



ASEDP NO. 12

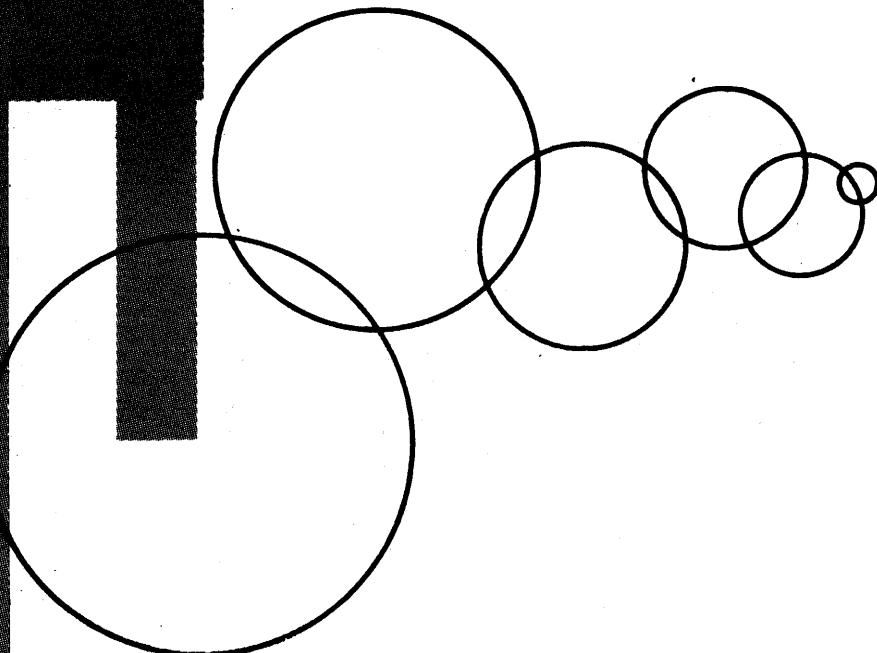
**INDONESIAN INDUSTRIAL DEVELOPMENT AND
ITS IMPACT ON THE ECONOMY
Deregulation Measures and Business Activity**

Edited, by

**SURYO SEDIONO
KUNIO IGUSA**

Contributed by

**MOHAMMAD SADLI
ASRIL NOER
DORODJATUN KUNTJORO - JAKTI
ANWAR NASUTION
AHMAD HAMID**



**INSTITUTE OF DEVELOPING ECONOMIES
TOKYO 1991**

CONTENTS

Introduction	i
Chapter 1. The Indonesian Economy in the Pacific and the Role of Private Enterprise	1
1. Political and Ideological Background	1
2. The Importance of the Pacific Region	2
3. Development of the Private Sector in Indonesia	5
3.1. Foreign Investment as Initial Pacermaker	5
3.2. Effects of Economic Development and Structural Change	9
3.3. Influence of Deregulation	10
3.4. Financing of the Private Sector	12
3.5. Problems of Privatization	14
3.6. Institutional Aspects : the Chamber of Commerce and Industry	15
3.7. Equity and Distributional Problems	18
4. Summary and Conclusions	20
Chapter 2. Foreign Investment and its Impact upon Industrial Development	23
1. Introduction	23
2. Export led Growth Strategy and Investment.	
2.1. Impact of the de-regulation measures on trade investment & financial sector since 1983	24
2.2. Industrial Policy : Turning-point from Import-substitution to Export-industries	25
2.3. Exports of manufactured goods	27
2.4. The need for industrial expansion, diversification and restructuring	27
2.5. Export-led Growth Strategi	29
3. The Role of Investment in Industrial Development	30
3.1. Total Investment and PMDN.....	31
3.2. Foreign Investment : PMA	31
3.3. Location of Industry	35
3.4. The Impact of Foreign Investment	36
4. Relocation of Industries and Influx of Foreign Capital to Indonesia	38
4.1. Global tendency of relocation of industries	38
4.2. The Indonesia Case	39
4.3. Competing Forces	39

4.4. Expectation and Performances	40
4.5. Japan : The Leading Goose	42
4.6. Korea : The High Achiever	45
4.7. Taiwan : Competing with PRC	46
4.8. Hongkong : Capital Flight Facing Hongkong 1997	47
4.9. Singapore : The Late-Comer	48
4.10. Concluding Remarks on Relocation	49
 5. Review of Theories on International Trade and Political Jargons	49
5.1. Comparative Advantage	50
5.2. Competitive Advantage	51
5.3. Value-added	52
5.4. "Brood Spectrum" vs Specialization	53
5.5. Policies of Structural Adjustment : "Broad-Base"	54
5.6. Theories on International Trade	54
 6. Foreign Capital Flow and Foreign Investment	54
6.1. Waves of Capital Flow	54
6.2. Complementary Activities	55
6.3. Annual Flow of Capital : 1990	55
6.4. Investment Climate	56
 7. Concluding Remarks	56
Appendix I	59
Appendix II	73
Appendix III	76
 Chapter 3. Domestic Investment and Growing Business Circle in Indonesia	85
1. Introduction	85
2. Inward Looking Policies	85
3. The Era of Deregulation	87
4. Investment Growth in Post Deregulation	89
4.1. Approval During 1980 - 1990	89
4.2. Cumulative approval by Sector 1968-1990	91
4.3. Domestic Investment Sectoral Growth in Post Deregulation	92
4.4. The Trend of Domestic Investment Location	98
4.5. The Rise of Export Oriented Investment	103
5. Conclusion	105

Chapter 4. Deregulation Policies and Changing Environment of Investment in Indonesia, 1982-1991	107
1. Introduction	107
2. Background of Economic Reform in the Period of 1982-1991	108
2.1. The Reopening of the Economy, 1966-1969	108
2.2. "Comparative Advantage" Based Growth, 1969-1974	110
2.3. Oil Boom I, 1973-1978	110
2.4. Oil Boom II, 1979-1981	110
2.5. Oil Price Crash, 1982-1988	111
2.6. BOP Crisis of 1983 and 1986	112
2.7. Effects of the External Shocks	112
2.8. Pressures on the Economy for Reform	115
3. Development of Deregulation Policy Packages	117
3.1. The Two Stages of Deregulations	117
3.2. Bank and Financial Deregulations	119
3.3. Tax Reform	121
3.4. Business and Investment Reform	121
3.5. Trade Reform	123
3.6. Transportation Reform	124
3.7. Differences in the Timing of the Reforms	125
3.8. Extra-Ordinary Measures of 1985-1991	125
4. Impact of Deregulation on the Environment of Investment	126
4.1. Response of the Private Sector	126
4.2. The Sudden Jumps in PMA and PMDN	129
4.3. Structural Change of the Economy	132
4.4. "Sumarlin Shock II" 1991	133
4.5. Difficulties in the Real Sectors	134
5. Conclusion	136
Chapter 5. Reform of the Banking Sector in Indonesia, 1983-1991 ..	141
1. Introduction	141
2. Characteristic of the Banking Industry and Monetary Policy Prior to the October 1988 Deregulation	142
2.1. The Structure of Commercial Banks	144
2.2. Branching and Geographic Dispersion	146
2.3. Special Preference to State Banks	148
3. Deregulation Measures in the Banking Industry	149
3.1. Relaxation of Credit Policy	150

3.1.1. Credit Programmes	150
3.1.2. New Selective Credit Policy	151
3.2. Access to Public Sector Deposits and Foreign Exposures	151
3.3. Rediscount Windows	152
3.4. Relaxation of Entry Barriers	153
3.5. Measures to Strengthen the Capital Base of the Banks	153
3.6. Other Measure to Improve Competition	154
4. The Impact of Deregulation	155
4.1. Micro Effects	155
4.2. Monetary Policy	158
4.2.1. The Money Supply Determination	168
4.2.2. Intervention in Foreign Exchange Market and Instrument for Open Market Operations	160
4.2.3. Interest Rates	164
4.2.4. Inflation	165
5. Conclusion	166
Chapter 6. The Role of Small Scale Industries in Economic Development	169
1. Introduction	169
2. Some Criteria of the Small Scale Industries	170
3. The Role of Small Scale Industries in Creating employment and their Characteristics	171
3.1. The Development of the Number of Establishment Employment	171
3.2. The Development of Value Added per Worker in MLI, SI and HCI and its Characteristics	174
4. Assigned Mission of Small Scale Industries	178
4.1. Mission of Small Scale Industries	178
4.2. Additional Employed Workers Will be Absorbed Within Five Year in Small Scale Industries	179
5. Government Policy in Promoting Small Industries	180
5.1. Business Interrelated between Classification of Firms	180
5.2. The Development of Subcontracting System in Japan	181
5.3. Hierarchical Subcontractors Feature in The Japanese Subcontracting System	184
5.4. The Position of Subcontractors in its Relation with Parent Company	184

5.5.	Benefit of Subcontracting System	186
5.6.	Subcontracting in Indonesia	187
5.7.	Component Reject Ratio	188
5.8.	Subcontractors Background	189
6.	Foster Father Program	190
6.1.	Projection of the Number of Foster Father	190
6.2.	Foster Father Performance	191
6.3.	State Owned Enterprises Foster Father	191
7.	Concluding Remarks	192

Name of the Authors

Drs. Suryo Sediono
Member of Institute for Economic Studies,
Research & Development (LP3E)
Indonesian Chamber of Commerce & Industry
(KADIN INDONESIA)

Prof. Dr. Ir. Mohammad Sadli
Member of Institute for Economic Studies,
Research & Development (LP3E)
Indonesian Chamber of Commerce & Industry
(KADIN INDONESIA)

Dr. Asril Noer
Director of Promotion Division,
Investment Coordinating Board of Indonesia
(BKPM)

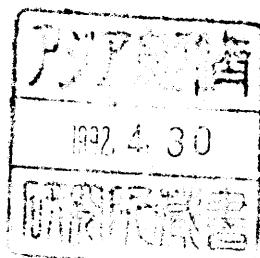
Dr. Dorodjatun Kuntjoro-Jakti
Associate Dean for Academic Affairs
Faculty of Economics
University of Indonesia

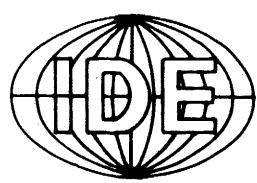
Dr. Anwar Nasution
Lecturer
Faculty of Economics
University of Indonesia

Drs. Ahmad Hamid
Center Chief
Centre for Economic and Development Studies
The Indonesian Institute of Sciences
(PEP-LIPI)

Kunio Igusa
Overseas Research Officer,
Institute of Developing Economies
(IDE, Tokyo)

**This report is a result of Joint Research
Project between LP3E-KADIN (Jakarta) and
IDE (Tokyo) in 1990**





ISBN : 4-258-55007-8-C3033



ASEDP NO. 12

**INDONESIAN INDUSTRIAL DEVELOPMENT AND
ITS IMPACT ON THE ECONOMY
Deregulation Measures and Business Activity**

Edited, by

**SURYO SEDIONO
KUNIO IGUSA**

Contributed by

**MOHAMMAD SADLI
ASRIL NOER
DORODJATUN KUNTJORO - JAKTI
ANWAR NASUTION
AHMAD HAMID**

アジア経済研究所



10264513

**INSTITUTE OF DEVELOPING ECONOMIES
TOKYO 1991**