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INDONESIA ASSESSMENT 1994

Finance as a Key Sector in Indonesia's Development

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Finance as a Key Sector in Indonesia's Development

Edited by Ross H. McLeod

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AUSTRALIAN NATIONAL UNIVERSITY
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Foreword

*Philip Flood AO**

The Indonesia Update Conference is a major opportunity for Australians to be informed about and to assess economic and political developments in our largest and most important neighbour.

The Australian National University, and especially those concerned within the Research School of Asian and Pacific Studies, deserve congratulations for the way this conference has attracted distinguished Indonesian representation, and for their contribution, and those of other Australian scholars, to knowledge about Indonesia in government, business, academia, the media and the wider community. This is reflected especially in the presence of Professor Dr Ali Wardhana who, as a senior Minister for twenty years and now as Special Adviser to the President, has played a distinguished role in overseeing the sound macroeconomic management of the Indonesian economy. Impressive attendance at this conference is also a tribute by the wider community to the strength of scholarship about Indonesia within this University.

More and more Australians are aware that Indonesia's economy has been growing strongly, and that Indonesia has played an important role in enhancing security and stability in Southeast Asia. But I wonder how many appreciate the scale of change which has taken place in Indonesia over the past thirty years, the dramatic nature of change which is continuing now, and the fact that Indonesia is becoming a very influential nation in world affairs.

By the middle of the next century Indonesia will be, in terms of population, the third largest country in the world, after China and India. Indonesia's population will have overtaken that of the

*Text of the Opening Address to the Indonesia Update Conference, August 1994.

United States, and may be between 300 and 350 million. If Indonesia should sustain average GDP growth rates of recent years, by the year 2050 Indonesia's economy will be larger than that of Japan today and will be close to that of the United States.

Per capita gross domestic product by then is likely to be greater than that of contemporary Spain. If Indonesia's GDP should grow at an average of 7 per cent annually, per capita GDP would be higher than that enjoyed today by Australia and approaching that of Canada. During the decade 2000-2010 the affluent middle class in Indonesia, living mainly in the larger cities, will probably grow to something like two or three times the entire population of Australia. Australians now at school will therefore be dealing, during their working lives, with a neighbour which is a major power wielding great influence in world affairs.

An important component of Javanese culture is the *dukun*—a person who has a special role in healing and in divining the future. The *dukun* is likely to be consulted by a farmer seeking to know the most appropriate time to start planting rice seedlings, by the merchant wanting to know the most favourable day to set off on a business trip, or by parents who want to know the most auspicious day for their daughter's wedding. A wise *dukun* would certainly say it is intrinsically hazardous to make projections and growth rate assumptions for many years ahead. But he would concede that they provide a broad indication of where Indonesia is heading and what this means for our region.

A *dukun* would have less difficulty in reflecting on the changes in Indonesia over the past thirty years. President Soeharto's New Order Government has succeeded in transforming Indonesia from an impoverished and divided country into a dynamic and rapidly developing one. The New Order has managed the country's growth with an impressive degree of success.

Just as in Australia, there are disagreements in Indonesia about national goals. In Indonesia these focus on many issues—the pace and direction of *keterbukaan* or openness, the place of Islam in national life, the widening gap between the affluent and the poorer sections of the society, the behaviour of large conglomerates and those controlling them, the evolution of *dwifungsi*, the role of legal institutions as a source of protection for the rights of ordinary people, and the Javanisation of many political and cultural arrangements. There are, too, unresolved issues concerning the province of East Timor.

The question is raised: Has the process of establishing political institutions gone far enough such that the eventual transition to a new President will be a successful one? My own view is that there are good grounds for thinking that the political, economic and social structures of the New Order, though still changing significantly, are robust enough to survive the passing of power to a new President. There are no major power brokers in Indonesia today who would seek to upset the momentum of economic development which has benefited the vast majority of Indonesians.

We err if we underestimate the pride and self confidence which Indonesians feel in their achievements. Though there are strong and divided voices about the path ahead, there is a conviction among the elites that the gains of the past thirty years in relative stability and sustained economic growth must be preserved and built upon. Indonesians know they are the leading country in Southeast Asia; they know they have the resources and the skills to build in the coming decades on the kind of progress which has been made in the last three. While the transition, when it takes place, may not be smooth, it seems unlikely to be associated with the kind of trauma which shook the archipelago in the mid sixties.

There is no doubt that President Soeharto has presided over a remarkable transformation in Indonesia. I would like to hope that he will visit Australia during his current and latest five-year term of office. Indeed it would be appropriate if he visited during 1995, the fiftieth anniversary of Indonesia's declaration of Independence. This would acknowledge the unique role Australia played in subsequent years in taking the initiative to have the UN Security Council begin the process of ending hostilities with the Netherlands, and then for our action to sponsor Indonesia's admission to the United Nations.

It was on 10 August 1947 in a message broadcast from Radio Djogjakarta that the then Republican Premier Amir Sjarifuddin declared to the Australian Prime Minister J. B. Chifley that:

... [t]he Government and people of Indonesia have, with relief and deep gratitude, followed every move of your Excellency's Government in defending the Indonesian cause before the forum of the United Nations. We have noted with great satisfaction that the Australian people have upheld an old tradition in assisting the Indonesian people, who are linked with the Australian people in

their common struggle in the cause of freedom and democracy (Dorling 1994:248).

These events of nearly 50 years ago are not as well remembered in Australia as they should be. As well as reminding us of links from the past, a visit by the President in 1995 would consolidate the remarkable developments of recent years to strengthen a wide-ranging bilateral relationship, and it would help set the framework for strong cooperation in the future. President Soeharto, more than any other leader, has made a major contribution to ensuring a benign strategic environment for Australia, and has fostered stability and cooperation throughout the region. In suggesting this I am not urging that we should agree with every policy Indonesia has adopted during his period as President. My point is more that the Australian community should offer a warm welcome to a neighbouring leader. We should create the conditions in which he should feel welcome here, in the same way that we have created such conditions for an American President and for a Japanese or a Chinese Prime Minister.

Since returning to Australia, one part of my present role has brought me into contact with State Ministers and Departments of Education, and of course with a large number of universities and colleges. This has made clear to me what a tiny proportion of Australia's school age population is being exposed to any effective teaching about Indonesia. While there is an unparalleled level of academic expertise about Indonesia in our universities, and while the Indonesian language is taught more widely here than anywhere outside Indonesia and Malaysia, very few primary and high school children across the nation are learning anything about Indonesia and its place in our political and commercial future. With the exception of the Northern Territory and Queensland, our children still go through primary and secondary school with only the most rudimentary exposure to knowledge about Indonesia and other countries in Asia. The appreciation by national political leaders of all parties of the importance of Indonesia is not matched by effective action at the state level to train teachers, change curricula, and provide effective teaching materials. The knowledge available in our universities and reflected in the Update Conferences is not reaching Australia's children.

Now let me turn to today's special topic, which bears on economic reform in Indonesia and Australia.

In the last 26 years since the establishment of the New Order, and especially since the early 1980s, there has been substantial

reform of economic policies in both Indonesia and Australia. There are important parallels in the way both Australia and Indonesia have approached economic policy in recent years. At the risk, perhaps, of oversimplifying the process, it can be said that one important theme of the reform process here in Australia has been the trend towards a greater reliance on market forces. Associated with this, of course, has been the widespread recognition that we need to become more export-oriented, especially in our dealings with Asia.

Vigorous though the reform process has been in Australia, I think it is fair to say that we have been outdone by the vigour of that process in Indonesia. The deregulation process began in Indonesia in the early 1980s, when the so-called 'economic technocrats', with the strong support of President Soeharto, moved to introduce the first of a series of deregulation 'packages'. In the eleven years since that process began, a continual stream of packages has been announced, each one removing or streamlining regulations and controls on economic activity in a wide range of sectors. Of course, some of these were more adventurous than others but, taken together, they constitute a remarkable set of reforms to the Indonesian economy. Firmly and steadily, the previously Byzantine set of controls on economic activity that existed in Indonesia at the end of the Sukarno era has been whittled away.

Needless to say, the deregulation process has been only one of the factors which has contributed to Indonesia's economic success in recent years, but it has clearly been an important factor. And the role of the senior policy-makers such as Professor Ali Wardhana—and colleagues such as Professor Widjojo Nitisastro, Dr Radius Prawiro, Professor Mohammad Sadli, and so on—has been quite central to the process. Rarely has such a small group of policy-makers played such an influential role in changing the direction of economic policy in any country.

Indirectly, we in Australia have benefited from Indonesia's economic success. If events had been otherwise in Indonesia during the past quarter-century, we might have had a large neighbour beset with enduring economic problems, with all of the political and social consequences which would have flowed from that. Instead, today we find ourselves next to a nation that has done extremely well, and with which, I hope, we will develop even closer links during the years ahead.

Very important challenges remain. Indonesia's income per capita is still low. The process of development needs to continue. This is true especially in Eastern Indonesia, and in some areas of Java. Looking to the next decade, there are important political challenges which Indonesia will need to address. And environmental problems will certainly become more pressing, especially on Java, as the population soars well beyond the 100 million mark (in an area just over half the size of the state of Victoria).

Australia, and the whole of Southeast Asia, has a vital stake in Indonesia's continued success. Here in Australia we will continue to be ready to do what we can to contribute to the process of development in Indonesia.

In opening this important conference, I look forward to a stimulating and informative discussion on the financial issues to be discussed today. They will provide a window into the future economic and political directions of Indonesia.

Glossary

\$	means US dollar throughout
ABRI	armed forces
BAKORSTANAS	military security body
Bimas	mass guidance agricultural extension program
BPPC	Clove Marketing Board
BPPT	Agency for the Evaluation and Application of Technology
BRI	Bank Rakyat Indonesia
<i>dwifungsi</i>	dual (military-civil) function
FKPPI	association of children of former military officers
Golkar	state political party
ICMI	Association of Muslim Intellectuals
Jamsostek	Workers' Social Security
<i>kabupaten</i>	district (level of government below province)
Kadin	Chamber of Commerce and Industry
Kassospol	Social and Political Affairs Command
<i>keterbukaan</i>	openness
KIK/KMKP	subsidised loan program for small business
KNPI	State Youth Association
Kopassus	Special Forces
KORPRI	civil servants' corps
Kosgoro	Veterans Association
KUK	small business lending

Kupedes	general purpose village lending
LBH	Legal Aid Institute
M0	base money
M1	narrow money
M2	broad money
Pakdes	December policy package
Pakfeb	February policy package
Pakjan	January policy package
Pakjul	July policy package
Pakjun	June policy package
Pakmar	March policy package
Pakmei	May policy package
Pakto	October policy package
PAL	state ship building company
<i>Pancasila</i>	five principles of state
PDI	Indonesian Democratic Party
<i>Petisi 50</i>	Petition of 50
PKI	Indonesian Communist Party
<i>pribumi</i>	indigenous Indonesian
SBI	Bank Indonesia certificate
SBPU	money market securities
SBSI	industrial organisation (not officially sanctioned)
Simpedes	village savings deposit
SPSI	workers' union (officially sanctioned)
<i>yayasan</i>	foundation

Contributors

Keynote Speaker at Indonesia Update 1994

Professor Dr Ali Wardhana is one of the key members of the group of past and present government officials known collectively as the 'Berkeley Mafia' (after the University of California at Berkeley, where many of them studied) or the 'technocrats'. This group is widely credited with quickly restoring stability to the economy following the chaos of the last few years of former President Sukarno's reign, and with overseeing the sound macroeconomic management which has permitted such rapid growth and structural transformation of the economy over the last quarter of a century.

He was Minister of Finance in the first cabinet of President Soeharto's New Order Government, serving three five-year terms before becoming the Coordinating Minister for Economics, Finance and Industry for a further five year term. After relinquishing this position in 1988, he became an Adviser to the Government, and in 1993, a Special Adviser to the President.

It was during Pak Ali's term as Coordinating Minister that the first, far-reaching banking deregulation policy package was introduced, in June, 1983, and he was also instrumental in introducing the even more startling second deregulation package in 1988, following which Indonesia's banking system could be said to have become one of the most liberal in the world.

Pak Ali's attention has not been restricted merely to macroeconomic management and microeconomic reform in the banking sector. He has also had a strong involvement in policies responsible for the extraordinary growth of the stock market, and in the arduous process of preparing new laws for the banking, insurance and pension funds sectors and for the capital market.

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Dr George Fane is a Senior Fellow in the Department of Economics, Research School of Pacific and Asian Studies, at ANU. His areas of specialisation are development economics and tax and trade policy, with reference to Indonesia and Australia.

Phillip Flood AO is Director General of the Australian International Development Assistance Bureau (AIDAB), and a former Ambassador to Jakarta.

Dr Stephen Grenville is Assistant Governor (Economic) of the Reserve Bank of Australia. He was formerly attached to the International Monetary Fund representative office in Jakarta.

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Mr Hendrobudiyanto has been an executive director of Bank Indonesia since 1983. His main responsibilities now are in the field of bank supervision, and he is one of two Bank Indonesia representatives on a government committee charged with working with the state banks to deal with their well publicised problems with bad loans.

David Knox is the Foundation Professor of Actuarial Studies and Director of the Centre for Actuarial Studies at the University of Melbourne.

David Linnan is an Associate Professor at the University of South Carolina School of Law. He is currently conducting research as a Fulbright Scholar at the Jakarta Stock Exchange and with the Capital Market Supervisory Agency (Bapepam), in cooperation with the Faculty of Law at the University of Indonesia.

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Richard Robison is Professor of Asian Studies at Murdoch University. He is Director of its Asia Research Centre, which undertakes research on social, political and economic change in

contemporary Asia. He is the author of several books on the political economy of Indonesia.

Dr Soeksmono B. Martokoesoemo was a Director of Bank Indonesia from 1966 to 1981, during which time he was heavily involved in guidance and supervision of the lending operations of Indonesian banks. Since then he has served as Director of the Agriculture and Rural Development Department of the Asian Development Bank, and as Senior Adviser to Bank Rakyat Indonesia and the Jakarta Stock Exchange.

Acknowledgments

Several organisations and many individuals have contributed in various ways to the success of this year's *Indonesia Update* conference and this *Indonesia Assessment* volume. Financial support was provided by the Australian International Development Assistance Bureau (AIDAB), which has made a special grant to support the *Update* conference series, the Department of Foreign Affairs and Trade (through its annual grant to the Indonesia Project), and the Research School of Pacific and Asian Studies at the ANU. I thank each of these institutions for their assistance.

Phillip Flood, AO, Director General of AIDAB, gave the opening address at the conference, and his speech is presented here as a Foreword. I thank him, along with the Indonesian Ambassador to Australia, Mr Sabam Siagian, the Director of the Research School of Pacific and Asian Studies, Professor Merle Ricklefs, and Professor Ross Garnaut, Convenor of the Economics Division, for their personal support for the conference. I am especially grateful to all those speakers and session chairpersons who made the long journey from Jakarta—and others who travelled less far from warmer parts of Australia and braved the cold of Canberra in winter in order to share their thoughts with us.

In addition to the papers presented at the conference, several more (apart from my own) were written specifically for this volume. These were contributed by George Fane, Boediono, Anwar Nasution, Kathryn Marshall, David Linnan, Henk Moll and Karel Palallo. I greatly appreciate the effort all these contributors have put into drafting and revising their papers in order to meet a very demanding publishing deadline, as well as that of those who presented papers at the conference.

Organisation of the conference and preparation of the manuscript for this volume were ably assisted by many colleagues. Bev Fraser and Allison Ley from the Department of Political and Social Change played major roles in ensuring both that the conference ran smoothly and that the editing and formatting work was completed in a very short time. Peta Kennedy added considerably to the quality of the manuscript at the proof-reading stage with her keen editorial eye, also working to extremely tight time constraints. Beth Thomson stepped in at the last minute with invaluable formatting assistance. Winnie Pradela's background support as Indonesia Project Administrator was greatly appreciated. Other Project members Liz Drysdale and Lynn Moir lent a hand from time to time, and several graduate and undergraduate students gave up some of their precious time to help with running the conference.

I am grateful for the contributions of the Head of the Indonesia Project, Dr Hal Hill, and of Professor Ben Kerkvleit and Dr Harold Crouch, of the Department of Political and Social Change, who were always ready to give me the benefit of their advice, but who also gave me a great deal of freedom to organise the conference and prepare this volume. My colleague Dr Chris Manning, organiser of last year's highly successful *Update*, gave me many helpful hints based on his own experience.

As last year's editors noted, the *Indonesia Assessment* series is now well established as a major annual publication on Indonesia. With the move to publication by the Institute of Southeast Asian Studies in Singapore, it is hoped that the series will reach a much wider audience—especially in that region—than was possible when the volume was published in-house. My final word of thanks, therefore, goes to our new publishers, for their cooperation in bringing this volume so quickly to what I hope will be a large and appreciative readership.

R.H.M.