Indonesia's Private Sector

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1. THE COLONIAL LEGACY

The composition of the private sector and the problems today still reflect the legacy of the colonial system. Before World War II the modern sector was dominated by the Dutch companies, with a number of medium-scale Chinese companies on the ascendancy. The Dutch companies were engaged in plantation, mining, international trade, banking, shipping, manufacturing, construction, etc. Many Chinese companies, diversifying out of trade, entered medium-scale manufacturing of consumer goods; their plants are often located in provincial towns in Java. Some Chinese business houses, however, also ventured in plantations, such as of sugar, tea and coffee.

The native Indonesians living in rural areas in those days occupied the traditional sectors of subsistence and smallholders’ agriculture, petty trade, local transportation, handicrafts, etc. In increasing numbers, as population growth diminishes available land per farmer, and especially on Java, the village people became plantation laborers, construction workers, paid agricultural hands, or found other non-farm employment.

In the cities, members of the Indonesian elite and educated class started working in the colonial administration. Modern education was not widely available for them as yet and therefore these job opportunities were still adequate. Most such employment, however, was limited to clerical duties and mid-level functions.

Although the indigenous Indonesians shared some administrative power with the Dutch, they were not in the position to play a significant role in the modern sector. When World War II broke out, there were only

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a few hundreds of university trained medical doctors, lawyers and engineers, who could be easily absorbed in government service. There were virtually no trained economists and managers, and the private sector was not even attractive for employment. Before the outbreak of the war there were a handful of indigenous Indonesians who did well in textile and commodity trade, and subsequently went into manufacturing, but their companies did not attract many educated Indonesian much.

The swelling urban population below the elites, many with some primary education from Moslem schools, drifted into trade, home industry and handicrafts, such as textile weaving and batik, and became the nucleus of a nascent indigenous middle class. They became the “underdogs” in the colonial commercial hierarchy, below the Chinese trading class. That is why they were inclined to organize themselves in socio-economic associations and took part in the nationalist (i.e., emancipation) and later independence movement. Such associations were often based on Islam as a binding force. These were the first challengers of the Chinese hegemony in trade.

The Chinese representing some two to three per cent of the population became the middlemen in the economy, linking the modern Dutch-controlled economy with the traditional sector. The Chinese migrated into the Dutch East Indies in the nineteenth century to become employed. The Dutch welcomed these migrants because of the need to have an alien, but non-western, middle class between the Dutch and the indigenous population. A similar phenomenon occurred in the British colonies. The Dutch, in their efforts to subdue the native sultanates, also tried to curb the native ocean going mercantile fleet.

The Dutch were never quite laissez-faire in the administration of their colonies. The East Indies first became an exclusive trading area of the V.O.C, a private Dutch trading company with monopoly power. At a later stage the Dutch government took over the administration of the territory from this company. The inclination for direct intervention and involvement in business continued.

Apart from private interests in mining, plantations and trading, the colonial government over the years invested in a number of state enterprises, usually in public utilities, like electricity generation and distribution, railways, postal and telegraph service, the Java Bank, the rural credit banks, inter-island sea transportation, participation in mining and petroleum exploration, etc. Some educated Indonesians held mostly sub-managerial positions in such enterprises.
The Netherlands East Indies government was not necessary holding lock-out in the latter half of nineteenth century. It was laissez-faire in mining, for instance. The person who discovered petroleum, tin, coal, manganese, nickel, bauxite, asphalt, among others, was given the mining license without limitation. This laissez-faire policy was given up by the Act of Mining in 1899 and the Mining Regulation in 1906. Because of the change of the former in 1919, the rights of mining and inflammable gas came under government control.

American and European companies had invested in the industrial sector in Indonesia from the late 1920s into the 1930s, for example, Goodyear (tires), Union Carbide (dry batteries), Unilever (margarine and toiletries), Philips (electric bulbs) and British American Tobacco (B.A.T.) in cigarettes). A more open economic policy was adopted to cope with increasing population pressure and the worsening economic and political situation in the world.

2. THE JAPANESE OCCUPATION

The Japanese occupation during World War II produced a great number of vacancies of functions previously occupied by the Dutch. For the first time it gave the Indonesians a chance to rise into administrative and managerial ranks, as the Japanese war time administrators could not fill them all. The Japanese also administered these occupied enterprises as government-controlled entities as these all had to be integrated in the war mobilization scheme.

This wartime experience was very crucial for the learning process of the Indonesians to man the modern sector economy. The occupation also meant complete nationalization of almost all enterprises in the modern sectors. The distance between government and enterprise administration was narrow. Of course for the Indonesians it was not a good schooling in normal enterprise management working for a profit in a competitive environment. However, with all these shortcomings it laid the foundation of the public sector in the Republic of Indonesia. Some of the orientations (and habits) of management and administration in a war time situation continues even until today, e.g., target orientation versus efficiency.

3. IDEOLOGIES OF THE INDEPENDENCE MOVEMENT

The independence movement was to a significant extent inspired by socialist ideas of how to construct, or reconstruct from a colonial past, a national economy. It was extremely reform oriented, even
"revolutionary" (i.e., destruct and build anew), and as an anti thesis of the past, or the status quo, it incurred an anti-private-enterprise bias. It placed great emphasis in the role of the state with its political power for changing structures and systems and therefore regards state enterprises as instruments of state policy to reconstruct the economy and society.

In the rural and traditional sector the favored socio-economic organization is the cooperative, because cooperatives are not "capitalistic" as they are associations of people rather than of capital. Decision making in cooperative is on a one-man-one-vote basis, not on the strength of equity ownership, and for this reason was regarded much more democratic. The belief in cooperatives as one of the main pillars for the national economy is enshrined in the 1945 Constitution of the Republic which is still upheld today. The government always dispenses major assistance and large subsidies for the growth of cooperatives, especially in rural areas. There is even a minister for cooperatives. Village cooperatives supporting the rice cultivation intensification scheme have become very important, but critics will say that they have become extensions of the government controlled extension service, with too much intervention from the top and too little free and autonomous development.

The Indonesian independence movement, however, never espoused a policy of complete nationalization or socialization. It favored a "mixed economy" but with strong government control and planning. Therefore the regime had a preference for the public sector, where the companies function as "agents if development" and are the "instruments of the state" in the execution of developmental policies.

Private enterprise had its place in such a system because, first of all, in its social philosophy the independence movement did not want to have a complete break with the past (although it professed aiming to liquidate "the vestiges of colonialism and the capitalism"), secondly, because it realized that there would be a deficiency of investment capital if the modern private sector was to be excluded. The emphasis in the doctrine is not so much on "ownership of the means of production" as well as on "planning".

4. THE FIRST PERIOD OF INDEPENDENCE

Because of these ideological inclinations the development of the private sector economy did not progress well in the first period of independence from 1945 through 1966, that is, the period of President Sukarno. This era
Indonesia's Private Sector

was marked by acts of nationalization or control of foreign, mostly Dutch, enterprises by the government. These actions were seen as a necessary part of the decolonization process. Since the Indonesian elite had no vested interest in the modern private enterprise sector, this policy of nationalization did not encounter resistance. As a matter of fact, from the occupation period the interest of this elite had been linked with the state run enterprises.

It is relevant and convenient to distinguish the important elements of the private sector. They are: the Chinese enterprises, the foreign enterprises and those owned by indigenous Indonesians. Why are such distinctions along racial lines significant or important? Because in a post-colonial country like Indonesia, “political economy” (i.e., institutional economics related to the power-structure) is still very important.

The newly independent country has not finished its social transformation and its “nation building” process. The socio-economic “status quo” was not a stable situation and there was constant political pressure from the part of the holders of the political power to change it. The objective is to build a “national economy” as an anti-thesis of the status quo during the colonial period. The later is portrayed as a situation where Western enterprises are on top of the political pyramid, followed by the Chinese (or then called “alien orientals”) and where the (indigenous) Indonesians were only occupying the bottom position. The socio-political objective is now to elevate the weak majority at the bottom using state power as protector and facilitator. Before a genuine indigenous modern private sector can develop, the public sector becomes the spearhead and bulwark of the emancipation process. Differences in citizenship, culture and religion accentuate the division between the categories. Indonesian policy vis-à-vis the modern sector is always strongly “nationalistic” and reform oriented. Economic nationalism has always been a strong force since independence, even also during the present “New Order” which prides itself of being pragmatic.

A significant difference should be noted between the Indonesian and Indian history. In India the (strong) domestic private sector had given firm political support to the Congress Party in the years of the freedom movement. In Indonesia such support came only from the indigenous small enterprise sector, mostly organized on religious (i.e., Islam) basis, while the Chinese business class stayed largely neutral. This has influenced political attitudes in the post independence period.
During the first period of independence the private sector did not develop much and again political development was the root cause. The Indonesians proclaimed their independence in 1945, immediately after the end of World War II. The period until the end of 1949, however, was occupied by a revolutionary struggle with the Dutch who tried to re-establish their power; during this time the country was even divided in a “republican” territory and an “occupied” part. Hence no peaceful development could take place.

The early 1950s was a short period of relative peace, of reconstruction and an effort of accommodation to the former colonial master. The Korean War boom brought even a short spell of prosperity. Since 1957 this peaceful period also came to an end as a political dispute with the Dutch over the status of West Irian culminated in a virtual nationalization of all Dutch enterprises.

The late 1950s and the early 1960s were relatively quiet and the government tried to develop the economy according to economic development plans. In the meantime, the development of domestic politics, heavily influenced by western European style multiparty system, did not produce political and administrative stability. Attitudes towards foreign investments and foreign enterprises were not favorable, if not suspect, and the same towards Chinese enterprise were ambivalent at best. On the other hand, state enterprises barely managed to keep their heads above water while the indigenous private enterprises were just emerging as a result of hothouse protection.

A landmark policy of the early 1950s was the “Benteng (fortress) policy” of Minister of Trade Iskaq, which distributed import licenses to some five thousand indigenous Indonesian traders and importers, many of them were newborn “briefcase” entrepreneurs. Many of these new entrepreneurs, because they had no capital and experience, sold off their licenses to the old Chinese traders. Only a handful of these Benteng importers survive today, but such policies of trying to pressure-cook indigenous Indonesian entrepreneurial development was typical of the efforts of “economic nationalism”, and even today such governmental inclinations still exist. Political favoritism of the ruling parties with respect to the selection of business to be granted favors also affected the further development of this indigenous business class. Every time another political party came to power, different people were favored. Hence there were businessmen related to the nationalist party, the socialist party, the Moslem parties, etc., which during the forty years of independence did not show strong survival strength.
The period until 1966 (when the so-called New Order government took over) was characterized by political instability and low economic growth, without new foreign direct investments, without much foreign aid, with high inflation and stagnant exports.

However, there were some exceptions worth recording. The foreign oil companies, such as Caltex, Stanvac, and Royal Dutch Shell started exploration and production again after the old Dutch style Concession Agreements were replaced by Contracts of Work where the state is recognized as sovereign owner of the subsoil resources. In the new arrangement the foreign oil companies became “contractors” for the government but bearing all risk and bringing in the required capital.

Although not called aid, the Japanese war reparation started. The treaty was signed in January 1958 and there were payments amounting to US$ 233 million in total, continuing for 12 years. Furthermore, there were production sharing cooperation, not direct investments, with Japanese companies. For example, North Sumatra Petroleum Cooperation (NOSODECO), signed in April 1980 with a credit line of US$ 52.3 million; Sulawesi Nickel, signed in November 1962 with a credit line US$ 1.4 million; Japan-Indonesia Sugar Refining, signed in August 1964, with a credit line of US$ 12.5 million.

Some large public-owned industrial plants were constructed with US EXIM-Bank credit and PL480 collateral loans, such as the urea fertilizer plant in Palembang (completed in 1963), the cement plant in Gresik (first stage completed in 1955, second stage in 1960).

Around 1963 there was again a political confrontation with the West, i.e., the British and the Americans, and a pronounced political overture to the left. The economy suffered some more under such circumstances. Not much positive developments could be reported as to the development of the private sector in this period. The foreign private sector was virtually nationalized, i.e., their operations taken over by the government but leaving ownership undecided. The Chinese private sector did reasonably well in surviving but could neither grow nor flourish. The economy was very much state-controlled; price controls and foreign exchange controls were extensive. Only wheeler-dealers, smugglers and those who could obtain import licenses made good money.

The indigenous private sector could also not develop in an orderly way. On the other hand, under such circumstances of economic deprivation and scarcity the “informal sector” survived and in a way even flourished. Many government employees and their wives tried to
make ends meet with buying and selling used articles in a gray market. What was important of this phenomenon is that it gave to those normally non-trading classes experience, and after a while a taste, in commerce. During the Japanese occupation and the difficult times of early independence a number of upper class morals and habits of not dirtying their hands with trade broke down and paved the way for the emergence of a commercially inclined attitude among the elites.

A frequent phenomenon in newly dependent developing country is that ruling elites have not come from a commercial or industrial class; as a matter of fact they often are not even friendly to the latter. When such an elite class make policies, they will earnestly try to further the national interest, but such policies may not give the right incentives for the business class to perform. Such policies often have “socialist” orientations (e.g., more oriented toward the interests of agricultural workers and industrial laborers rather than employers), but if the most basic important part of the economy is still basically private enterprises, including the farmers, then such policies will not readily produce steady economic growth. Perhaps the government, in a mixed economy, should also come (at least partly) from the business class, or should at least have ties with the business class to be able to understand their problems.

5. THE NEW ORDER PERIOD

It is only during the present era of the so-called New Order government of President Suharto that much of the stigma of private enterprise was removed. Nevertheless, one must recognize that old teachings and prejudices die hard.

The prevailing political stance for the past twenty years had been “pragmatism”, which is a policy blend of still respecting old ideological commitments embedded in the 1945 Constitution and trying to accommodate these with the requirements of the growth of the economy under present circumstances. The 1945 Constitution in article 33, for instance, contained the mandate that “branches of production important for the State and of dominating interest to the livelihood of the masses of people have to be controlled by the State”. Such were the convictions of the founding fathers of the republic, many of them were steeped in the socialist traditions of western Europe before World War II.

On the other hand, the new government that replaced the old regime in 1966 recognized that the country was heavily capital deficient and also needed new technologies to develop the economy. The new
government overcame the old prejudice against foreign investments and enacted a law to attract and to give guarantees to incoming foreign investments. This law of 1967 was soon followed by another law extending the same incentives to domestic investments, meaning rupiah based investment by domestic private enterprise. Because many of the strong domestic private enterprises were Chinese-controlled, it meant that the new government wanted to extend its pragmatic approach to this part of the business community, the growth of which had never been free from domestic socio-political controversy.

Although most Chinese are Indonesian citizens and have long been rooted in the country, nevertheless because of the country's colonial history, they were regarded as somewhat alien by the indigenous Indonesians, and often became the subject of discrimination. The prejudice was that the Chinese have their loyalties outside the country and that they are part of a wider network of overseas Chinese, such that their assets will leave the country in case there is an urgent economic or political reason.

However, the New Order government, recognizing that the domestic Chinese are part of the "national assets", deemed it opportune to utilize their capital and capabilities to develop the national economy rather than to leave them apart. If foreign investments are being encouraged, which will produce a strong foreign presence in the national economy, it does not make good sense to hamstring the potential strength of one important segment of the domestic private sector. Domestic Chinese, because of their roots in the country, will at least be inclined to stay, in comparison to the foreign investors who, according the law, only hold temporary rights.

A prudent government, however, will still respect the strong historic predilections and steer a balanced course. That is why the new government did not abandon the old preference for a strong public sector. This sector can be appreciated as being part of the "indigenous or national" sector, especially when there is no strong indigenous private sector as yet. Hence, fueled by the revenues from the oil boom, this public sector also grew much during the present regime. Apart from the traditional public utilities sector, it also includes heavy industries, such as steel and shipbuilding, and chemical industries, such as cement, paper, fertilizers, and petroleum refining.

The modern enterprise sector in Indonesia today consists of three major elements, i.e., the public sector, the foreign sector and the domestic private sector. There are, however, partnerships and other relationships
between these three sectors. The current administrative definition of the foreign sector is a company registered under the foreign investment act. Foreign banks, however, are not under this act and neither are the foreign oil companies working under Production Sharing Contracts.

There are little statistical measurements of their relative strength if the three sectors, and from visual observation it is hard to tell even how the ranking order is. In banking the public sector is very dominant (75% in terms of assets), also in petrochemicals and in plantations. In downstream manufacturing industries private interest have the upper hand, and also in trade. Although there is a lot of interactions and interrelations between these three sectors, e.g., in joint ventures, their distinct politico-economic roles should be kept in mind. They are not equals but they are meant to complement each other.

6. CHINESE VIS-À-VIS INDIGENOUS ENTREPRENEURS

Within the domestic private sector a relevant distinction could be made between the so-called "strong" and "weak" economic sectors. "Strong" and "weak" are political euphemisms for identifying the Chinese and the indigenous Indonesian entrepreneurs without a sensitive racial connotation. The Indonesian government is in term of formal policy always non-racial in orientation because such is one of the tenets of the independence movement, but it nevertheless has to contend with strong popular sensitivities. The indigenous Indonesian entrepreneurs are mostly in the weak category, while many of the foreign and Chinese enterprise are assumed to belong to the strong category. This numbers game is a subjective matter, because no good statistics exist. However, the large(r) foreign and Chinese enterprises have greater visibility, especially in big cities.

For the sake of long term social and political stability it is important that the gap between the weak and the strong economic group be bridged and their disparities alleviated. There is a government program to assist the growth of these small and weak enterprises by providing them with small business credits with subsidized interest rates and small government contracts. State banks are reserved for that same category.

To foster linkages between the social categories of enterprises, including foreign, several policies are being promoted. Incoming foreign investments are required to associate themselves with domestic partners in joint ventures, where the local party has to have a 20% share at the start. In ten years the domestic share should be given the opportunity to
Indonesia's Private Sector

grow to 51%. With the Deregulation Package of December 24, 1987, however, greater flexibility is introduced in those numbers. Minimum local equity can be as little as 5% for exporting ventures located in free trade zones, without a time limit for increasing the local equity share. The time limit for divestment of foreign majority ownership is extended to 15 years with a possibility of extension of another five years. Clearly, those local equity criteria are political considerations and are more guidelines rather than strict rules.

Since 1974 state banks only lend term (investment) credit to domestic companies which have an “indigenous majority”, meaning that such domestic companies have to be majority-owned by indigenous Indonesians for at least 51%, or when majority share ownership is held by non-indigenous (meaning Chinese) Indonesian citizens, the majority of directors and commissioners should be indigenous Indonesians. Commissioners are members of the supervisory board.

This policy was instituted in 1974 after the large scale students’ demonstration during the visit of the Japanese Prime Minister, Mr. Tanaka, to the ASEAN capitals, which shook the government. These popular feelings were probably as much directed to the government and underscored the concerns of the students and other population groups of perceived rising inequities as a result of the liberal and open door policies during the execution of the First Five Year Plan (REPELITA I). The requirement that foreign investors have to have an Indonesian partner from the start and that the later equity share should rise after ten years to at least 51% also comes from the same motivational source.

Official policy and practice, however, are not always congruent. In practice the requirement that only so-called indigenous companies have access to investments loans from government banks is met only in a nominal sense, giving rise to so-called Ali-Baba companies where indigenous Indonesian parties (i.e., the Alis) fulfill the majority requirement, but in reality the original owners (i.e., the Chinese Babas) still control the operations. The state banks, cognizant of such facts, tacitly condone the arrangements because otherwise too few companies would be able to meet the minimum own capital requirements. For the government, these nominal accommodations are also sufficient for the time being, because one cannot force the development of certain desired conditions. If a start can be made of social or business integration between the different categories, that would be enough.

How did the Chinese and the indigenous Indonesian businessmen and entrepreneurs fare under the preference scheme or discrimination?
Again, hard statistical facts are unavailable, but the popular perception is that both categories were doing well, that is, when the economy still went strong until 1982. Preference schemes fit the so-called underprivileged areas economically more affordable in good times.

From the Indonesian side the supply of entrepreneur was also growing fast. Such was a reflection of swelling numbers of graduates from secondary and tertiary educational institutions. Education was much improved during the last fifteen years. If before the government was the most preferred place of first employment, that changed during the 1970s. For one thing, the government could not absorb too many new employees and more, while government pay scales were never adequate. For another thing, the private sector was given more appreciation and encouragement by the government, and especially the preference schemes were attractive for young educated indigenous Indonesians to enter business. Staff salaries are also much more attractive in the private sector, especially when the times are good.

The negative side of the preference schemes, however, was that the starting young entrepreneurs did not have to work and fight hard for their survival and growth, and this experience did not steel them to face the harder times since the recession of 1983. But even under such circumstances, there were still considerable government projects and procurement, including those of state owned companies, so that there was still a comfortable niche for some of them. In general, however, business conditions have become largely a thing of the past. Hence growth, if not survival, has become harder for these up and coming entrepreneurs.

The Chinese entrepreneurs have been able to hold their position and most probably even strengthen, because of superior business acumen, much longer experience and the effect of their extensive national and international networks. They also have learned to accommodate and cooperate with indigenous entrepreneurs when government business is at stake. The latter need them for their capital and experience and so a symbiotic relationship is shaping up, especially among the younger generations as they have shared the same national educational experience. Many of the old Chinese business people were educated in Chinese schools or were first generation migrants. Since the last twenty years there are only national schools in Indonesia. Young returning graduates from overseas universities, from both races, have a greater affinity to work together since they “talk the same language”.

58
7. THE FOREIGN BUSINESS SECTOR

After a virtual absence between 1957 and 1967 foreign enterprise came back as part of the policy of the New Order government. They came under the Contract of Work and Production Sharing contracts in the oil industry and under the foreign investment law in industry and other sectors.

The oil industry has always followed its own regime. On the one hand effective tax rates are much higher than in other sectors, but on the other hand they have (or had) more freedom and privileges. During the time of President Sukarno they were operating under a “let alone” arrangement, especially with respect to foreign exchange transactions and other operational requirements. Such liberties were a recognition of the industry’s importance for the national economy. The rest of the economy was virtually nationalized or socialized.

During the past twenty years old the New Order regime, these foreign oil companies in oil and gas virtually dominated national production, although they all had to respect Pertamina, the national oil company, as their landlord. The Production Sharing (PS) companies are nominally subcontractors of Pertamina, but operate under sufficient degree of freedom, fifteen years ago even much more so than now. Under the terms of the Production Sharing contract, “the management of the operation is in the hand of Pertamina”. The interpretation, however, in the past was liberal, and these subcontractors had only to submit their annual budgets and work program to Pertamina for approval. For the rest they were free. During the last five years or so, there have been increasing pressure for greater local content and more use of local services, but the foreign management still has large degrees of autonomy (although their complaints about time consuming Indonesian bureaucracy continued). The government’s present interest is to gradually stimulate the growth of local sources of inputs and the growth of local companies serving the oil industries.

The presence of foreign (investment) enterprise in industry, mining, forestry, banking, and other sectors is significant. If the leverage of foreign companies in companies registered as domestic investment is also taken into account, the overall influence of international business in Indonesia is very important. Many domestic companies are supported by their international partners for their overall capital requirements, for their technology, technical manpower, marketing and sales back-up, etc. The automotive, heavy equipment, electronics and electrical appliances industries, for instance, can be said to be dominated by the Japanese
industry. Indonesia is for Japan a very important target country for their overseas investments, number two only after the United States, with some US$ 7 billion of investments at stake. The Americans, on the other hand, have some US$ 4 billion invested in Indonesia, mostly in oil and gas, where they are dominant. Apart from Europeans, Canadian and Australians, there is also an emerging entry of Asian foreign investment, such as from South Korea, Hong Kong, Singapore, Taiwan and India. Often, as with Taiwan, Hong Kong and Singapore, their investments are indirect through local Chinese partners.

These foreign enterprises, as they operate under a foreign investment law are subjected to several restrictions. Foreign investment companies, and the foreign banks, do not enjoy national treatment. For instance, they are not permitted to establish their own marketing network as subsidiaries, but have to operate through local distributors. They cannot borrow Rupiah funds from state banks. Foreign banks cannot operate outside Jakarta. This discrimination was (at the inception of foreign investment policy in 1967) meant to protect domestic companies which are perceived to be weaker. When domestic savings were scarce, incoming foreign companies were expected to bring in capital from abroad rather than borrow local funds. There is also a law barring foreigners from domestic retail trade that historically was directed at non-national Chinese in the countryside. National treatment, however, is recently (i.e., part of the December deregulation package) given to joint ventures with 51% Indonesian ownership. It took twenty years to break this rule. Moreover, this national treatment is an incentive for joint ventures to divest, and is explained by the government as an incentive to the domestic parties in the joint ventures.

The underlying idea is that foreign capital and know-how should be complementary and assist the growth of national enterprises and not compete with the latter. As a matter of fact, the popular philosophy is that the growth of national enterprise is to be protected from outside competition, Indonesia, as a latecomer in industrialization and having a large — albeit often still potential — domestic market, has been very protectionist in outlook, and regards its domestic market as its major asset for industrialization. Effective protection against imports, both in term of tariffs and non-tariff barriers, is often high. Foreign enterprises working within the country are regarded a necessary element to complement and assist national capabilities. In reality, however, these restrictions are not severe. They involve a restriction in distribution, no access to government banks for (often subsidized) investment credits, expansion only if national enterprises cannot fill the market, while their
Indonesia's Private Sector

license in only limited to 30 years (although extendible). On the other hand, they have a legal guarantee for repatriation of profits and capital, and they are by law protected against nationalization.

Foreign enterprises once operating in the country enjoy also the protection regime. Matter of fact, that was the great incentive for the entry of so many import substitution industries. One can say that these foreign enterprises, once inside the country, share the same protectionist inclination.

Most of these foreign investment industries working mainly for the domestic market similarly contribute to a high cost economy. The scale of the plants were geared towards the size of the domestic market. Often the technology was not the most advanced or the most efficient for local conditions. Capital costs of the equipment and auxiliary facilities were often significantly higher per unit of capacity than in their home country, while the costs of raw materials and technology were often subject to transfer pricing. The high protection and the still unfulfilled domestic market made all stuffing of the cost possible.

A symbiotic relationship grew between the international companies and their domestic partners who were mostly Chinese during most of the last twenty years. Because foreign companies could not engage in distribution, and because this network has been mostly in Chinese hands, the Chinese partners in (mostly Japanese) joint venture companies received handsome distribution profits, which became their major vehicle for capital accumulation and for strengthening their position in the following stages. Because of the ravages of the national economy at the end of the Sukarno period, even the Chinese probably had little capital left. Compare the country's exports twenty years ago which hardly reached a quarter of a billion dollar, with over twenty billion dollars at the height of the oil boom. For developing countries, foreign trade (the best reflection of the modern sector) has always been the major source of capital accumulation. It should be mentioned, however, that for an OPEC country government contracts and procurements became very important sources for profit and capital formation also.

Although Chinese companies became the most numerous partners in Japanese direct investments, it should be noted also that government enterprises (e.g., in the Asahan aluminium smelter), public enterprise (e.g., Pertamina in a number of oil industry related ventures) and some indigenous companies (e.g., in automotive) became important partners.
8. COMPETITION AND THE ROLE GOVERNMENT

It is hard to pronounce an unambiguous judgment whether or not effective competition prevails in the Indonesian economy. The best answer is yes and no, depending on time and place.

Indonesia is a typical developing country trying to industrialize in a hurry. The prevailing beliefs or doctrines are not against monopoly, unless this is “to the detriment of the interest of people”, as stated in the State Guidelines, but who is to judge about the latter? There is no legislation yet to work it out. The role of the government in guiding and promoting economic development, directly through policies and indirectly through the public sector, is great, and since scale economies will tend to produce monopolies or oligopolies, this will entice the government to step in to regulate the market. Like in India, large state enterprises are often occupying the “commanding heights” of the economy, because this is part of the doctrine of planning.

Protection against competition from imports is high. During the first period of the New Order government, that was done mostly by tariffs. Import quotas were non-existent and complete import bans exceptional.

Over time non-tariff measure crept in. The government felt restricted by GATT agreements to impose too high import duties, except for luxurious consumption goods. When industries move from downstream to midstream and upstream, each of them demands tariff protection. This process resulted in a cascading structure with very high nominal tariff rates at the downstream end.

Too high tariffs for consumer goods, on the other end, encourage smuggling. For archipelagoes like Indonesia, situated near a free port like Singapore, smuggling under different names are an open invitation and a favorite pastime for less scrupulous entrepreneurs. Smuggling can take the form of outright physical entry through improperly policed routes between the small islands (Singapore is but a stone throw’s away from the nearest Indonesian island). “Smuggling” is also carried out in the form of passengers’ goods between Singapore and Indonesian ports of entry. Then there is a favorite type of smuggling through under-invoicing and declaring the goods under low(er) rates entries, which is called statistical smuggling. In one way, such smuggling is probably a blessing in disguise because it provides the consuming public protection against to high tariffs and prices. On the other hand statistical smuggling for intermediate goods parts, components, etc., produce unfair competition for manufacturing companies that could not resort to such means. The
foreign investment companies are at a handicap because they could not afford such practices.

Because of this competition from smuggling, import controls through complete bans became an accepted policy. For quite some time the importation of completely build-up passenger cars, television sets and radios has been prohibited, and the list has a tendency to expand and includes now fruits, perfumeries, spirits, etc. The argument in favor of complete bans and import quotas is that under the latter scheme smuggled goods, once they hit the street, cannot be acted upon because of the difficulty of providing the source. If an article is banned, then it can be confiscated if it is for sale. Such is not a foolproof system, because banned goods, mainly stemming from international passengers from ships and airplanes, still can be seen in stalls in Jakarta. But at least this is only a small phenomenon.

The practice of import quotas is not widely used because of the difficulty of defining the quantities and the importers. When quotas are practiced the government tends to control the channel by assigning the importation to a stage owned trading company which in turn could be further assigned to work with a private consortium. This system is called approved trading system. To the extent it is applied to control the importation of industrial raw materials, such as steel, raw materials for plastics, tin plates, it is not popular among the business community because it raises costs downstream, erodes export potential, and the windfall profit benefits only the consortium while the government is foregoing revenues from import duties. The assignment of a particular consortium is also an inequitable affair for the majority.

The reason for the government's intervention is to support the establishment of a mid- or upstream industry. The company, or companies, which are given the privilege to take part in the consortium, can use the profits for capitalization of the venture. The argument of the government is that there is no better way to establish the needed industry because under ordinary competitive conditions no investor would want to come in, also the capital requirements are too high for the degree of risk. This protection solves the problem of competition and capitalization. Do such examples constitute an example of socialization of a private enterprise which become the chosen instrument of the state for an execution of a project? It looks like that. But why not choose a state owned company? And why not choose the budgetary way to subsidize the establishment of such and industry? Such is one of the existing policies debates.
In one way it shows the ambivalent attitude of the government vis-à-vis state and private enterprise. Sometimes public enterprises are preferred, at other times the choice is for a greater role of private enterprise. Public enterprises are seen as the backbone of the economy, but the private sector is seen as much more dynamic and entrepreneurial. It shows the eclectic inclinations of the ruling regime.

There is one kind of competition from imports which have not found a satisfactory solution. Periodically, when world demand is weak, international suppliers try to unload their supplies at very competitive prices, perhaps below full costs and under their own domestic prices. Indonesia still has no anti-dumping law. There is some practice to collect import duties on “fair prices”, more to safeguard government revenues. Because of such occasional “dumping” practices, domestic industry feels more secure with high import duties, but this create a cascading effect of duties if industry moves backward. Another demand is for quantitative restrictions. Ultimately, existing industries got used to protection and when felt necessary press the ministry of industries for continuation of protection.

The policy of industrialization is still improperly integrated with trade policy. That is because the two camps, one favoring high protection and the other favoring more competition, are equally strong. Since 1983, however, the country realizes that domestic industry has to assume an export capability, and with all the sources of high costs that objective became difficult. Hence there is a growing recognition for a more rational industrialization policy not based on high and permanent protection, but how, how much (protection) and when (to phase out) still have to be worked over time.

Competition among domestic enterprises is also often controlled by government. When the New Order government came in, it abolished the extensive price controls of the old regime because it wanted to rely on the price mechanism for the allocation of resources. Such is still the ruling policy, but old habits die hard. One of the economic doctrines of the New Order is that it is against “free fight competition”, because the latter is too much identified with “capitalism”, which even the New Order cannot embrace. Hence the new doctrine is price mechanism for efficient allocation of resources without the excesses of competition. Excessive competition is also regarded as wasteful as it is the result of overinvestment and underutilization of capacity. Therefore, the idea of capacity regulation became popular, and industrial licensing becomes the natural outcome.
In reality it is difficult for the government to determine the optimal capacity in an industry because of poor statistics and technical information. There is always a cat and mouse game within the industry about this licensing of capacities. The existing industries like the protection and register often more capacity than effective just to persuade the government to early close the industry for new entry. On the other hand, other companies try to persuade the government to allow expansion or new entry under a variety of excuses. Some companies even undertake expansions without government permission and foregoing the usual investment incentives (exemption of import duties for capital goods, investment allowance, etc.). One can often observe that competitive spirit within private industry is often lively and that the inclination is more for expansion rather than contraction. This is one answer to the question posed before, i.e., whether or not competition prevails in Indonesia? The competitive spirit is great but everybody tries to jockey for an advantageous position, and in a regulated environment the game is as much played with the government.

Indonesia also has no legislation against monopoly, oligopoly and other restraints of trade. The attitude with respect to market power is ambiguous and ambivalent. On the one hand, it recognizes that size could convey greater efficiency, on the other hand, one of the political doctrines condemns monopoly if it hurts the interests of the people. This latter doctrine has not been spelled out in implementing laws or regulations. With respect to a government enterprise’s monopoly, such as for public utilities and Pertamina, the national oil company which has a monopoly over the sales of fuels domestically, the public is only recently becoming critical because of the drive against the high-cost-economy.

Although in general there is no government control over prices, especially in the private sector, nevertheless the government price regulating practice is commonly felt. First of all with regard to the major state enterprises, especially those of a public utility nature. Sugar is mostly produced by state owned enterprises and prices are administratively set. The prices for fertilizers produced by public enterprises or otherwise imported by semi-governmental bodies are also controlled. So are the sales of domestic fuels by Pertamina. The cement industry, regarded as a “vital industry”, is also often the subject of price control. This industry is a virtual oligopoly, although not anymore dominated by public enterprise.

Because inflationary conditions in Indonesia are endemic, the public often demands price controls by the government. The effectiveness of
price controls differs from situation to situation. Whenever there is an acute shortage, then a black market develops at the retail end which the government cannot control. Control is only practiced at the point of factory. Imports could provide relief, but are not always free and the tariff protection could be too high. Consumer goods are not subjected to price control. There is price stabilization for rice but through market operations done by a government agency.

Because of the great influence of government on economic life, i.e., the many regulations and the frequent policy changes, government relations become very important in the life of private companies, especially for the larger ones. In this respect, the foreign, the Chinese and the Indonesian companies, all have their own handicaps and advantages. Ministers and high government officials normally do not come from the commercial class. Economic minister are not political party people (although they are members of “Golkar”, the political organization supporting the government) but are so-called technocrats, which means that they are often professional economists but not businessmen. They are good at formulating macro-economic policies, even sectoral perhaps, but usually have no empathy for the problems of companies. Moreover, the general social and economic ideologies favor small business, the economically weak sector (meaning small indigenous ventures), cooperatives, rather than modern or business.

The foreign and Chinese enterprises normally have no good access to government circles, because they do not belong to the same “political class”. However, in practice they have their own advantages. The entry of foreign companies has been courted by the government and those companies are often large companies with professional managers. They can communicate with the sophisticated technocrats more on a par, as compared with directors of indigenous Indonesian companies. The Chinese managers, again especially the professionally or better educated among them and those representing large companies, have often also effective communication power. The Indonesians convey greater political clout, but the others can communicate more effectively and professionally. Nowadays, however, the ranks of better educated and professional Indonesian managers and directors have swollen. For government relations large companies now often employ as directors retired high government officials to improve access to government circles.
9. THE CHAMBER OF COMMERCE

Indonesia has an active Chamber of Commerce and Industry, in Indonesian called KADIN Indonesia. It is a relatively young institution still groping for effective performance and recognition. Membership is voluntary and that is one of the weaknesses of the organization since it has no financial strength. It aspires, perhaps appropriate in the current Indonesian social and political setting, a legal position under public law and that under such provision all registered companies above a certain criterion should become a member and pay dues. Such a system prevails in a number of West European countries as a result of Napoleonic codes (e.g., in France, Netherlands, and West Germany). A non-governmental organization encompassing all of the enterprise sectors, including state enterprises and commercially oriented cooperatives, and recognized by the government as the only “partner in economic development” for this sector of the society, will have teeth and financial strength for the execution of its functions.

KADIN Indonesia has long lobbied for a law to give its existence a strong base. This law came in early 1987. The new Chamber of Commerce and Industry covers the three major sectors of the economy (i.e., so mentioned in the Constitution), i.e., the private enterprise, the state enterprise and the cooperative sector. Hence the new Chamber of Commerce and Industry does not represent the private sector alone, but the whole enterprise sector. This was not the original idea of Kadin Indonesia, but a decision by a governmental drafter on the law. On the other hand, it does not contain compulsory membership. Apparently, the drafters of the law could not see such necessity as yet, although the door towards obligatory registration of companies with the Chamber of Commerce and Industry is not closed, since the government can (later) decide to transfer certain public duties and functions to the Chamber. For instance, periodic registration of companies can be entrusted to the Chamber. In the law the government has great powers over the Chamber.

The Indonesian Chamber of Commerce and Industry reflects the present day social, economic and political environment. Its membership does not constitute a homogenous constituency. The strong element are the state enterprises, the foreign (investment) enterprises, the large (often Chinese) domestic business houses and a number of upcoming largely medium scale concerns owned by indigenous Indonesians. On the other hand, the small enterprises and the cooperatives comprise the overwhelming majority. What and who should KADIN represent? Theoretically all of them, but where should the emphasis be and what if
sectoral interests are not convergent? In industrial countries, the Chamber of Commerce tend to represent more local and small- to medium-scale companies, while the large corporations have their own associations, such as Keidanren in Japan. The latter arrangement, however, is not tolerated in Indonesia; big boys should not overtly gang up. In its policy dialogue with the government, Kadin Indonesia tries to represent overall national interests, but especially tries to defend the interests of the business sector will respect to government's macro economic and sectoral policies. However, it is obliged to pay particular attention to the interests of the upcoming indigenous (small) business class, because this sector, strong in the provincial and district chambers, holds the majority of voting rights in the election of the governing board of the national chamber.

KADIN consists of the national organization in Jakarta, called KADIN Indonesia, 27 provincial KADINs, and many more district KADINs. There are also over 200 industrial, service and trade associations, covering sectoral interests, and a number of special interest organizations, such as representing young entrepreneurs, small business, women entrepreneurs, etc., which all fall under the aegis of KADIN. In Jakarta there are also a number of bilateral Business Councils and special chambers, such as the American Chamber, the Indonesia-Netherlands Association, the Indonesia-Canada Business Council, etc., also nominally falling under the umbrella of KADIN. Some of them, such as the bilateral Councils are an integral part of the KADIN Indonesia operations while others, such as the American Chamber, are very autonomous.

In the provinces and districts the majority of Kadin’s members consists of indigenous local business, a great number of them engaged in construction of government project projects or otherwise suppliers to government procurement. The local Chinese merchants do not often participate in the (local) chamber, and foreign investment plants located in the provinces are represented more in the national KADIN. Hence, in practice the bulk of Kadin’s membership and those having voting right consists of small, or the otherwise upcoming, indigenous enterprises. In line with the national preoccupation of “equity first”, KADIN’s representation is mainly concerned with the interests of this sub-sector of the business community. In the provinces and district such representation is also very relevant. In the capital city, however, interacting with the central government and mainly concerned with policy dialoging vis-à-vis the central government about macro-economic and broad sectorial policies, the interest of the larger and stronger business sector are better taken into account. The industrial, service and trade association also can
interface directly with government (i.e., minister and their staff) to defend their particular interest.

The Chamber of Commerce and Industry is under the circumstances an effective instrument for the upcoming private and business sector to interface with the government and to promote its long run developmental interest. The private sector historically does not have the political clout and does not enjoy high esteem, as does the cooperative sector. But in the New Order era the role of the private sector is given greater recognition. Recently this trend became accentuated in all of ASEAN as was reflected in the resolutions of the third ASEAN summit in Manila in December 1987. On the other hand, as long as the quality of leadership in the private sector, especially the indigenous part, does not command great respect as yet, it is harder to defend its interests against a politically and intellectually dominating government. Effective policy dialogue requires “parity”, and it is the task of the Chamber to develop this parity of interface.

A chamber of commerce has the traditional functions of, first, representing the interests of the private sector vis-à-vis the government. In Indonesia this is probably the most important function, because of the dominant role of the government in the economy, and because the government is still the most important buyer of goods and services. In this procurement the government also applies a preference scheme for the small business sector. This share, however, needs constant watching for fairness and open access. An allocation system based on administrative decisions will always have a tendency of becoming rigged by collusions and favored groups. In a developing country where the government position is very powerful, any influence that can function as a countervailing power has a very useful role.

The second function of a chamber of commerce is the collection and dissemination of information useful for the conduct of business. A third is trade promotion activities, i.e., the organization of trade delegation, trade fairs, seminars, etc. A fourth function is training and education. Chambers in Europe, for instance, have a very important role in the latter and are assigned certain public functions, such as holding examinations and issuance of certificates, sometimes even the management of harbors and airports.

All these commercial functions require funding and personnel of quality which is developing countries are not easy to get. In developing countries dues from voluntary membership never can be a steady or sufficient source of income. If regular dues cannot meet expenses a
chamber has to operate with donations from large companies which probably see a political advantage to support the chamber. That is why the Indonesian chamber would very much a semi-public status, with compulsory membership endorsed by the law. In Indonesia today such a status for the chamber is deemed more practical than a completely independent non-governmental association.

10. THE OUTLOOK FOR THE FUTURE

Will the private sector grow in importance in Indonesia, where for reasons of ideology, the public sector is more respectable, and where the cooperative sector is mentioned very prominently in the Constitution?

The answer is affirmative, as long as the present political regime continues. The main reason probably is that the private sector is much more dynamic and resourceful than the public sector and the cooperatives. The public sector will grow as long as the financing capabilities of the government is great, such as in period of the oil booms. In a time of financial scarcity probably the private sector will grow faster. From 1982 through the early 1990s, there will probably be no more oil booms and public development funds will be sufficient only for the construction of infrastructure projects.

On the other hand, if only the foreign and Chinese enterprises will grow fast, over time this will produce a political backlash and efforts to restrict their activities will grow. Hence, social engineering requires a more balanced growth of the various sub-categories of the private sector, and a symbiotic relationship between the three major sectors of economy, i.e., the public the private and the cooperative sector.

For a faster growth of the indigenous private sector two facilitating factors are required, i.e., the provision of capital and a greater supply of entrepreneurial talents as well as managerial personnel. Moreover, time is still required for a maturing process.

Capital could come from surpluses out of operations as well as from banks. The existing stock market is not yet an effective recourse. This market is very limited as yet because of strict rules for going public whereas the government did not want to allow speculation to take place. The stock market is seen more as a distributional means to allow small savers among the general public to buy shares, more for earnings of dividends rather than for capital gain. That is why at the moment only 24 "blue chips" foreign investment enterprises and a smaller number of large domestic companies have been allowed, actually urged, to "go
Indonesia's Private Sector

public" to about 20% of their stocks. Before the recession of 1983 the favored policy of the government was a dividend policy that provides a return on investments (based on "offering price" of the public shares) a little bit better than the interest on saving deposits in state banks, i.e., 12% per annum. That was easy enough for most of these import substitution industries in prosperous times, but since 1983 such dividend payments became more difficult.

The December 1987 deregulation package contains provisions to put new life into the existing Stock Exchange. Conditions and procedures for a company to go public were simplified, foreign parties could own Indonesian shares, and bearers' shares were introduced. A new "Over the Counter" window will be established with less stringent requirements for a company to go public. Companies could also issue bonds. Market making functions will be introduced among traders and specialists. In the past very little transactions took place at the quoted share princes.

The growth of domestic enterprises, especially belonging to the group of indigenous Indonesians, has been dependent on government banks. The government state banks since 1974 operated under the guideline to lend long-term investment credits only to "pribumi" (meaning indigenous) enterprise, where Chinese can take part but only in a minority position. Interest rates at government banks have always been lower than with private banks because the average cost of money is lower for the former.

Government- or large state-enterprise (such as Pertamina) are good sources of business, and that is why Indonesian indigenous business cavorts around the government. Capital formation through government related means is a favored growth strategy for this sector.

The supply of entrepreneurial and managerial talents is improving over time as a result of enlarged educational opportunities domestically as well as abroad. In former times the government was the major, if not the sole, employer of graduates of universities and technical schools as far as they came from indigenous Indonesian families, but for a number of years such is not the case any more. Job opportunities and careers in the private sector are as much preferred, even more so in boom times.

In early 1986 there was a popular public debate concerning the desirability of "privatization" of public enterprise. The roots of this debate lay in the unfavorable situation of the government budget, i.e., a forty per cent drop in the capital budget, because of diminishing oil revenues. Because this decline was seen as a trend, the hopes for
continued economic growth was put on the shoulders of the private sector.

The government also proclaimed an efficiency drive, realizing that productivity, rather than large amounts of investments, must now produce economic growth. Against this background the performance and the growth potentials of the public sector enterprises were subjected to evaluation and criticism, and the inevitable question was being asked: Could privatization of large non-vital public enterprises put new blood into the system?

There are no obvious and easy answers. Which state enterprises should be privatized, to what degree, by what procedures, to whom should the new ownership be offered, etc.? The interesting features are that there seemed to be an emerging disposition by government to entertain the idea and to study practical possibilities. Interestingly, this public debate, initiated by certain key economic ministers, petered out and not much more was heard in 1987. In large developing countries with a strong and entrenched public enterprise sector, it is not easy to privatize this sector. A more popular intermediate objective is to make public enterprises more efficient and profitable by improving the management and perhaps much more important, by giving them greater operational autonomy. Only if the latter fails, because of systemic difficulties (e.g., what agency or agencies will represent the state as shareholders, and how will they have as controlling agencies?), partial or complete privatization will become recourse of last resort.

What will the future of the foreign (investment) companies be? Will they be able to normally continue and expand, or will their growth be curtailed and existence finally phased out?

It is difficult to draw a certain scenario. Their existence will be subjected to conflicting influences. The ideological influence will limit their future. Foreign direct investment is seen as “supplementary” to the national capabilities, in terms of capital, technologies, managerial know-how and other requirements of industry. If such inputs have been successfully transferred to the host country, then the raison d’etre for foreign direct investment will cease, and national companies will continue their role. That is why the license for foreign direct investments is granted (only) for 30 years, though this is extendible. There are presently no cases as yet where this time period is up, because the first licenses were granted in 1967.

In practice, however, it will depend on the mood and practical
requirements of the time, to what extent the interpretation of the contributions of foreign investments, i.e., capital, technology, know-how, etc., are still regarded as critical for the further development of the economy. A developing country will often be deficient in industrial research and development and a number of direct foreign investments (e.g., in automotive and electronics) will always apply recent technological developments of a proprietary nature, making it difficult for a developing host country to keep up. The history of the Indian automotive industry is such an example.

If the pragmatic approach to problems will still prevail in the future, then the presence of foreign direct investments will likely continue beyond the end of the century. On the other hand, the forms and relationship will see evolution. At the moment, for instance, most foreign direct investment enterprises are majority controlled and management is still in expatriate hands. There will be a pressure for the gradual substitution by Indonesian personnel, ownership and control. Non-equity relationships, e.g., technical contracts, licensing, management arrangements, etc., will also have a greater presence. Again, motivating this will be the force of economic nationalism.

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73