period covered in this Survey; much of it involved Muslim–Christian clashes, often spilling over into attacks on Indonesian Chinese property and shop-houses. This culminated most alarmingly in major clashes on January 22, just after Idhul Fitri, in Ambon (a predominantly Christian region with a substantial minority of recent Buginese newcomers, who are strongly Muslim). Allegations were made that pro-Soeharto elements had instigated the outbreaks, though little convincing evidence has yet emerged. The declining moral authority and self-confidence of the police and military since the November riots, and following revelations about armed forces behaviour in Aceh over many years, led to mounting public concern about crime and violence in the main cities and some rural areas. There have been frequent reports of acts of piracy against trucks carrying consumer goods on the main highways, often accompanied by savage attacks on the drivers. All this gave rise to a lot of talk in early 1999 about social disintegration, intercommunal conflict and even 'social revolution', in Gus Dur's highly-coloured phrase.[1] Complaints became increasingly widespread about government weakness in the face of social unrest, and about the lack of strong leaders in any part of the Indonesian elite. Since the newly emerging political parties will soon be competing vigorously to build up mass support across the nation in the lead-up to the elections—and sometimes clashing, despite official orders to prevent this—social tensions seem likely to persist until a strong post-election coalition government can be formed.

The special MPR session held in November had the same membership as the previous meeting in March, consisting largely of Golkar members elected in 1997 and Soeharto-era appointees; it was notable mainly for the vehement protests by student activists challenging the body's legitimacy and commitment to reform. Although the decrees adopted there embodied some concessions to the demands of the reformers, the clashes that occurred between the students and the military outside the Assembly stirred up fears of mass rioting if the situation slid out of control. Fortunately, this happened only to a small extent in comparison with the mid May outburst (Johnson 1998: 8–9), but 14 students and civilians were killed during clashes with the armed forces in a major incident at the Semanggi bridge near the parliament (DPR) building on 13 November.

Among the decrees passed (unanimously, as usual) by the MPR, by far the most important was a stipulation that the President and Vice-President may in future hold office for no more than two terms of five years. Another laid down firmly that a general election must be held by May or June 1999. Several rather general decrees were passed calling for good government and the avoidance of KKN (corruption, collusion and nepotism); for the government to investigate those suspected of corruption, including the Soeharto family; for officials to be required henceforth to declare their wealth before and after their appointments; and for the National Commission on Human Rights to be strengthened. Two of the more important decrees dealt with regional autonomy and 'economic democracy', and are discussed below. None of these was sufficient to satisfy the more militant student activists who were demanding immediate action to exclude the military altogether from the MPR, but they brought some temporary calm.

With elections approaching, an intense debate developed during December–January in the DPR and among the political parties on the voting arrangements to be enacted into law. The issues at stake were:

- whether ABRI should continue to appoint a number of representatives to the DPR (in return for its members not having voting rights in general elections);
- whether civil servants should still be barred from joining political parties and required to support Golkar (the doctrine of '*monoloyalitas*' established under the Soeharto regime);
- the nature of the new multi-party system; and

- the choice to be made between a 'district system' of smaller single-member constituencies and adherence to the proportional representation (PR) system with large electorates, maintained ever since the 1950s.

The latter issue is of considerable significance to the long-term development of the party system in Indonesia, although it was the first two issues that aroused the greatest public controversy during the parliamentary debate. ABRI resisted demands that its representation be reduced from 75 to zero, finally accepting a compromise at 38. Golkar gave way on the issue of *monoloyalitas* for civil servants, but won detailed concessions on some minor matters that will favour its traditional supporters. The multi-party system to be created requires that parties must be represented in at least nine provinces, and in half of all *kabupaten* in those provinces, in order to be recognised and permitted to contest the election. However, since it is intended that only 20 of the 200-odd parties that have sprung up since last May will be allowed to participate, a semi-independent body will be set up to screen them. (The former practice of screening individual candidates and excluding any the government dislikes will not be repeated.) The outcome looks more like a victory for the status quo forces than for the advocates of far-reaching reform.

The issue of whether to adopt a 'district' system of single-member constituencies, using the *kabupaten* as the electoral unit, was of potentially great historic importance. It had been under consideration since mid year by a government-created think-tank called the 'Tim 7 Juni', consisting of 10 of the country's ablest political scientists headed by Dr Riyas Rasyid, a senior official of the Ministry of the Interior. They seemed at first to be leaning towards the district system or, alternatively, some form of mixed system, as in Germany. But Golkar and the major parties were reluctant to abandon the PR system based on the provinces (the three largest of them with nearly 20 million voters each), and when the bill was finally adopted after some intense last-minute bargaining, this system was retained. PR systems with large electorates tend to produce strong party machines and weak elected members (especially when, as under the New Order, the state authorities often apply pressure on the party to discipline or expel outspoken members of parliament). This debate therefore represented an opportunity to reform the party system fundamentally. A single-member or district system would make members much more directly accountable to voters in smaller electoral units, hence less subservient to the party machines. The opportunity to achieve such a change was narrowly missed.

The outcome of the June election is unpredictable, but a coalition of several parties seems inevitable as the basis for the next government. Five or six of the main parties are expected to win 10–30% of the overall vote and seats, with Golkar, PDI (the Indonesian Democracy Party) and possibly PPP (the essentially Muslim United Development Party) likely to be the largest. The political situation will be very fluid until the election (and after)—although perhaps more stable than recently because so much energy will be directed at it.

ECONOMIC DEVELOPMENTS

Against the volatile socio-political backdrop some short-term economic indicators have been surprisingly stable and positive. The rupiah has strengthened and the value of shares listed on the Jakarta Stock Exchange has risen, despite the political unrest. The December quarter growth estimate of –0.3% was better than expected (although the figure is preliminary and subject to revision). This puts the change in real GDP for calendar 1998 at –13.7%.

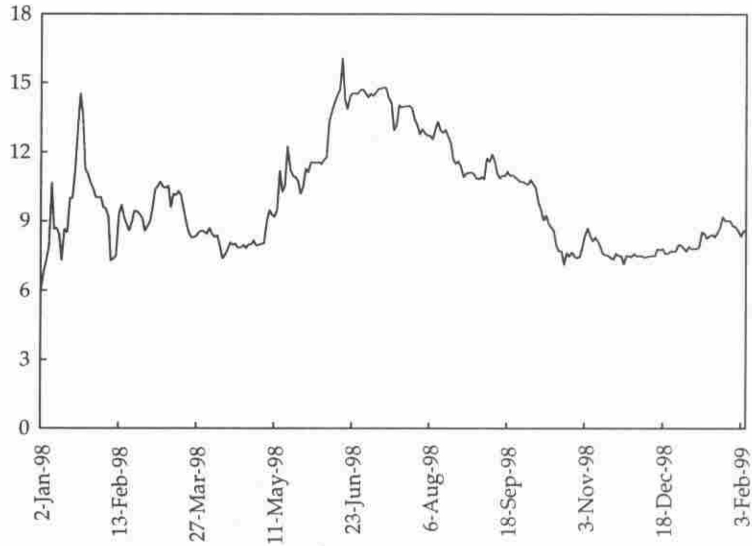
The assumptions underlying the 1999/2000 draft budget provide an indication of progress on some fronts over the past 12 months. The budget assumes an exchange rate of Rp 7,500/$ (compared with Rp 10,600/$ in the 1998/99 budget); an inflation rate of 17% (where 66% was assumed for 1998/99); and GDP growth of 0% (as against the 1998/99 budget projection of –12%).

The Exchange Rate

The rupiah strengthened against the dollar during October and remained relatively stable to the end of December (figure 1). A slight weakening in January was attributed to uncertainty about prospects for the Chinese yuan and fallout from the devaluation and subsequent floating of the Brazilian real. It may also have reflected concern that parliament would be unable to agree on electoral laws, thus delaying the election. The rupiah steadied and strengthened slightly after the electoral reform legislation was passed.

The stability of the currency during November and December was surprising in view of the political tensions around the country. While it had declined to an all-time low of around Rp 16,000/$ during the May rioting, the exchange rate did not waver in the face of the 13 November protests. Nor did it respond to the subsequent demonstrations and racial riots, but trading was very thin, and the foreign exchange market was buoyed to some extent by incoming IMF funds. The budget's exchange rate prediction had generally been accepted as realistic, but now looks a little optimistic. Bank Indonesia admitted to intervening in late January to try to hold the rupiah around the Rp 8,000/$ mark, and interest rates were increased slightly with this aim. The rupiah may weaken later in

FIGURE 1 *Exchange Rate, January 1998 – February 1999 (Rp '000/$)*



Source: Pacific Exchange Rate Services.

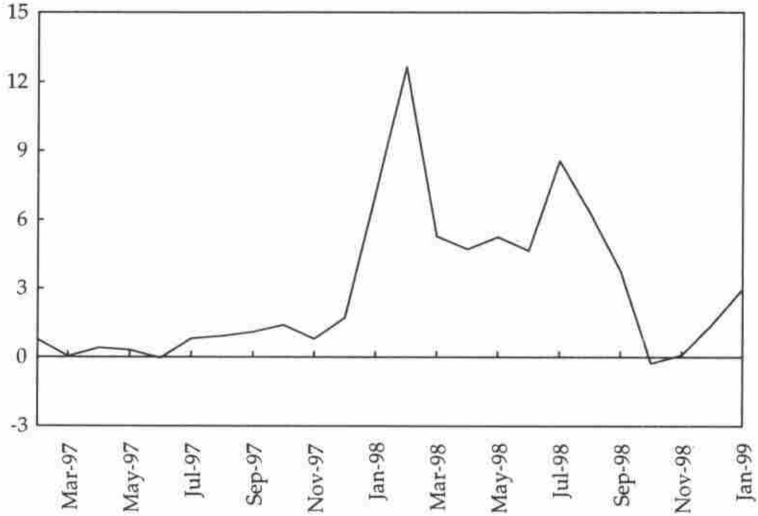
the year when IMF disbursements decrease and foreign debt repayments resume.

In contrast with Malaysia, speculation about moving to a fixed exchange rate or currency board has died down in Indonesia, and the floating regime is generally accepted. However, Amien Rais, leader of the opposition party PAN (Partai Amanat Nasional, the National Mandate Party), has stated that he does not oppose a currency board system.

The Stock Exchange

The Jakarta Stock Exchange (JSX) Composite Index rose from 276 at the end of September 1998 to steady at around 400 in mid February. Unlike the rupiah, it did not weaken during the parliamentary debate on electoral reform, although it became more volatile than earlier in the year. The volume of trade has fluctuated markedly, and is much lower on average than in early 1998. Traders report that there is little in the way of overseas interest in the market.[2]

FIGURE 2 *Monthly Changes in the CPI, February 1997 – January 1999*
(%)



Source: BI, *Weekly Report*.

Inflation and Monetary Policy

Figures released in the IMF's 13 November Supplementary Memorandum of Economic and Financial Policies show that in contrast with the period immediately following the onset of the crisis, Bank Indonesia (BI) met its monetary targets from mid 1998 through to September 1998. In the absence of IMF confirmation it is difficult to say whether the November and December targets were met, because BI's published figures are not easily reconcilable with those the IMF uses for targeting.[3] The IMF target was for a 4.4% increase in base money between September and November; since BI figures show a rise of 9.7% (BI, *Indonesian Financial Statistics*, December 1998), it appears the November target may have been missed. This could help explain the return to significantly positive inflation in December and January after –0.27% was recorded in October and 0.08% in November (figure 2). December base money contracted to only 3.8% above its September level, however, suggesting that monetary policy may be back on track.

The annual increase in the consumer price index for 1998 was 78%. The failure to meet the targets earlier in 1998 and the lack of long-term targeting had caused uncertainty about the direction of monetary policy, and are consistent with this inflation outcome (Fane 1998). The achievement of recent targets generated greater confidence in monetary policy, and inflation fell sharply. The 13 November Supplementary Memorandum did not set monetary targets beyond February 1999, however.

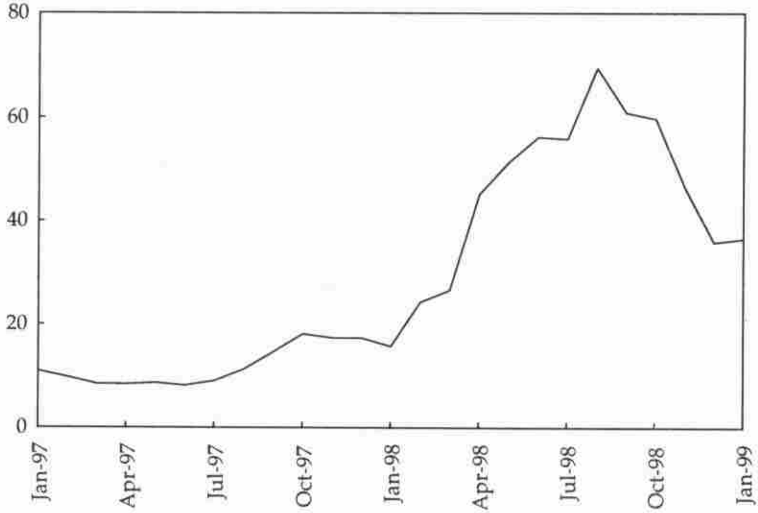
The introduction of a new central bank law, which, among other things, would ensure Bank Indonesia's autonomy, was initially scheduled for 30 September 1998 as part of the IMF package of reforms, but was still being debated by parliament in early February. The law in its current form may increase BI's independence, even though its board of directors (the governor and five to seven deputy governors) is still to be appointed by the President, because it stipulates that the President cannot dismiss a member of the board unless he or she resigns or is found guilty of a criminal act. At the time of writing parliament was demanding a greater role in deciding the central bank's key management team: specifically, members of Golkar were proposing that while the President could appoint the board, the candidates should be selected by the parliament. A further aim of the bill is to transfer BI's supervisory role to another agency. All factions of parliament reject this proposition, on the grounds that BI has the required expertise and that introducing a new supervisory authority would spread that expertise too thinly.

Interest Rates

Interest rates had been set high to support the rupiah. The recent decline in inflation and the strengthening and stabilisation of the rupiah allowed BI to reduce nominal interest rates (figure 3) and so lessen the burden on the corporate sector. In response to the late January weakening of the rupiah, BI increased interest rates slightly, but they are not expected to rise further. BI director Miranda Goeltom suggested that interest rates could fall below 30% before the end of March (*JP*, 25/1/99).

The most important issue is not the absolute level of interest rates but the relationship between bank borrowing and lending rates. The difference between lending and deposit rates continues to be negative and is the greatest problem confronting the banking sector, after recapitalisation. Lending is currently not profitable, and without bank lending it is impossible to reinvigorate the private corporate sector. Negative spreads also hinder the bank recapitalisation program because over time they will dissipate any capital injected into the banking sector.

FIGURE 3 *Interest Rates on One-Month SBIs,*[a] *January 1997 – January 1999 (% per annum)*



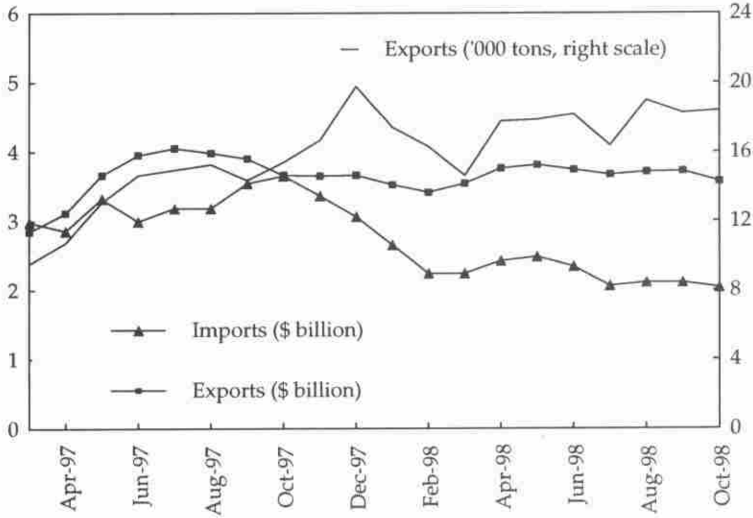
[a]Bank Indonesia Certificates.

Source: BI, *Weekly Report*.

Exports and Imports

Export volumes exhibited strong growth throughout the Survey period. In the first 11 months of 1998, exports from the largest seaport, Tanjung Priok, are reported to have reached a 20-year high, and to have increased by 66% over the same period in 1997 (*Asia Pulse*, 26/1/99). A decline of 5.7% in the value of total exports between January and September 1997 and the same period in 1998 was attributed to a steep fall in the oil price, which is forecast to remain low for 1999.[4] Exports of agricultural products rose 21% over the same period. The dollar value of imports continued to decline, reflecting the depth of the crisis. The 1998 second quarter balance of payments figures show a merchandise trade surplus of $5,077 million, slightly higher than the first quarter figure of $4,971 million. Figure 4 plots three-month moving averages for the value and volume of non-oil exports and the value of non-oil imports from January 1997 to October 1998. Since trade figures beyond this date are not yet available, the graph does not reflect the impact of the subsequent strengthening of the rupiah.

FIGURE 4 *Non-Oil Exports and Imports, March 1997 – October 1998*



Source: BI, *Indonesian Financial Statistics*.

THE SOCIAL IMPACT OF THE CRISIS

Poverty

Relatively little research has been done on the human dimensions of the crisis because of a lack of reliable data. Until recently evidence has been largely anecdotal. Newspapers report large numbers of children on the streets of Jakarta, falls in school enrolments and tremendous increases in poverty. Formal estimates of change in the level of poverty have been made by simulating the crisis using pre-crisis data, with widely disparate results. In 1996, 11% of the Indonesian population were living in poverty; estimates for 1998 range from 28.6 million (14% of the population) to 100 million people (49%).[5] New data and a review of the assumptions underlying the various predictions suggest that poverty is more likely to be in the range of 14–20% than 40–60%. This is not to understate the impact the crisis has had on many Indonesians' lives, however. Head-count poverty rates are not sensitive to the degree of poverty, and so do not tell us whether those who were already poor are now poorer. And many people above the poverty line are also encountering difficult times. The prospects for school and university leavers, for example, are vastly bleaker than two years ago, and this may affect their labour market opportunities for years to come.

Estimates of Poverty from Pre-Crisis Data. One of the more pessimistic poverty estimates is that of the ILO, which predicted that 100 million Indonesians (49% of the population—39% in urban and 53% in rural areas) would be living in poverty by the end of 1998, and that this would increase to 140 million in 1999 (66% of the population—57% in urban and 72% in rural areas). These calculations assumed that nominal household income would not increase and that inflation in 1998 would lead to an 80% rise in prices of basic staples, with a further 25% increase in 1999.[6] We now know that although the inflation rate was close to what was assumed, the assumption that nominal incomes would not rise did not hold. Central Statistics Agency (BPS) figures show that in the first nine months of 1998 nominal agricultural wages increased 26%, 17% and 30% in East, Central and West Java respectively. This trend also holds in the Outer Islands: for example, nominal wage growth was 68% in North Sulawesi and 38% in West Nusa Tenggara over the same period.

BPS produced a similar poverty estimate by a different route, predicting in mid 1998 that poverty would reach 39.9% of the population (Department of Information 1998). The BPS calculation rested on the assumption that those at the lower end of the income distribution would be hardest hit by the crisis. These individuals had experienced higher than average income growth between 1990 and 1996 and so, it was reasoned, would experience a faster decline during a contraction. More recent data suggest the opposite has happened—those with above mean income have experienced the sharpest income declines. BPS also incorrectly assumed a faster inflation rate in rural than in urban areas.

The ILO and BPS predictions for 1998 put poverty at about the same level as in the late 1960s. Yet the most recent BPS estimate of real GDP change in 1998 (–13.7%) suggests income per capita is still higher than in 1993 (Garcia Garcia 1998). It is difficult to reconcile this with the ILO and BPS results unless one assumes a massive shift in the distribution of income away from the poor, yet the evidence suggests that the change has been in the opposite direction.

The World Bank (1998) used BPS sectoral growth rates to estimate poverty in 1998/99. It categorised households in the 1996 household survey (Susenas) according to the sector from which they derived most of their income, and applied the sectoral growth rates to household incomes. An economic contraction of 12%, as was predicted in the 1998/99 budget, resulted in an aggregate poverty rate of 14% (actual poverty in 1996 was 11%). This was forecast to increase to 14.5% with zero growth in 1999/2000. Urban poverty was predicted to be almost 9% and rural poverty about 18%.

The ILO and BPS poverty estimates used assumptions that were later found to bias the predictions upwards, whereas that of the World Bank probably understates poverty to the extent that its assumed contraction of 12% in 1998 was below the actual figure of 13.7%. Comparisons with previous years' poverty rates suggest that the World Bank figures are likely to be much closer to the truth than those of the ILO and BPS.

Data from the Crisis Period. Data collected during the crisis period remove the need to make arbitrary assumptions, but are time-consuming to collect and process. The results of crisis period micro-level surveys are only now beginning to appear.

Sumarto, Wetterberg and Pritchett (1998) use *kecamatan*-level survey data collected by BPS to assess regional differences in the impact of the crisis on poverty. *Kecamatan* representatives were asked to compare economic conditions in their region with those in the same month in 1997. The study was thus intended not to produce absolute poverty rates, but to offer information on changes in poverty over time. Information was obtained on 'coping mechanisms' (for example, selling of assets), food security, employment, education and health. *Kecamatan* indices were then constructed to reflect this information, and maps produced to illustrate geographic variations. The study found that:

- urban areas have been harder hit by the crisis than rural areas;
- both urban and rural areas on Java have been hard hit relative to other areas; and
- the magnitude of crisis impacts is not correlated with pre-crisis levels of poverty.

The third result is interpreted as implying 'little connection between initial poverty and the magnitude of the shock ... [Thus] many of the areas hardest hit were the relatively well-off areas that had booming modern economy sectors pre-crisis'. Other hard-hit regions were urban areas in East Kalimantan, West Kalimantan, North Sumatra, Aceh, Lampung, Nusa Tenggara Barat, Nusa Tenggara Timur and Timor Timur. Parts of the Outer Islands reported positive effects from the crisis, largely through increased export earnings due to exchange rate depreciation.

The lack of correlation between pre-crisis poverty and the effects of the crisis presents a difficulty for policy makers. Should aid be targeted to redress the impact of the crisis or should it aim solely at poverty alleviation? Because the hardest hit areas were not in all cases the poorest before the crisis, pre-crisis data are not necessarily useful for targeting purposes. In other words, areas not classified as 'poor' before the crisis may now be among the poorest, and so would not be detected using old data.

A special round of the Indonesian Family Life Survey (IFLS2+) provides household level data on changes in living conditions since the onset of the crisis.[7] IFLS2+ re-surveyed a sub-sample of households that had been interviewed in late 1993 and again in August–December 1997 as part of the regular IFLS project. The re-survey in August–November 1998 allows comparison of the same households before and after the crisis. A report on the preliminary results from IFLS2+ (Beegle, Frankenburg and Thomas 1998) provides findings that are consistent with those of the *kecamatan* studies. The results are indicative only, because of the small sample size. The sample is also not completely random, since households that had moved had not been tracked down when the report was written. It thus omits people likely to have been most affected by the crisis. The results show that neither mean nor median real per capita expenditure had declined in rural areas. In urban areas mean real per capita household expenditures had fallen by around 40%. Median per capita expenditure had declined by much less than the mean, and expenditure inequality had fallen sharply. Taken together, these results suggest that individuals at the upper end of the distribution have experienced the largest proportional declines in expenditure.[8]

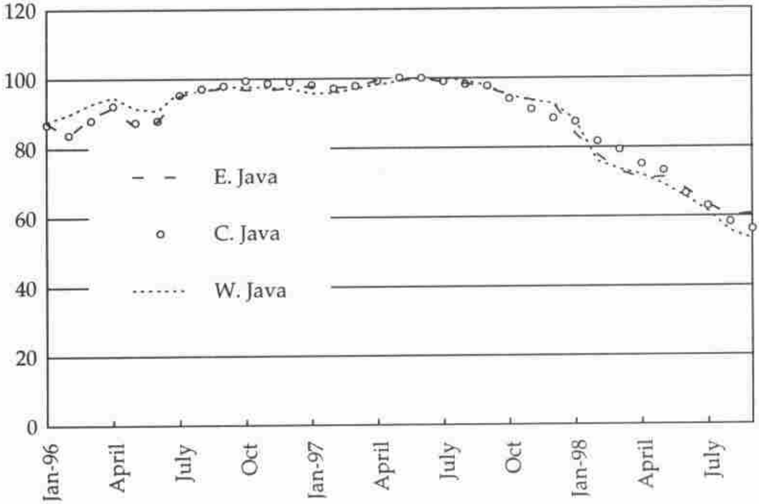
Unemployment and Wages

The 1998 unemployment rate, as calculated from the BPS Labour Force Survey (Sakernas) conducted in August, is less than 6%, in contrast to previous 'ball-park' estimates of around 15% (e.g. ILO 1998). The lower Sakernas figure reflects the fact that the informal labour market was much better able to absorb those who lost jobs in the formal sector than the ILO (and others) had assumed. It is thus more important to focus on changes in the real incomes of the poor than on unemployment rates, which are of dubious accuracy and difficult to interpret. Real wage data are not available for all sectors of the economy, least of all the informal sector, where the vast majority of individuals are self-employed. Figures 5a and 5b give an indication of real wage movement, showing the decline in real agricultural sector wages on Java and in selected Outer Island provinces. Although nominal wages have risen, real wages have fallen by approximately 40% since the crisis hit in mid 1997. This suggests that agriculture, one of the few sectors to experience positive growth in 1998 (0.2%), has probably absorbed some of the labour from the non-agricultural sector.

Schooling

In response to concern that dropout rates were escalating, the government introduced scholarship programs for poor secondary school students in July 1998, together with block grants to primary and secondary schools in poor areas. Lowered educational attainment is one avenue through

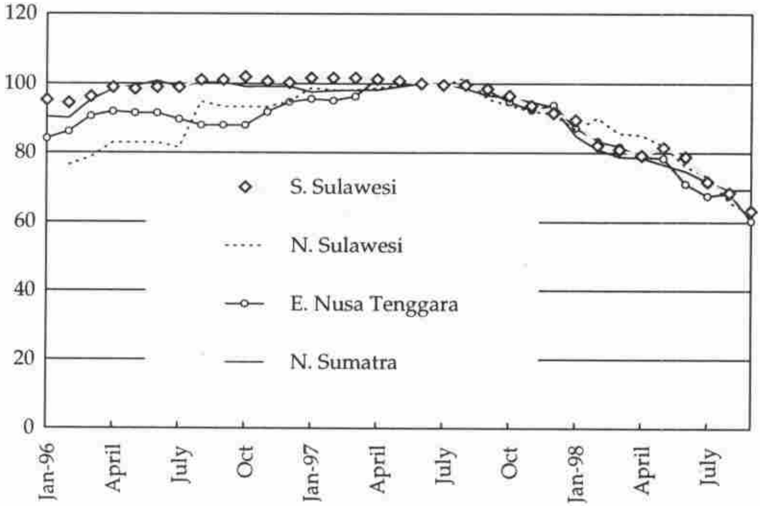
FIGURE 5a *Real Wage Trends in Agriculture in Java, 1996–98 (Base June 1997 = 100)*



Source: BPS, *Indikator Ekonomi*.

which the crisis could have a serious long-term impact on Indonesia's growth prospects. There are no reliable data on dropout rates just before the program was introduced, but estimates based on pre-crisis data suggest that the effect could be severe. Data from 1986/87 show that junior secondary enrolment rates fell from 62% to 52% as a result of income declines at that time, which were minor compared to the current contraction (World Bank 1998). BPS estimates that enrolments could have fallen by 14% in 1998/99. IFLS2+ data from just after the introduction of the block grant program show that primary and junior secondary (SD and SMP) enrolments had declined by about 5.4 percentage points, from 93% prior to the crisis, and high school (SMA) enrolments by almost 10 percentage points. Since the pre-crisis SMA enrolment rate was 35%, the latter figure corresponds to a fall in high school enrolments of almost one-third! It is unclear as yet how successful the block grants have been in stemming the decline in enrolment rates. Stories abound of 'unofficial' school fees being imposed in place of the official fees. Dropout rates are higher among poorer families, but do not seem to vary with the gender of the child.

FIGURE 5b *Real Wage Trends in Agriculture in Selected Outer Provinces, 1996–98 (Base June 1997 = 100)*



Source: As for figure 5a.

Coping Mechanisms

Evidence on the strategies people are using to cope with the crisis is still largely anecdotal. The *kecamatan* survey shows that people are selling assets and cutting back their participation in *arisan* (rotating savings and credit associations). There have been reports of large-scale migration back to rural areas and a return to agriculture; this is consistent with agriculture being among the few sectors experiencing positive growth. One possible reason for the weaker impact of the crisis in rural areas is that informal coping mechanisms are still intact in the villages—for example, the sharing of resources across households. Similarly, small and medium enterprises are reported to be weathering the crisis better than larger companies, because they are less reliant on formal markets, and less reliant on now far more costly borrowed funds.

Food Security

Although the main rice harvest was the worst in six years, Indonesia experienced no real rice shortage in 1998; the shortfall between domestic demand and supply was met by increased imports of rice. Rice production was low because of drought and dramatic rises in the cost of fertiliser and pesticides. The rice harvest is expected to return to normal in 1999 thanks to good wet-season rains.

ECONOMIC POLICY PROGRESS

IMF Update

The government's economic agenda is still largely driven by the requirements of its agreements with the IMF, consisting of four main Memoranda of Economic and Financial Policies (table 1). The latest (IMF IV) was signed on 29 July 1998 and has been followed by three supplementary memoranda.[9] The IMF was satisfied with Indonesia's performance at the time of writing, and the disbursement of funds has run according to the schedule set out in IMF IV. Table 2 shows the schedule of disbursements under the Extended Fund Facility, which replaces the three-year standby credit of 5 November 1997. The IMF has also committed itself to providing extra funds for the June elections and to strengthening Indonesia's foreign exchange reserves.

IMF IV is broadly consistent with IMF III (Johnson 1998: 32). It establishes performance criteria and monetary, fiscal and external targets to end March 1999, and strengthens the bank and corporate restructuring programs by providing more detailed frameworks. It also addresses the need to reduce the budget deficit in the next three years by better targeting subsidies to the needy, improving revenue performance, and streamlining public expenditure management.

TABLE 1 *IMF Letters of Intent*

Memoranda of Economic and Financial Policies	
IMF I	5 November 1997
IMF II	15 January 1998
IMF III	10 April 1998
IMF IV	29 July 1998
Supplementary Memoranda to IMF IV	11 September 1998
	19 October 1998
	13 November 1998

TABLE 2 *Schedule of IMF Disbursements*

	Amount Disbursed or Planned (million SDRs)[a]
Under Standby Credit	
5 November 1997 – July 1998	3,700.0
Under Extended Fund Facility (EFF)	
25 August 1998	733.8
25 September 1998	684.3
25 October 1998	684.3
25 November 1998	684.3
15 February 1999[b]	684.3
15 May 1999	171.2
15 August 1999	171.2
15 November 1999	171.2
15 February 2000	171.2
15 May 2000	171.2
15 August 2000	171.2
15 October 2000	171.2
EFF Total	**4,669.1**
TOTAL	8,369.4

[a]Special Drawing Rights; as of 20 August 1998, one SDR = $1.32542.
[b]Deferred until mid March.

Source: IMF Press Release, 25 August 1998.

The supplementary memoranda provide further details and strengthen the restructuring programs. The privatisation timetable has been extended owing to 'weak market conditions'. There have also been delays in social safety net expenditures. The phasing out of food and fuel subsidies is discussed and timeframes are given.

Bank Recapitalisation and IBRA

The bank recapitalisation program has been delayed, not least because of difficulties in completing audits of the banks in question. IMF IV expected this process to be over by the end of August 1998, but by mid November only 27 of the 54 banks under the control of IBRA (the

Indonesian Bank Restructuring Agency) had been audited. There is considerable opposition to the program. On the one hand, the banks' owners fear loss of control. On the other, there are concerns that recapitalisation may transfer wealth from the general public to the wealthy elite who are the principal shareholders of the private banks. The current schedule has the program being completed by March 1999 (three months after the previously announced deadline), but at the time of writing there was little hope of the revised target being met.

The restructuring program rests with IBRA, which is politically weak in relation to its difficult task; its slow progress is a cause for concern. IBRA's lack of authority was evident previously in its dealings with Soeharto crony Bob Hasan: he repeatedly postponed meeting with the Agency, and IBRA later failed to act against him when he breached the deadline for repayment of his bank's debt to BI. In a positive move in November 1998, President Habibie agreed to extend IBRA's life by four years, and handed responsibility for ratifying the agency's decisions to the respected Finance Minister, Bambang Subianto. Habibie also committed the government to allowing IBRA a free hand to seize and liquidate banks' assets, and to prosecute owners who failed to ensure repayment of their banks' debts to the government, but commentators remain sceptical.

Audits of most of the larger banks have been completed, and the latter have been classified into one of three categories according to their capital adequacy ratio (CAR; i.e. the ratio of equity capital to risk-weighted assets):

- Category A: CAR over 4%;
- Category B: CAR between –25% and 4%;
- Category C: CAR below –25%.

Category A banks are not included in the recapitalisation program, since a 4% CAR is regarded by the government as acceptable for the time being—although this is only half the internationally accepted standard, and one-third of the level Indonesia had set as a target before the crisis. Category B banks will be eligible to participate in the program, but Category C banks face the threat of being excluded and required to close or merge with other banks if they are unable to raise their CARs above –25%. Surviving banks will be required to submit plans showing how they intend to raise their CARs to 8% in three years' time (*Financial Times*, 12/12/98). It is not clear how many banks will survive the restructuring program. President Habibie has said that he would like to see about 50, but the Governor of Bank Indonesia stated subsequently that the government had no target for the number of banks (*Wall Street Journal Interactive Edition*, 10/1/99). The Governor also signalled that the government would exercise its discretion as to whether individual Category C banks would actually be closed.

Of the 150 banks that had been audited by early 1999, 40 fell in Category C, 56 in Category B and 54 in Category A (*Indonesian Business*, January 1999). Despite all but one of the state banks falling into Category C, all are to be recapitalised. Four of them (Bank Ekspor Impor Indonesia, Bank Bumi Daya, Bank Dagang Negara and Bapindo) are being merged to form Bank Mandiri, a process expected to be completed by May or June 1999 (*Kompas Online*, 4/1/99). No explanation has been given for the different treatment of state and private banks.

The government will provide up to 80% of the funds necessary for recapitalising Category B banks; the remaining 20% are to be supplied by the banks' current owners. Rather than paying for newly issued shares with cash, which would have an undesirable expansionary impact on the money supply, the government will inject its equity contribution in the form of government bonds; these will take the place of non-revenue-generating bad loans, providing a risk-free source of earnings for the banks. Although this approach has been under discussion for some time, there is still considerable confusion about the interest rate to be paid on the bonds. Most recently, the Coordinating Minister for Economics, Ginandjar Kartasasmita, has stated that they may be indexed to inflation, paying a real interest rate of 3% p.a., but that the government was still also considering the possibility of using more familiar nominal, market-determined, fixed or floating bond interest rates (*Bisnis Indonesia*, 8/1/99). There is much to be said for inflation indexing of loans and other interest bearing securities in Indonesia's present circumstances, given recent wild fluctuations in the inflation rate. If the government used this approach it might act as a catalyst to encourage the banks to consider using it themselves in their deposit-taking and lending activities.[10]

Interest payments on the bonds are expected to amount to Rp 34 trillion in the 1999/2000 fiscal year, of which Rp 18 trillion will be a charge on the budget, and Rp 16 trillion is expected to be covered by off-budget sales of assets of troubled banks (*Bisnis Indonesia*, 8/1/99). At 20.5% interest (3% real adjusted for 17% inflation), this estimate implies a total bond issue of Rp 166 trillion. If the bonds are inflation indexed, the actual interest payments will be far smaller than Rp 34 trillion, at just 3% of Rp 166 trillion, or Rp 5 trillion. The remainder will take the form of an increase in the nominal value of bonds outstanding. A benefit of combining indexation with inflation-corrected accounting is that it would show that the true budget deficit is much smaller than it appears to be when no account is taken of inflation.

The government appears to lack a clear and coherent program for bank recapitalisation. Finance Minister Bambang Subianto had previously announced that the majority state-owned Bank BNI was likely to be among the first to be recapitalised 'because it was already publicly listed'. The wholly state-owned Bank Rakyat Indonesia was also said to be a priority because of its role in providing services to small businesses and farmers (*Antara*, 15/12/98). Neither bank has yet been recapitalised. Trade and Industry Minister Rahardi Ramelan is reported to have said that Bank PDFCI was to be restructured to become a trade-financing agency, but this was contradicted by the Finance Minister (*Wall Street Journal Interactive Edition*, 4/2/99). The planned acquisition by Bank BNI of the state-owned savings bank, Bank Tabungan Negara, was cancelled at the beginning of February (*Wall Street Journal Interactive Edition*, 4/2/99).

In late January 1999, it was announced that the first banks to be recapitalised would be Bank Lippo, Bank Sembada Artanugroho, and 10 state-owned provincial banks.[11] This would involve government outlays of Rp 4.3 trillion, of which Bank Lippo was to receive the lion's share of Rp 3.75 trillion (*Reuters*, 29/1/99). The choice of Lippo Bank—controlled by the ethnic Chinese Riady family, which is said to have close ties to President Habibie—and the high proportion of the funds going to it generated a strong negative reaction because it appeared to be yet another case of Soeharto-style cronyism.

Whether this reaction was justified is unclear, but the government has been justifiably criticised for its failure to supply adequate information about the transaction (*JP*, 5/2/99). In the absence of details as to the outside auditor's estimate of the value of equity and the price at which the new shares were issued, it is impossible to know whether there was an element of subsidy of the bank's owners by the government. Nevertheless this seems highly likely: it is hard to imagine why the owners would sell shares in the bank to the government unless the price received was above what they thought to be their true value. Banks' owners have an enormous informational advantage over the government in estimating the true value of assets and equity—not least because many bank loans are to companies that are part of the same conglomerate.

An alternative approach to recapitalisation that would address concern about its being a means of subsidising the rich would be for the government to take a much more hard-nosed, market-driven approach than it has until now. Banks that cannot—or will not—boost their CARs to 4% could be taken over by the government and offered for sale to foreign or domestic buyers—including the current owners—willing to bring equity up to this level. Given that equity is often likely to be negative, bidders would have to be given the option of specifying the minimum value of bonds the government would need to include in the sale package: that is, it should be possible for the sale price to be negative. The advantages of such an approach are: that it would rely on the market rather than an audit firm to put a value on the banks' assets; that it could avoid the disruption and waste of investment in physical and human capital implicit in closing banks down; and that it would prevent the government from becoming even more heavily involved as a bank proprietor (at a time when it is planning to divest ownership of the existing state banks). The original owners could be expected to offer a price at least as high as that which they would offer in the direct negotiations that now form the basis of the government's approach, and other bidders may offer something even better.

According to the government, the provincial banks were included in the first recapitalisation group because of their potential for accelerating economic development in the regions. An alternative explanation is that the element of opposition to recapitalisation that arises in the private sector banks, because of their owners' desire to avoid loss of control, was absent in these cases, as it was with the four national state banks that are being merged. The fact that only two private banks were included, one of them with close links to the President and the other so small as to be of little importance to the recapitalisation program overall, serves to reinforce the impression that it will be a long time before the program is completed.

In a surprising move recently, Bank Indonesia announced an easing of the limit on bank lending to individuals or groups (other than those related to the bank) from 20% to 30% of bank capital. Concentrated lending by banks is regarded as a major source of fragility in the banking system and a significant contributor to the collapse that is now having to be addressed through the recapitalisation program. BI was criticised before the crisis for its failure to enforce the previous limit, but now seems to want to forestall such criticism in the future by softening the regulation, rather than by putting more effort into its job as supervisor. BI claims that it lowered the limit to stimulate lending (*JP*, 11/1/99), but this move will do nothing to convince observers that it has the will to tackle bank sector reform seriously.

Debt Restructuring

Indonesia's private foreign debt is estimated at around $80 billion. Restructuring this debt is imperative in re-establishing a functioning business environment and as a spur to economic growth. The government's approach to debt restructuring relies upon the Indonesian Debt Restructuring Agency (INDRA), bankruptcy law reform, and the Jakarta Initiative.

INDRA. The Indonesian Debt Restructuring Agency (McLeod 1998; Johnson 1998: 52; Evans 1998: 9–11) was established in July 1998 to aid in the repayment of foreign debt. It offers debtors the benefits of rupiah-based loans and a three-year grace period on capital repayments, and extends the term to maturity to a minimum of eight years. As of 18 December 1998, no company had formally committed itself to the INDRA arrangements, and it was reported that only one firm had demonstrated an interest in the scheme. The standard agreement contracts had not yet been finalised, precluding full commitment. The deadline for involvement in INDRA is 30 June 1999. As most firms are currently not paying off their debts, little benefit is to be had from an early commitment, and many presumably will make a decision closer to the deadline.

Bankruptcy and Commercial Courts. Indonesia's new bankruptcy law was mooted in IMF III and became law on 21 August in the form of a Government Regulation (No. 1, 1998), replacing the 1905 bankruptcy law. It is to be implemented by newly established commercial courts in Jakarta and other major cities. The courts are intended to offer a speedy resolution of bankruptcy cases, and to this end a tight time constraint is written into the law: they have 48 hours to set a hearing date, 20 days to begin the hearing, and 30 days to deliver a judgment (Johnson 1998: 35).

The courts were set up and the bankruptcy law developed within very tight time restrictions imposed by the IMF (Lindsey 1998). Approximately 30 judges received less than 30 days training before presiding in the new courts. The result has been heavily criticised (*FEER*, 22/10/98). A number of controversial decisions have been handed down, often on questionable grounds. As of 25 November only 17 cases had been filed, and only three bankruptcies declared. One of these has since been overturned on appeal to the supreme court. Lindsey (1998) argues that it is unreasonable to expect judges to have a comprehensive understanding of the new law in such a short time and, more importantly, that the law ignores the inherent problems of the Indonesian legal system—corruption and subordination to political pressure. Significant structural change of the judicial system is needed for progress to be possible. The bankruptcy law was intended to shore up business confidence in the economy and the legal system; to date it has only heightened the lack of confidence of all participants.

The Jakarta Initiative. It had been hoped that the prospect of legally enforced bankruptcy would encourage debtors to negotiate with creditors, thus accelerating debt restructuring (*Reuters*, 3/11/98). In the absence of a credible bankruptcy court, however, the role of the Jakarta Initiative Task Force is to facilitate the voluntary restructuring of distressed or illiquid, but operationally viable, corporations. The Initiative was launched in early September 1998 by the government and the World Bank as an alternative to INDRA. Unlike the latter, the Jakarta Initiative offers a framework in which to restructure both domestic and foreign debt, and provides guidelines on how debt restructuring should be conducted (Department of Finance 1998). It is expected that many debt restructuring deals will involve some degree of debt forgiveness and debt–equity swaps. Government regulations that present obstacles to debt–equity swaps are to be removed and the relevant tax laws reviewed. The Task Force expressed the hope that multinational companies would provide $2.5 billion in interim financing that could be used to entice domestic companies into the debt restructuring program (*JP*, 24/11/98), but nothing further appears to have come of this idea.

The World Bank did not expect to see any definitive outcome of the Initiative until the first quarter of 1999 (*Reuters*, 3/11/98). In late January 100 companies (with a combined debt of $12 billion owed to domestic banks) were working within the guidelines. Nine had already negotiated restructuring deals, but their aggregate debt was trivial at only Rp 1.5 billion ($200,000) (*Reuters*, 28/1/98). The Jakarta Initiative appears at this early stage to be more successful than INDRA, but it has not yet had a substantial impact.

Privatisation

The government's commitment to raise $1.5 billion in fiscal 1998/99 from the privatisation of 12 of Indonesia's large government corporations was revised—somewhat optimistically—to $1 billion by the end of March 1999. To date only about $120.5 million has been raised, $115 million from the sale of a minority shareholding in the cement company Semen Gresik and a further $5.5 million from the sale of 100 million shares (53.8% of the government's minority stake) in Indofood (*JP*, 15/1/99). The government now owns 4.7% of Indofood and is still the majority shareholder in Semen Gresik.

The listing of Aneka Tambang (mining) on the Australian Stock Exchange, scheduled for February, was deferred to March (*Reuters*, 2/2/99); the government intends to divest 14% of its shares, maintaining a majority holding of 51%. Tenders for a 12% share in Indosat (telecommunications) were due on 25 January. The government is expecting to raise about $200 million from the sale of Pelabuhan Indonesia (Pelindo) II (port operator), tenders for which were due on 5 February (*Asia Pulse*, 3/2/99). It is also divesting itself of shares in Angkasa Pura II (management of the Sukarno–Hatta airport) and Perkebunan Nusantara IV (plantations).

In line with the IMF schedule, the government has produced a masterplan for the divestiture of all state enterprises over the next decade. The other companies whose privatisation is now scheduled for the 1999/2000 financial year are Telkom (telecommunications), Tambang

Timah (mining), both of which are already listed on the JSX, and the wholly government-owned companies Jasa Marga (toll roads), Tambang Batubara Bukit Asam (mining), Pupuk Sriwijaya and Pupuk Kaltim (fertilisers) and Krakatau Steel (*Wall Street Journal Interactive Edition*, 8/2/99). Companies in fields including hotels, trading, construction, mining, civil engineering and fertiliser production are slated to be privatised by 2001.

The government ascribed the privatisation delays to weak economic conditions and depressed prices, conditions most would have described as inevitable when the plan was announced. A further explanation is that foreigners planning to conduct the due diligence audits of the companies to be privatised have been deterred by foreign government travel alerts on Indonesia. Commentators have suggested also that there are almost certainly political reasons for the delays. The minister in charge of the privatisation process, Tanri Abeng, has acknowledged that he has taken cultural resistance to foreign ownership into account. Workers at Semen Gresik, Indonesia's largest state-owned cement producer, demonstrated vigorously against the proposed takeover by Mexican firm Cemex. Cemex originally offered to pay double the current market price for a 51% stake in Semen Gresik, which would have fulfilled a quarter of the IMF's privatisation target. Instead, the government gave in to anti-foreigner sentiment and offered only 14% of the company for sale. The government's desire to maintain a majority shareholding in most of the 'privatised' corporations is undoubtedly dampening foreign investor enthusiasm, because it makes it much more difficult for any new shareholder to implement significant change in management practices and corporate strategy. It has also been suggested that recent improvements in the exchange rate and other economic indicators have lessened the government's sense of urgency.

Subsidies

Rice. Holding rice prices well below the world market price, as was done in the early months of the crisis, was an inefficient way to provide safety net support to the poor. The subsidy tended to flow to all consumers regardless of their income levels, placing an unnecessarily heavy burden on the budget; but the policy also encouraged the illegal export of rice by traders exploiting the domestic–international price difference, thus tending to force the price up in any case.

To enable the government to reach its welfare objectives more cost-effectively, a targeted rice program was initiated in July 1998 in conjunction with the World Bank. It was initially constructed to provide rice to families adversely affected by El Niño, and provided 10 kg per month to poor families at Rp 1,000 per kg (about one-third of the market price). The program was said to be reaching six million families by end October (somewhat less than the 7.5 million specified in IMF IV), but is now being rather ambitiously extended to 17 million poor families (*Reuters*, 10/12/98), and the amount of rice increased to 20 kg per month. In addition, a supplementary program for children and pregnant women was mentioned in the October 19 Letter of Intent to the IMF. The World Bank has recommended a phasing out of rice subsidies once the agricultural sector has returned to normal production levels (World Bank 1998).[12]

As a result of its massive imports of more than 5.8 million tonnes of rice in 1998, Bulog ended the year with a record stockpile of 2.3 million tonnes. With such a large stockpile, and with an expectation that the crop for 1999 will be over 50 million tonnes, it is questionable whether Bulog will be in a position to maintain its floor price as it did regularly before 1998, purchasing up to two million tonnes of rice from farmers. Certainly, however, with its present stores, Bulog will be able to continue the low-cost rice distribution program for needy families. From July to the end of January, this program distributed just over 500,000 tonnes of rice throughout Indonesia.

Private traders were allowed to import rice for the first time in 30 years as of late September 1998, and this removal of Bulog's monopoly has resulted in domestic rice prices moving fairly close to international levels. But the government continues to set a floor price for rice ready for milling (*gabah kering giling*), which it raised from Rp 1,000 to Rp 1,400–1,500 (depending on locality) on 1 December 1998 to provide a further incentive to production. This means that at times when the world price falls appreciably below this floor, Bulog will either incur a loss if it sells to consumers at the world price, or see its stockpile increasing rapidly if it does not, since consumers will purchase cheaper imported rice from private traders.

Fertiliser. Early during the crisis it was decided to offer fertiliser to rice farmers at less than half the world market price, to compensate them for rice prices being held down. When it became evident that with this policy farmers were having difficulty obtaining fertiliser because a great deal was being sold to the plantation sector or exported, the subsidy was terminated. This occurred on 1 December when the planting season was well underway. As well as increasing the floor price of rice to compensate farmers, the government reduced the interest rate in the subsidised farm credit program (KUT) from 14% to 10.5% p.a., and raised the ceiling on loans to Rp 2 million per hectare (*Antara*, 2 December 1998).

Social Safety Net Programs

The World Bank decided in late December 1998 to postpone the disbursement of its $1 billion loan for the fiscal year 1998/99. The funds will instead be released to the new government after the election in June. This decision reflects the relatively low expenditure on social safety net (SSN) programs to date: by November 1998 only about 30% of the available SSN funds for fiscal 1998/99 had been used (Abimanyu 1998a). This was due largely to the lack of data for targeting purposes and weak bureaucratic support in the regions, and in part to a lack of familiarity with SSN policies. Some officials are also hesitant to be involved in disbursing funds, fearing accusations of corruption.

The elements of the social safety net system, as described by McCawley (1998), are:

- *a food security program* to guarantee availability and affordability of food across society. The most prominent element is the targeted rice program, which is reported to be working as well as can be expected, with minimum 'leakages'.
- *a labour-intensive public works program* to reduce unemployment and encourage productive activities. The World Bank (1998) reports that the main inefficiency in the government's labour-intensive employment generation programs is the payment of above-market wages: if lower wages were paid, only the really needy would find the programs attractive.
- *a social protection program* to protect access to health and education facilities. Rp 1.4 trillion ($184 million) has been allocated to the health sector for programs aimed at poor families, pregnant women and children under the age of two. This will include provision of medical supplies directly to Community Health Clinics (Puskesmas) and free provision of contraceptives. The social protection program also includes school block grants and scholarship schemes.
- *promotion of the 'people's economy' (ekonomi kerakyatan)*, especially through support for small and medium enterprises (SMEs), and including promotion of cottage industries at the village level.

The total cost of the programs is put at Rp 17.2 trillion ($1.7 billion); they will be financed through the development budget, from both rupiah funds and Consultative Group on Indonesia (CGI) contributions.

In an attempt to maintain control over 'leakages', NGOs will be involved in implementing the safety net programs at the local level. NGOs remain sceptical, however, believing their involvement in program monitoring to be merely cosmetic. In the absence of a tight selection process, the task may be allocated to 'quasi-NGOs' formed for opportunistic reasons only.[13]

Micro-Credit. The government aims to meet some of the objectives of the safety net programs by introducing new micro-credit schemes. It was announced in November that 16 subsidised loan programs would be established and allocated Rp 10 trillion ($1.3 billion). Most of the schemes will be targeted at SMEs or at poor families.[14] They will offer subsidised credit at an annual rate of 6–16% (the rate for normal commercial loans has been about 50% in recent months). Some schemes will not require collateral. Working capital loans are limited to Rp 5 million and require repayment within a year. Investment loans may be up to Rp 25 million, with repayment within 25 years.

The success of micro-credit schemes in other countries has hinged on the provision of credit at market rates to individuals who would not otherwise have access to it (owing to lack of collateral, for instance), or on strictly controlled access to credit if it is subsidised. An institutional structure that discourages cheating and default, such as group-based lending, is important. Like previous Indonesian subsidised credit schemes, the present ones lack these characteristics. They appear to be little more than subsidised credit programs, with the funds to be disbursed via commercial banks. Critics claim that the schemes lack the controls necessary to prevent significant 'leakages', and that institutions that were not cooperatives have been able to acquire cooperative status and gain access to the subsidised funds (*JP*, 14/12/98). There have also been reports that the implementation of the credit schemes has corresponded to a large increase in time deposits, the inference being that people are earning handsome financial returns by depositing funds from the subsidised credit schemes at far higher commercial rates.

The targeted rice program has been more successful than the other social safety net programs: the labour-intensive programs, in particular, are likely to benefit far fewer Indonesians. The tragedy is that, at this time of perhaps greatest need, not all the available funds have been used. This is to some extent understandable given the difficulty of mobilising such an extensive program in such a short time.

'EKONOMI KERAKYATAN' AND CHINESE INDONESIANS

The establishment of a 'people's economy', one of the four areas to which social safety net expenditure will be directed, involves the dispersion of economic decision-making power to large numbers of Indonesians. Discussion of the 'people's economy' at the November Special Session of the MPR culminated in Decree No. XVI/MPR/1998 on Political Economy within Economic Democracy, which stipulates that:

- National economic development is designed to create a broad base of small and medium-scale enterprises ... and to foster mutually beneficial linkages between cooperatives, SMEs, large companies and state enterprises. The implementation of economic democracy shall seek to avoid the concentration of economic assets and forces in the hands of a small number of people and companies. Cooperatives and SMEs, as the main pillar of national economic development, shall be given as much opportunity, incentive and assistance as possible, without ignoring the role of big business and state enterprises.
- National land use shall be organised in a just manner, and the concentration of land use rights and land ownership in the hands of a few individuals or companies shall be prevented in light of efforts to enhance the strength of cooperatives, SMEs and the people at large.
- Banks and financial institutions shall give top priority to cooperatives and SMEs while continuing to work within the principles of sound business management.

The decree greatly strengthens the hand of advocates of an interventionist approach to economic policy as against the advocates of reliance on market forces, and could result in discriminatory measures against Chinese Indonesian businesses. Above all, it enhances the position of the Minister of Cooperatives and Small Enterprises, Adi Sasono. A close associate of President Habibie and former member of ICMI (the Indonesian Association of Muslim Intellectuals founded by Habibie), Adi is emerging as one of the most high profile ministers in the cabinet. His Department has been allocated Rp 20 trillion ($2.67 billion) in the current budget for credit programs directed at cooperatives and SMEs, giving him the ability to dispense patronage on a lavish scale, and hence ample scope to build a network of political supporters in the run-up to the election.[15] There is little doubt that he is appealing to the strong vein of economic nationalism and anti-Chinese Indonesian sentiment within the body politic. He has already made several calls for bank assets taken over by IBRA and the proceeds from the privatisation of state enterprises to be redistributed to cooperatives. He has asserted that President Habibie 'fully supports the proposal to distribute the assets of conglomerates and banks taken over by the government among small and medium enterprises and cooperatives' (*JP*, 16/12/98). Whether he can push this kind of policy through cabinet and translate his rhetoric into effective policy making before the elections is doubtful. The longer-term political significance of his exploitation of *ekonomi kerakyatan* as a popular slogan is harder to assess.

President Habibie has himself urged that the significance of MPR Decree No. XVI not be misunderstood. 'You should not imagine that the decree would serve as an impediment to the presence and development of big companies', he has said. 'The government and the people still need big private companies so long as they do not practise monopoly' (*Asia Intelligence Wire*, *Antara*, 8/12/98). While Adi Sasono's policies have been widely interpreted as a thinly disguised attempt to wrest power from the Chinese Indonesians who dominate so much of the business world, for which there appears to be a good deal of popular support, the government has been careful to avoid any overt commitment towards such a strategy. The word '*pribumi*' (indigenous) was carefully avoided in the MPR decree, albeit after some debate.

While there have been some calls for a program of positive discrimination for *pribumi* businesses similar to Malaysia's New Economic Policy (NEP) of 1971–90, the government has repeatedly denied that it plans to nationalise private sector assets.[16] An alternative approach to weakening ethnic Chinese domination of the modern business sector is the anti-monopoly law passed by the DPR in February, which attempts to limit firms' market shares. The law is likely to be far less effective than the simple expedient of removing all the policy interventions that protect large firms from the need to compete with others or with imports.

Political imperatives demand that the government show it is taking immediate and positive action to reduce the huge gap between the rich and the poor (which to a large extent means between the ethnic Chinese and *pribumi*) that emerged during the Soeharto era. This issue cannot be ignored except at high political cost at a time when so many Indonesians are struggling to survive below or close to the poverty line. However, any blatantly discriminatory action against the ethnic Chinese is bound to have adverse effects on their willingness to resume investment in Indonesia (or refrain from shifting additional capital offshore), and on the attitudes towards Indonesia of foreign investors. Hence, more indirect measures must be devised—almost inevitably of a long-term character. More effective fiscal policies directed at tapping the wealth of the rich, particularly through urban property taxes, should be a potent instrument in the struggle for a more equitable distribution of wealth and income. Measures to eliminate the distortions and economic rents that the wealthy ethnic Chinese conglomerates have exploited in recent decades should be another, although the market-based logic of such policies will run counter to the interventionist thrust of *ekonomi kerakyatan*.

The principle that must be upheld in this sphere is that any policies pursued by the government should be racially non-discriminatory,

TABLE 3 *Government Budget*
(Rp trillion)

	1998/1999	1999/2000 (draft)	change (%)
REVENUE	**263.9**	**218.2**	**–17.3**
Domestic revenue	**149.3**	**140.8**	**–5.7**
Oil and gas	49.7	21.0	–57.8
Oil	32.9	12.4	–62.2
Gas	16.8	8.5	–49.3
Non-oil and gas	99.6	119.8	20.3
Income tax	25.8	40.6	57.2
Value added tax	28.9	34.7	19.9
Import duties	5.5	3.0	–46.3
Excise	7.8	9.4	20.7
Export duties	0.9	2.6	175.2
Land and building tax	3.4	3.2	–4.8
Other taxes	0.5	0.6	4.5
Non-tax revenue	26.7	25.8	–3.2
Foreign revenue	**114.6**	**77.4**	**–32.5**
Program loans	74.0	47.4	–36.0
Project loans	40.5	30.0	–26.0

directed at wealthy *pribumi* as well as wealthy Chinese Indonesians, and at subsidising poor *pribumi* and poor Chinese Indonesians equally. To the extent that the goals of *ekonomi kerakyatan* can be achieved by ensuring social safety nets for the poor and reducing the income gap—levelling up from the base of society rather than levelling down—they deserve support, but in so far as they imply seizure of Chinese Indonesian assets on a purely racial basis they are likely to have disastrous consequences.

THE BUDGET

The draft government budget released on 5 January 1999 (table 3) was generally well received. The point most applauded is the apparent control over the deficit (6.5% of GDP) in a year in which revenue from oil and

TABLE 3 (cont.) *Government Budget*
(Rp trillion)

	1998/1999	1999/2000 (draft)	change (%)
EXPENDITURE	**263.9**	**218.2**	**–17.3**
Routine expenditure	**171.2**	**134.6**	**–21.4**
Personnel expenditure	24.8	32.0	29.3
Salaries/pensions	19.1	25.3	32.3
Rice allowances	1.9	2.1	11.5
Food allowances	1.5	2.1	41.9
Other domestic	1.2	1.5	29.0
Overseas	1.2	1.1	–7.8
Material expenditure	11.4	11.0	–3.4
Domestic	10.1	10.0	–0.5
External	1.4	1.0	–24.4
Regional routine expenditure	13.3	18.4	38.7
Personnel	12.6	17.6	39.8
Non-personnel	0.7	0.8	17.2
Amortisation & interest payments	66.2	44.8	–32.3
Domestic debt	1.9	0.4	–80.4
Foreign debt	64.3	44.4	–30.9
Other expenditure	55.5	28.2	–49.1
Oil subsidies	27.5	10.0	–63.7
Other	27.9	18.3	–34.7
Development expenditure	**92.7**	**83.6**	**–9.7**
Rupiah financing	52.1	53.6	2.9
Project financing	40.5	30.0	–26.0
GOVERNMENT SAVINGS	–21.9	6.2	

gas is predicted to fall by over 60%. The rupiah-financed development budget which, surprisingly, encompasses the safety net programs, has increased by only 2.9% over its 1998/99 level. This has been achieved in part by giving greater priority to maintenance and operational expenses

TABLE 4 *Development Budget*
(Rp trillion)

Expenditure	1998/1999 Total	1998/1999 %	1999/2000 Total	1999/2000 %	% change
Regional budgets	13.8	26.5	16.5	30.7	19.3
Regional development	10.8	20.6	13.6	25.3	26.1
Inpres Backward Villages Program	0.2		0.0		
Village Development Funds	0.5		0.8		
Kabupaten/Kotamadya Development Funds	3.8		6.1		
Provincial Development Funds	1.7		3.2		
Inpres Primary School Program	0.6		0.0		
Inpres Health Program	0.8		0.0		
Inpres (PMT-AS)	0.4		0.0		
Inpres PDMDKE	2.7		0.0		
Social Safety Net and Social Empowerment Program	0.0		3.5		
Land and Building Tax & Stamp Duty	3.0	5.9	2.9	5.4	–4.8
Central budget	17.3	33.1	15.5	28.9	–10.3
Departments/institutes	14.6		14.2		
Other	2.6		1.3		
Subsidies & bank recapitalisation	21.1	40.4	21.7	40.4	2.9
Fertiliser subsidies	2.1		0.0		
Subsidised credit programs	4.0		3.7		
Bank recapitalisation (interest on bonds)	15.0		18.0		
Total	**52.1**	**100.0**	**53.6**	**100.0**	**2.9**

Source: Abimanyu (1998a).

over the construction of new infrastructure. Fertiliser subsidies have also been removed.

Table 4 shows changes in the development budget. Although the Inpres programs (funded by special grants to the regions from the central government) appear to have been eliminated, they have simply become the regions' responsibility and so are included in the Provincial and

Kabupaten/Kotamadya Development Funds. The budget allows for increases in the salaries of civil servants, members of the armed forces and retirees, but these are not sufficient even to offset last year's high inflation, let alone address the problems of accountability and transparency that arise from having such a poorly paid public service. The amount allocated for interest payments is also lower, in part because of the increase in the value of the rupiah and the suspension of principal repayments as agreed with the Paris Club of creditor nations.

Oil and gas revenue will decline because of depressed world prices and the assumed rise in the value of the rupiah relative to last year. Foreign aid funds have also decreased in rupiah terms, both because fewer dollars have been committed and because of rupiah appreciation. The budget shows some of this revenue loss being made up for by a 175% increase in export duties because of booming export volumes. The government expects part of this to result from a rise in palm oil exports following the recent reduction in the export tax on crude palm oil from 60% to 40%. (This tax had been imposed in June 1997 to secure domestic supply by discouraging exports.) Other export taxes have also been reduced. Income tax receipts are forecast to rise by 57%. Bank interest income is expected to be a major source of income tax revenue, although interest rates are now falling; the extent of capital flight will also be important in determining how much can be raised through the tax on interest income. (Interestingly, BI data show that rupiah deposits are now far above pre-crisis levels.) A 20% increase in income tax receipts has therefore been suggested as more realistic. Value-added tax revenue is also predicted to rise, as is non-tax revenue from the privatisation of state-owned companies (*JP*, 7/1/99).

In terms of its likely macroeconomic impact, the budget appears contractionary. Expenditures net of amortisation and interest payments decrease by 12% nominally but by more than 50% in real terms. Non-oil and gas domestic revenue is predicted to rise by 20% nominally—a real 32% reduction.[17] The real decrease in expenditure outstrips the real decline in non-oil and gas domestic revenue by Rp 18.4 trillion. The contractionary nature of the budget is at odds with the IMF's recent statement that an important pillar of the next Letter of Intent will be expansionary fiscal policy.

A point of contention is the cost of the bank recapitalisation program. In contrast with the days of the Soeharto regime, when parliament merely rubber-stamped the budget, representatives of Golkar, the military faction and the PDI have all called for less to be spent on bank recapitalisation and more on extending the social safety net. Parliament has also questioned the optimism of the assumptions underlying the budget, given the fragility of political conditions (*Reuters*, 12/1/99). The Finance Minister announced on 7 February, however, that there would be no significant revisions to the draft budget, which was to be formally debated by parliament in late February.

The government is relying on foreign loans of Rp 77.4 trillion ($9.7 billion) to finance the budget deficit. This initially required it to find an additional $5 billion beyond what had already been pledged. The Japanese government has since committed $2.4 billion from its Miyazawa plan to cover some of the shortfall, and has indicated that it might be prepared to provide more assistance later in the year. Negotiations with members of the CGI, the Asian Development Bank and the World Bank are continuing.

REGIONAL AUTONOMY

The issues of regional autonomy and decentralisation of financial powers are at last receiving serious attention, under the pressure of unrest in Aceh, Irian Jaya and East Timor (*FEER*, 21/1/99: 10–14). The budget provides for a 39% increase in grants to the regions—by far the largest proportionate increase on the expenditure side, but still less than 10% of total expenditure. There has also been talk of a transfer of taxing powers and government functions to the regions, with suggestions that eventually something approaching half of all government revenue would go to them—which seems an unrealistically high figure. This would occur either through a direct transfer of some taxing powers to the provinces or *kabupaten* (the latter apparently being the preferred recipients of fiscal autonomy, being more easily manipulable), or by remittance to them of a greater share of the tax revenues now collected there by the central government. The issues are complex, since the resource-rich and wealthier regions stand to benefit most from such changes in the short term at the expense of the poorer regions.

Little progress has been made towards a more effective distribution of taxing powers between central and regional governments since the issue first arose in the late 1950s, despite some discussion of the matter in parliament between 1967 and 1974. The question receded into the background in the 1970s when the surge of oil revenues into the central government's coffers enabled it to provide lavish grants to the regions. Some attempts have been made in the 1990s to decentralise both government functions and revenue sources to the regions, but with limited success so far (Booth 1992; Hill 1998).

East Timor

In a surprise announcement on 27 January, President Habibie held out for the first time ever the possibility that the government would consider granting East Timor independence if an offer of substantial autonomy, put forward in negotiations with Portugal under United Nations auspices, was rejected. Once the door had been opened to this hitherto almost inconceivable possibility, events began to move rapidly. Within two weeks Habibie had gone so far as to say his preference was for full independence for East Timor by the end of 1999, rather than a special form of regional autonomy. The military seemed to raise no public objection. Xanana Gusmao, the Falintil (Fretilin military forces) leader, has been released from a high-security prison to house arrest nearby so that he can take a more active part in negotiations over the future of the province. While Megawati Sukarnoputri (PDI) and Abdurrahman Wahid have expressed opposition to the granting of independence, Amien Rais and others have supported it.

The emergence of conflict between rival factions calling for independence (Fretilin) and continued integration with Indonesia—the latter allegedly provided with arms by ABRI forces—provides a foretaste of the political complexities that lie ahead. The government is unlikely to continue to provide development grants-in-aid at the current high level (on a per capita basis, six times the level of other provinces) after independence. That may have been a motive for the policy change, along with Indonesia's need to regain credibility among potential international donors.

CONCLUSION

In the last four months the Indonesian economy has shown tentative signs of a recovery, or at least a bottoming out of the decline. But the lack of real policy progress, especially in bank recapitalisation and debt restructuring, throws doubt on whether this will be sustained and converted into medium or long-term gains. Indonesia is still mired in the problems inherited from a severely distorted economy, and the socio-political situation is extremely fragile. Economic recovery is a slow process and, it seems, a slower one for Indonesia than for its neighbours. Only after the elections in June is there even the possibility of the beginnings of recovery.

12 February 1999

NOTES

* This Survey has been compiled with the generous assistance of Professor Jamie Mackie, who is mainly responsible for the sections on social and political developments and the people's economy. I also thank Chris Manning for providing the real wage graphs, Peter Gardiner for his comments on the section on the social impact of the crisis and all others who provided information and comments.

1 'Gus Dur' is the popular name of Abdurrahman Wahid, the widely revered head of the rural-based Muslim organisation Nahdlatul Ulama, and head of the new PKB party (Partai Kebangkitan Bangsa).

2 The JSX Composite Index is plotted over the last year at http://indobiz.com/news/jsx.htm.

3 BI publishes base money figures for the end of the month, while the IMF uses a 10-day average centred on the last day of the month to assess whether its targets have been met.

4 The government assumes an oil price of only $10 per barrel for the coming financial year budget. This may be compared with a price of $23 per barrel at the end of 1996.

5 The poverty line in Indonesia is defined as the level of expenditure associated with a daily consumption of 2,100 calories. This is lower than the poverty line set in most comparable countries.

6 Information in this section borrows heavily from Booth (1998).

7 The Indonesian Family Life Survey is a random household survey conducted by the RAND Corporation and the Demographic Institute (Lembaga Demografi) at the University of Indonesia. It was first conducted in 1993 (IFLS1). The same 7,200 households (on the islands of Java, Sumatra, Bali, West Nusa Tenggara, Kalimantan and Sulawesi) were interviewed again in 1997 (IFLS2) and then a sub-sample of 2,000 across 13 provinces were re-interviewed in August–November 1998 (IFLS2+).

   Two further data sets will eventually provide information on the social impact of the crisis. They are the '100 villages survey' conducted by BPS and funded by UNICEF, and a survey of schools conducted by the World Bank and the Ministry of Education and Culture. Both are said to be rich sources of data.

8 The interim report analyses expenditure, not income, data. Expenditure data are likely to be more closely related to household welfare than income data, but because we expect to see expenditure smoothing, changes in expenditure are likely to be smaller than income changes.

9 A fourth supplementary memorandum had been negotiated at the time of writing but had not yet received Washington approval and so was not publicly available. It was reported to focus on firm monetary policy, expansionary fiscal policy, bank recapitalisation and private company offshore debt restructuring. It also includes policies aimed at helping small and medium enterprises.

10 Inflation indexing made its original appearance on the policy making scene in the INDRA arrangements discussed by Evans (1998: 11–12) in the previous Survey.

11 Further batches were scheduled to be announced on 15 February, 7 March and 31 March (*Wall Street Journal Interactive Edition*, 1/2/99).

12 A scandal erupted over the distribution of 500,000 tons of rice sent by Japan as food aid. The rice is of a very high quality, and the government has stockpiled it rather than distributing it because it is said to be concerned about 'disrupting the country's rice market' (*JIJI Press Newswire*, 11/1/99).

13 The NGO sector already runs a form of safety net program, the Community Recovery Program (CRP), funded by the World Bank, Japanese and British ODA, the ADB and a number of other international organisations. Funds are managed by the UNDP office in Jakarta, and the program is being coordinated by a group of individuals from a consortium of NGOs. The CRP shares many of the objectives of the government scheme, with the exception of the labour-intensive projects (Abimanyu 1998b).

14 Subsidised credit has also been made available to public transport companies in major cities.

15 Press reports have linked his name with the emergence in January of a new party, Partai Daulat Rakyat (PDR, the People's Sovereignty Party), although he is not yet formally associated with it and officially remains a member of Golkar. PDR is described as a 'political machine' based on poor farmers, fishermen and *kaki-lima* (urban food vendors), a constituency that various other parties presumably will also be bidding for.

16 The circumstances that made possible the relatively smooth redistribution of corporate assets towards Malay business under the NEP are utterly inapplicable in Indonesia, so the likelihood that a similar policy could succeed is very low. The growth in the Malay share of total corporate wealth occurred at the expense of British companies, most of which were leaving Malaysia in any case between 1971 and 1990, and not at the expense of Chinese Malaysians, whose share of the cake actually increased in those years. The Malaysian economy was growing rapidly through that period, but Indonesia's is stagnant. Malaysia's financial system and bureaucracy were far more advanced, more efficient, better paid and less corrupt than Indonesia's (Mackie 1999).

17 These calculations deflate the 1999/2000 figures using the 1998 inflation rate of 77.63%.

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