Chapter VII

Indonesia: Growth Process in the 1990s and Future Adjustment Issues

1. Elimination of Social Instability — Key to Sustainable Growth

For the first time in five years, 1997 marks a politically important year for Indonesia. The sixth general elections for members of the House of Representatives (DPR) under President Soeharto's administration are scheduled for the end of May, but an overwhelming victory for the president's Golkar party has been expected since early last year.

Already 75 years of age, President Soeharto is one of the oldest active national leaders in the world. Although known as the "Father of Development," this year marks the 30th anniversary of his inauguration as president, and the strain caused by service of this length has become evident in various areas of this administration.

Despite a global call for a shift to the next generation in both the political and economic spheres, his seventh victory in a presidential election in March 1998 is certain. Although it is rumored that Soeharto's successor will be chosen from among the president's relations or intimate cabinet members, Soeharto himself has yet to clearly state his opinion on this topic. The July 1996 Jakarta riots occurred against this background, with subsequent riots frequently occurring in various areas throughout Indonesia.

In his annual New Year address to the DPR, President Soeharto expressed concern over the frequent riots in January 1997, offering an unprecedentedly strong appeal for public unity by declaring, "The good of the nation must take precedence over the good of individuals or small groups." This is not the first time the president has expressed this sentiment. The rapid growth seen from the end of the 1980s through the 1990s certainly strengthened the foundation of the Indonesian economy, but this growth has resulted in an obvious expansion of the gap between the lifestyles of the masses and those in middle and upper income brackets. Uncontainable public dissatisfaction over the expansion of this gap has led to frequent riots across the country and a recent increase of brutal crimes in Jakarta.

The most significant condition for preventing further social instability lies in maintaining sustainable economic growth without causing stagnation. The fact is, however, that obstacles to maintaining this growth are already evident throughout the Indonesian economy. Section Two examines the nature of future growth and explores future problematic areas inherent in the Indonesian economy.

2. Changing Industrial Structure and Future Prospects

(1) Steadily Expanding Manufacturing Sector

Indonesia is a traditionally agricultural country. Even at the beginning of the 1970s, when crude oil revenue began to gradually expand, agriculture accounted for nearly 50% of GDP. At this time, the commerce and service sector accounted for 30%, this and the agricultural sectors combined totaling 80% (Table 7-1). As subsequently described, these two sectors are still important to the Indonesian economy.

With surging petroleum prices caused by the oil shock, the mining industry rapidly expanded from the 1970s, outstripping the agricultural sector in 1980 and accounting for more than 25% of GDP. Although the commerce and service sector stood at less than 30%, these three sectors drove the Indonesian economy in the 1980s. The so-called "reverse oil shock" which began soon after, however, caused a gradual decline in the contribution to GDP by the mining industry, and the manufacturing sector, at last fostered by an import-substitution industrial policy, steadily grew, replacing the mining industry in this respect.

The manufacturing and agriculture sectors competed in terms of GDP contribution in 1990. Activity in the third investment boom subsequently drove the manufacturing industry's contribution up annually, with a parallel further decline in the percentage of GDP accounted for by agriculture. A comparison between 1970 and 1995 reveals that,

Table 7-1 Shifts in GDP Distribution Ratio by Sector in Indonesia

	1983 Price Base						1993 Price Base		
	1970	1980	1990	1991	1992	1993	1993	1994	1995
Agriculture	48.6	24.8	19.4	18.4	18.5	17.6	17.9	16.7	16.1
Mining	5.3	25.7	15.2	15.7	14.5	13.9	9.6	9.4	9.2
Manufacturing	9.0	11.6	19.4	20.0	20.6	21.1	22.3	23.3	24.0
Electricity/Gas/ Water Supply	0.5	0.5	0.6	0.7	0.7	0.7	1.0	1.0	1.1
Construction	3.1	5.6	5.8	6.0	6.3	6.6	6.8	7.3	7.6
Transportation/ Communications	3.0	4.3	5.5	5.6	5.8	5.9	7.0	7.1	7.1
Commerce/Service	30.5	27.5	34.0	33.7	33.8	34.2	35.4	35.1	34.9
Total GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Compiled from Indonesia Central Statistics Bureau data

while the manufacturing sector expanded approximately 2.5 fold, the agricultural sector decreased by approximately one-third. It should be noted that the construction sector's contribution had also expanded 2.5 fold compared with 1970, reflecting the boom in the investment and construction sectors that was experienced in the first half of the 1990s.

(2) Stagnant Agricultural Production and Increased Imports of Agricultural Products

The current Second 25-Year Development Plan (started in April 1994) estimates that agriculture will still account for 15.2% of GDP at the end of 2003, the year when the next (7th) five-year plan is complete. This 25-year plan stipulates that agriculture will account for a single-digit percentage of GDP once the country moves into the 10th five-year plan which will commence in 2013 (Table 7-2). This represents a gradual shift over the next 15-16 years in Indonesia to an industrial structure similar to that currently instituted in Thailand.

Despite the rapid growth of the manufacturing industry during the 1990s, 46% (approximately 37 million people) of all Indonesian workers are employed in agriculture, with those employed in the manufacturing industry at only 13% (as of 1994). With approximately 2.5 million people entering the job market each year, the absorption of employment into the agricultural sector provides a means for preventing unemployment.

Recently, however, extremely low production increases of main agricultural products in Indonesia have been noted. Although a relatively low economic position is likely to be assigned to agriculture by long-term plans, declining absolute values in agricultural production pose a serious problem for Indonesia with its population of 200 million.

Rice (unhulled conversion), for example, stalled at an annual average increase of 2% during the five-year period prior to 1995, and remarkable increases and decreases have at times been evident. Indonesia attained self-sufficient rice production in the second half of the 1980s, but imports have recently increased. In addition to the fact that, with economic growth, supplies of domestically produced rice have become insufficient to fulfill domestic demand, frequent droughts and floods, and particularly decreasing rice paddy areas caused by the construction of industrial complexes and planned communities in urban suburbs are also affecting the country's ability to meet rice demand. (According to a September 1996 government announcement, the 1995 national cultivation area of 11.43 million hectares had decreased by 200,000 hectares to 11.23 million hectares in 1996.) Rice imports, which were only $14 million (50,000 tons) in 1990, surged, increasing 36 fold to $514 million (1.8 million tons). The estimate for 1996 domestic production, which was announced at 51 million tons, also fell below the original target.

Although corn imports totalled only $2 million around 1990, these imports increased 77 fold in 1995 to $154 million, and domestic production growth did not exceed an annual rate of 4% during this period. Imports of barley, a crop which cannot be produced domestically, nearly tripled from $280

Table 7-2 Indonesian Economic Indices Until 21st Century

	Unit	Actual FY93 Results	6th 5-Year Plan End-of-Period Value (1998)	7th 5-Year Plan End-of-Period Value (2003)
(1) Total Population	1 million	189.1	204.4	219.4
(2) Population Growth Rate	%	1.7	1.5	1.4
(3) Workforce	1 million	78.8	91.4	105.2
(4) Number of Employed	1 million	78.8	90.7	103.8
(5) Average Life Expectancy	years	62.7	64.6	66.3
(6) University Enrollment Ratio	%	10.5	12.8	15.0
(7) GDP Growth Rate	%	6.6	6.2	6.6
Agriculture	%	2.4	3.4	3.5
Manufacturing	%	10.0	9.4	9.4
(8) Per Capita GDP	(1,000 rupias)	1,188	1,487	1,908
(9) Industrial Distribution Ratio				
Agriculture	%	20.2	17.6	15.2
Manufacturing	%	20.8	24.1	27.4

Source: Compiled from summary tables included in the Second 25-Year Long-Term Development Plan (PJP-2)

million in 1990 to $800 million in 1995. Imports of this crop are expected to further increase with future rapidly increasing demand as dietary improvements incorporate such foods as noodles and bread.

With the economic growth of the 1990s, a clear tendency toward import expansion is evident among general agricultural products and processed foodstuffs. Recent surging imports of fruit and dairy products seem to be a sign of changing dietary habits which have accompanied increasing incomes. The acceleration of these changes will bring additions to staples such as rice and barley, further increasing imports. Although complicated barriers to the expansion of agricultural production, including a decreasing rural population and graying of the farming community, are too numerous to detail, the possibility is strong that problems in food provision will emerge as a significant issue for Indonesia with its population of 200 million.

3. Economic Growth Driven by Foreign Investment

(1) Belated Full-Scale Foreign Investment Policy

With its weak domestic capital, former president Sukarno's nationalistic policy strongly influenced Indonesia, and the country adopted an industry-fostering policy which concentrated on state-run companies, even in the area of economic management. Leaning strongly toward the West, the Suharto administration undertook a complete policy shift toward the fostering of industry through privately operated companies and the introduction of foreign investment. As a result, Indonesia has already experienced several investment booms. The first occurred from 1967 to 1974, and the second from 1987 to 1990. The first took place with the enactment of the Foreign Investment Law by the Indonesian government in 1967, in which the government abandoned the closed economic policy formerly instituted during the Sukarno administration and shifted to open economy policy. During this boom, foreign investments were made in textiles, automobiles and electric appliances by companies taking advantage of government policy designed to entice import-substitution industries. These investments were made prior to the establishment of high import duties by the government that were aimed to protect the domestic manufacturing industry. At this time, large companies, particularly such Japanese companies as Matsushita Electric, Sanyo Electric, Toyota, Mitsubishi, Toray and Teijin, advanced into Indonesia in order to secure shares in this market, with the majority of these investments made as joint ventures with Indonesian companies capitalized by Chinese merchants.

As antiforeign sentiment born of social instability strengthened as a result of subsequent failed government economic management, however, the government reversed its position by introducing strict regulations on foreign investment, and foreign investment subsequently stagnated for more than ten years. This period, however, was also characterized by unprecedentedly favorable conditions in Indonesia brought about by the oil boom. The government was ultimately affected by its self-confidence and strong awareness of the country's strength, convinced that petroleum revenues would suffice without concessions having to be made to introduce foreign investment.

The second investment boom occurred when the government, reevaluating the long-term economic stagnation caused by the "reverse oil shock" at the beginning of the 1980s, finally began deregulation. Suffering from a long-term aggravated petroleum market, Indonesia at last recognized the importance of fostering the export industry, and implemented deregulation in order to strengthen this industry with foreign capital. At the same time, global currencies were adjusted according to the Plaza Accord of September 1985, and Japan and Asian NIEs began to unanimously shift production bases to Southeast Asia.

(2) Third Foreign Investment Boom — Will it be sustained?

The inflow of foreign capital into the country during the third investment boom far exceeded that of the first. Such countries as Thailand and Malaysia, however, had instituted policies fostering the export industry earlier than Indonesia did, and the flow of capital into countries with liberal preferential policies for foreign investments was much stronger. Investment in Indonesia was concentrated in labor-intensive light industry, and companies investing in the country consisted mainly of small and medium enterprises from such Asian NIEs as Korea, Taiwan and Hong Kong.

In addition to the deregulation policy that was instituted full-scale from the beginning of the 1990s and the fairly strong enticement offered to foreign investors as a result, the drastic appreciation of the Japanese yen which followed the bursting of the "bubble" economy from 1993 and a progressively stronger necessity for a further shift of production bases to Asia by both small and large companies need to be factored into this third foreign investment boom. Further, in June 1994, the government approved the introduction of 100% foreign-capitalized investments (1994 Ordinance No. 20), which had previously been prohibited, and Indonesia's first radical and large-scale conversion in foreign investment policy in 20 years seems to have enticed investors. The success of this policy was verified in a November 1996 announcement by the Indonesian Investment Adjustment Agency which stated that, of the 1,963 (a total of $88.8 billion) cases approved between the implementation of the ordinance in 1994 and the middle of October 1996, 751 cases (38.3%) totaling $34.7 billion (39.1%) represented 100% foreign-capitalized investments.

At the same time, an industrial infrastructure, including industrial complexes, road networks and power plants, has steadily been put in place, and the establishment of a "hard" investment environment comparable to those in countries such as China and Vietnam with which Indonesia competes for introducing foreign investment, must not be overlooked.

The amount of foreign capital which has actually entered Indonesia from the beginning of the 1990s is tremendous. In fact, 80% of total investments, reaching $127.2 billion, approved by Indonesia Investment Coordination Board (BKPM) from 1967 to October 1996 have been made since 1990. Specifically, 40% of these investments ($63.6 billion) were approved during the two-year period of 1994 and 1995 (Table 7-3).

Although the manufacturing industry accounted for a relatively high percentage of investments until the 1980s, the number of investments related to infrastructure and real estate, including investments in electricity, gas, water, hotels and restaurants, housing, real estate and office buildings, increased at a rate eclipsing that of manufacturing from the beginning of the 1990s. From 1994, however, a significantly successful shift in the Foreign Investment Law resulted in a return to increased investment in the manufacturing industry. In 1994, 79% of all cases of approved foreign investment involved the manufacturing industry, and 67% involved manufacturing in 1995.

A concentration of large-scale investments in petrochemicals from the beginning of the 1990s and a tendency toward steady increases in machinery-related investments, particularly from 1993, should be noted with regard to the manufac-

Table 7-3 Shifts in Foreign Investment by Sector in Indonesia

(monetary base; unit: $1 million)

	1990	1991	1992	1993	1994	1995	1996	90-96 Total (1)	67-96 Total (2)	(1)/(2)
Primary Industry	307	26	2,543	134	730	1,374	3,123	8,238	12,542	66%
Agriculture	170	14	66	112	690	1,153	1,211	3,417	4,451	77%
Fisheries	20	11	28	22	40	221	80	421	648	65%
Lumbering	2	1	138	0	0	0	136	276	650	42%
Mining	116	0	2,312	0	0	0	1,697	4,124	6,792	61%
Manufacturing (Secondary Industry)	5,647	3,971	5,668	3,423	18,739	26,892	15,254	79,593	114,383	70%
Foodstuffs	99	382	213	141	1,235	1,332	641	4,043	5,320	76%
Textiles	1,094	532	591	419	396	471	402	3,906	6,410	61%
Lumber	218	62	34	50	68	263	89	783	1,252	63%
Paper Manufacturing	730	822	686	202	5,120	2,541	2,905	13,006	23,845	55%
Pharmaceuticals	-	-	0	12	1	37	43	92	372	25%
Chemicals	1,998	926	2,342	1,171	7,743	19,368	7,164	40,711	49,953	81%
Nonmetallic Minerals	125	133	841	98	632	289	641	2,759	4,905	56%
Basic Metals	825	197	47	186	2,082	292	578	4,205	7,642	55%
Machinery	460	856	863	1,114	1,423	2,258	2,722	9,696	14,193	68%
Other	99	60	51	30	40	42	69	391	490	80%
Tertiary Industry	2,796	4,782	2,110	4,561	4,256	11,638	9,265	39,408	44,530	88%
Electricity/Gas/ Water Supply	-	-		2,276	2,397	3,549	3,809	12,031	12,460	97%
Construction	77	26	41	97	77	206	273	797	1,301	61%
Trade	-	-	-	693	87	31	45	855	1,063	80%
Hotels/ Restaurants	874	4,019	919	394	344	999	938	8,487	9,775	87%
Transportation	803	167	14	85	145	5,540	691	7,445	8,075	92%
Housing/Real Estate	902	403	240	384	795	1,062	2,131	5,917	6,744	88%
Offices	-	-	476	214	233	130	372	1,424	2,563	56%
Other Services	140	167	420	418	179	123	1,006	2,453	2,551	96%
Total	8,750	8,779	10,322	8,118	23,724	39,905	27,641	127,239	158,913	80%

Note: 1996 data from January to October
Source: Statistics approved by the Indonesia Investment Coordinating Board (BKPM)

turing industry. In anticipation of future Southeast Asian demand, a concentration of large-scale investments in pulp and paper was also evident in both 1994 and 1995. In contrast, there is an evident tendency toward a steady decrease in textile-related investments, which had been numerous in the 1980s.

Although 959 cases of foreign investment, a 20% increase in number, were made in 1996, the total investment sum stalled at $29.9 billion, a 25% decrease, due to a decline in the number of large-scale investments, including those in petroleum refining which had been high in the previous year. Consideration of investments by country reveals a clearly changing pattern in investments, including a relative decrease in investments by such Asian NIEs as Korea, Taiwan and Hong Kong, which comprised the country's main investors from the 1980s to the beginning of the 1990s, and a strong tendency toward increased investments from such neighboring ASEAN countries as Singapore, Malaysia and Thailand in their place.

Indonesia would benefit most from future investments in small and medium enterprises in supporting industry, including electronic and electrical appliances and automobile parts, and in agribusiness which contributes to the creation of employment in the agricultural sector and to the revision of income gaps.

The concept of the production of the Timor national car by the Humpuss Group, of course, appears a stronger means to usher in a new phase for the Indonesian automobile industry. In the automobile industry, this concept advocated by the Timor Group gave rise to significant controversy in 1996 both in Indonesia and overseas, and 1996 production levels fell 16.7% over the previous year to 325,400 cars. It is rumored that this concept is already being reevaluated due to the slumped demand experienced in Timor.

In addition to a successive number of new plans for entry to the automobile market by a large number of financial groups such as the Salim, Bakrie and Bimantara, progress is also being made in planned production increases by existing manufacturers through the introduction of new models and the construction of new plants. Conditions indicate that interest rates will not rise, and future domestic sales appear favorable. At the same time, the idea of the production of a national car and concepts by various companies of a domestically produced car are stimulating the advancement of automobile parts companies into Indonesia, and if these concepts take off, part imports can be expected to decrease and trade revenue in the automobile sector to improve.

A shift of production bases from Malaysia and Singapore to Indonesia, mainly in the parts industry, is continuing in the electronic and electrical appliance sectors. As the problems of surging rents and absolute shortages in simple industry are difficult to resolve in both of these countries, this trend is likely to continue. Semiconductor plants, mainly from Japan and Korea, will operate in Indonesia, and the domestic procurement environment for electronic parts also appears likely to improve further.

The Minister of Trade and Industry, Ariwibowo, announced in January 1997 that a total of $8 billion would be invested in the construction of a high-technology electronics-related industrial complex in which foreign-capitalized and domestic electronics-related companies will be concentrated in Bandong on the island of West Java. The United States company Intel is likely to contribute to this project, and a tax-exemption measure (tax holiday) offered to specified industries with the enactment of 1996 Ordinance 45 that was announced in July 1996 is expected to be applied in this case.

According to a research report issued by McKinsey & Co., a United States consultant, who participated in the formulation of this plan, future Indonesian exports of electronic products are expected to see an annual average growth rate of 35%, totaling $10 billion in 2000, and if this plan proceeds as expected, electronic product exports are expected to reach $40 billion in 2006.

4. Changing Trade Structure

(1) Expanding Industrial Product Exports

As a base for exports of petroleum and natural gas to Japan, Indonesia, the only Asian member of OPEC, has traditionally maintained a petroleum-dependent trade structure. The country is, however, succeeding in shifting away from this trade structure. Until the 1960s, the Indonesian trade structure was typical of developing countries with the country exporting natural resources and importing industrial products. Based on its image as a major crude oil and natural gas exporter (natural gas will be subsequently referred to by the Indonesian word "migas"), it is easy to believe that the country's exports were still based on the resources traded at that time. Until the 1970s, however, non-crude oil/natural gas (non-"migas") exports consistently surpassed "migas" exports. The majority of these non-"migas" exports comprised primary products such as timber and unprocessed agricultural and marine products.

The oil shock experienced at the beginning of the 1970s assigned Indonesia its place as a major petroleum export country. The country was accordingly able to avoid the economic stagnation experienced by other non-oil producing developing countries which was caused by the global slump in primary product prices. This development, on the other hand, represents the most significant cause of Indonesia's belated fostering of export-oriented industries. By not implementing an export-oriented policy until the second half of the 1980s, Indonesia was lagging by approximately ten years behind neighboring ASEAN countries such as Thailand and Malaysia, which had already begun active implementation of policies designed to foster the export industry from the second half of the 1970s. Indonesia implemented this conversion, however, at a fever pitch when a more than 45% depreciation of the rupiah to the U.S. dollar in 1986 offered an opportunity for swift conversion. As a result, the competitiveness of export prices for Indonesian products, mainly textiles, rapidly strengthened, and non-"migas" exports surpassed "migas" exports in 1987.

(2) Concern Over Stagnating Exports

Accounting for 13% of total exports, textiles represented the largest export item for Indonesia in 1995, with no other item accounting for more than 10% (Table 7-4). The rate of growth in textile exports, which had increased at an annual rate of 30-40% from the middle of the 1980s, however, rapidly fell from the beginning of the 1990s. In addition to strengthened regulations on textile imports that were implemented by European and North American countries, expanded domestic demand also appears to account for this. The majority of export-oriented capital investment and production increases are basically, however, concentrated on low-priced standard products made of synthetic fibers, and continued stagnation of export prices due to relaxed markets has led to declining growth. The textile industry must also respond to the shift away from quantitative expansion toward qualitative expansion. Although the government has revised its target for textile exports in the final year (1998) of its current 6th five-year plan down to $10 billion from the original $12 billion of September 1996, the Indonesian Textile Association (API) has stated that this revised goal will still be difficult to meet.

On the other hand, a significant gap between companies exists within the textile industry, and not a few companies are experiencing financial difficulties due to the burden posed by the increased minimum wage. According to research conducted by the Jakarta Chamber of Commerce and Industry in 1996, 403 of 2,203 existing domestic clothing manufacturers are suffering from the minimum wage raise and are verging on bankruptcy. In October 1996, Director of the Indonesia Central Statistics Bureau, opened discussion on the containment of wages at a meeting of the Central Committee on Wage Issues by stating, "The majority of companies in labor-intensive industries are structured on the original low wages, and labor costs account for a high percentage of production costs. The capacity of this industry and of companies to manage financial burdens must therefore be taken into consideration when evaluating an annual revision of the minimum wage and setting wage increases."

Until 1987, textiles represented the largest Indonesian export; plywood has subsequently replaced textiles, but recent sluggishness in this export is also noticeable. The most significant cause of this lies in slumped exports to Japan. Although imports of plywood from Indonesia by Japan accounted for more than 90% of total plywood imports at their peak, the figure plunged to 67% in 1995. Indonesia's neighbor Malaysia strengthened its presence in this market, with plywood accounting for 23% of its imports in 1995. Indonesian plywood exports to major importing countries other than Japan, including China and Korea, continue to be sluggish as well. Factors such as the export framework and prices are controlled solely by the Indonesia Plywood Association (APKINDO), and strong opposition has emerged to this association which in reality controls plywood exports, but does not approve membership of new commerce.

In a situation similar to that of the plywood industry, exports of agricultural and marine products, traditional export items, have also slumped through the 1990s to $2-3 billion, declining to 6% of the share of total exports. The average annual growth rate for the five-year period from 1990 stood at 7.7%, much lower than the 29% annual average growth rate for industrial products.

In contrast, the five-year annual average growth rate for industrial products, excluding plywood, lumber and textiles, stood at 57%, recording close to twice the growth of total industrial products. Of these products, growth in electrical appliances, chemical products, pulp and paper, footwear and mining products was especially strong. Growth in electrical appliances has been particularly notable, approaching the level seen with plywood, and these products are expected to be the second-most exported item in 1997, following textiles. Sports shoes, mainly destined for the United States, exceeded the significant figure of $2

Table 7-4 Shifts in Exports by Item in Indonesia (unit: $1 million)

	1990	1990 Share	1991	1992	1993	1994	1995	1996	1996 Share	95/90
Total Exports	25,675	100.0%	29,142	33,967	36,823	40,053	45,418	31,873	100.0%	176.9%
Oil/Gas	11,071	43.1%	10,895	10,691	9,746	9,694	10,465	7,310	22.9%	94.5%
Non-Oil/Gas	14,604	56.9%	18,248	23,296	27,077	30,360	34,954	24,563	77.1%	239.3%
Agricultural and Marine Products	2,083	8.1%	2,282	2,212	2,644	2,818	2,889	1,836	5.8%	138.7%
Coffee	369	1.4%	361	217	320	697	596	367	1.2%	161.5%
Prawns	672	2.6%	759	757	872	1,005	1,032	632	2.0%	153.6%
Tea	181	0.7%	143	141	156	89	85	64	0.2%	47.0%
Spices	152	0.6%	154	142	132	137	214	99	0.3%	140.8%
Fish	246	1.0%	328	326	445	329	372	236	0.7%	151.2%
Industrial Products	11,879	46.3%	15,068	19,613	22,944	25,702	29,328	20,620	64.7%	246.9%
Sub-Total (1)	5,753	22.4%	7,123	9,603	10,829	10,026	10,119	6,751	21.2%	175.9%
Plywood	2,726	10.6%	2,871	3,230	4,257	3,716	3,462	2,292	7.2%	127.0%
Lumber	110	0.4%	177	312	390	510	454	301	0.9%	412.7%
Textiles	2,917	11.4%	4,075	6,061	6,182	5,800	6,203	4,158	13.0%	212.6%
Sub-Total (2)	3,532	13.8%	4,957	17.0%	8,260	22.4%	13,677	9,843	30.9%	387.2%
Rubber	892	3.5%	981	1,125	1,063	1,391	2,191	1,527	4.8%	245.6%
Palm Oil	204	0.8%	335	356	472	718	747	546	1.7%	366.2%
Electrical Appliances	286	1.1%	527	1,097	1,672	2,380	2,778	2,117	6.6%	971.3%
Processed Foods	292	1.1%	391	430	436	813	819	584	1.8%	280.5%
Cement	97	0.4%	43	107	65	30	8	17	0.1%	8.2%
Furniture	285	1.1%	382	484	665	779	858	623	2.0%	301.1%
Chemical Products	114	0.4%	147	214	263	351	519	335	1.1%	455.3%
Paper Products	156	0.6%	268	345	500	671	1,011	594	1.9%	648.1%
Footwear	570	2.2%	994	1,324	1,661	1,888	2,055	1,417	4.4%	360.5%
Mining Products	636	2.5%	889	1,453	1,463	1,800	2,691	2,083	6.5%	423.1%

Note: 1996 data from Jan. to Aug., 1996. Sub-total (1) represents the total for plywood, lumber and textiles; sub-total (2) for this period represents the total of industrial products from rubber to the bottom of the column.

Source: Indonesia Central Statistics Bureau (BPS)

billion in 1995, carving out a stable niche as a principal export product. In addition, exports of pulp and paper and cement are expected to expand as a large number of investment projects have recently been planned and certain investments are currently being implemented.

New changes in the Indonesian export structure are expected to quickly emerge in the future due to a rapid increase of capital-intensive industrial export products and a shift away from the labor-intensive industries, including textiles and plywood, which were the driving force behind exports from the 1980s through the 1990s.

5. Increased External Debt and Deterioration of the Current Account Balance

(1) Surging Private Debt

According to an announcement by the president of Bank Indonesia on January 10, 1997, external debt, at $110 billion at the end of 1996, with government debt representing $56 billion of the 1996 total which decreased by $2.9 billion from the end of 1995. This decrease is explained by decrements caused by the depreciation of the yen and appreciation of the dollar and by the government's early redemption of external debt at a relatively high interest rate.

The fiscal 1997/98 budget, announced on January 6, 1997, provides for 19 trillion rupiah (approximately $8 billion) in fiscal 1997/98 in contrast to the 20 trillion rupiah (estimated at approximately $8.5 billion) provided for total debt repayment in fiscal 1996/97. As the government assumes yen depreciation decrements and early redemption of high-interest debt on a level similar to that of the previous fiscal year, $750 million is also provided in 1997/98 for early redemption, which had totalled 6 trillion rupiah (approximately $2.6 billion) over the past three-year period. High crude oil prices have resulted in higher government revenue than was estimated in the original budget, making early debt redemption possible. An estimated standard of $16.70 for crude oil prices was provided for in the fiscal 1996/97 national budget, but the market price has exceeded this by $3.00. According to Dr. Soebroto, former Mining and Energy Minister and former Director of the OPEC Executive Office, a $1.00 jump per barrel in the price of crude oil means a national budget revenue increase of 1.4 trillion rupiah (approximately $595 million), and this revenue increased 4.2 trillion rupiah ($1.787 billion) in only nine months between April and December 1996. As the estimated standard for crude oil prices is also set in the fiscal 1997/98 budget at the previous year's level and crude oil prices are also expected to continue to increase in 1997, revenue conditions are clearly ideal for Indonesia. Profits from the market sale of government-held stocks of state-operated companies are also beginning to constitute an important source of revenue for external debt redemption, and these sales are expected to be more actively utilized in the future.

Indosat, a state-run company, was put on the market in 1995, with Telecom and Tambang Timah following in 1996. Although Telecom simultaneously listed 9.33 billion shares, approximately 20% of paid-in capital stock, on the New York, London, Jakarta and Surabaya markets in November 1995, the government subsequently released 4.15% (approximately 380 million shares) of state-operated Telecom shares on the Jakarta and New York securities markets in December of the same year. The government successfully procured $600 million in capital and appropriated this capital to non-tax revenue in the fiscal 1996/97 budget, using it for early redemption of high-interest debt.

As a result of these efforts, the government's debt service ratio (DSR) has fallen from 16.4% in the fiscal 1995/96 budget to 14.1% in the fiscal 1996/97 budget and is expected to fall further in the 1997/98 budget to 11.8%. This ratio in the private sector, however, continues to gradually rise at 14.8%, 15.5% and 17.8% for each respective budget, and overall DSR for Indonesia has still stood at over 30%. A drop in this ratio from the previously high levels is not expected. DSR in excess of 25% is generally considered dangerous for developing countries, and Indonesia's debt situation, which incorporates highly active private offshore loans for infrastructure and large-scale manufacturing projects, must for the time being continue to be closely watched.

(2) Expanding Current Account Balance Deficit

Indonesia's current account balance deficit has steadily expanded over the past few years. Totaling $7 billion and accounting for 3.4% of GDP in fiscal 1995/96, this deficit is expected to reach $8.8 billion or 4.0% of GDP in fiscal 1996/97. This situation does not appear likely to improve, with the fiscal 1997/98 deficit projected at a similar level of $9.8 billion (4% of GDP). These projections are based on estimates that trade revenue will not increase over the short term due to sluggish export growth that has continued since about 1994 and due to difficulties in containing capital machinery upgrades and imports of parts and materials which are increasing as investments are implemented.

The trade balance deficit is offset by a capital balance surplus. This balance for the government and private sectors combined is expected to reach $10.8 billion in fiscal 1996/97, resulting in an estimated international capital account balance surplus of $2.6 billion. Fiscal 1997/98 capital inflow is also projected at a similar level of $10.9 billion, with an estimated international account balance surplus of $1.4 billion. Based on these figures, foreign currency reserves should increase to $19.1 billion in fiscal 1996/97 and to $20 billion in fiscal 1997/98.

The problem lies in the uncertainty of whether capital inflow will meet government calculations with the general elections to be held in 1997.

According to a report entitled "Indonesian Economic Prospects 1997" issued by the Indonesia Economic and Public Finance Research Institute in November 1996, annual capital flight of $1.7 billion was estimated with the previous general elections in 1992, and foreign investors are also expected to hold off on commitments to direct investment until the end of the elections in 1997.

6. Additional Factors for Concern about Sustainable Growth

(1) Strong Pressure for Wage Increases and Widening of the Income Gap

In addition to a thriving influx of foreign investments, Indonesian economic growth has been supported for the past ten years, since the middle of the 1980s, by domestic investments, particularly by financial groups composed of Chinese companies. As a result, Indonesian per capita GDP exceeded $1,000 in 1995, and per capita GDP is thought to have already surpassed $3,000 in Jakarta, the country's capital. Unequal national distribution of this economic development, as well as serious differences between industrial sectors, are, however, problematic. Indonesia has traditionally had the lowest level of wages among ASEAN countries, which represents the most significant reason for the shift of labor-intensive industries from other ASEAN countries to Indonesia. Table 7-5 illustrates the minimum wages in Indonesia's major provinces.

Table 7-5 Minimum Wage by Major Province
(daily wage base; unit: rupiah)

	1989	1996	96/89
Jakarta	1,600	5,200	325%
West Java	750	5,200	693%
East Java	635	4,000	630%
Central Java	780	3,400	436%
North Sumatra	1,200	4,150	346%
South Sulawesi	1,000	3,400	340%
Central Sulawesi	700	3,200	457%
Riau (Batam)	2,450	7,350	300%
Irian Jaya	1,800	5,150	286%
East Kalimantan	1,000	4,600	460%
Average	1,324	5,072	383%

The highest minimum wage of 7,350 rupiah is seen in Batam Island, an area which is noted for the success of its industrial complex, and the lowest of 3,000 rupiah is seen in Central Sulawesi, 2.5 times lower than that of Batam. Jakarta and its suburb of West Java province lie midway between at 5,200 rupiah. The minimum wage in the majority of provinces is estimated in the 3,000 rupiah range, a differential of nearly two-fold compared with Jakarta. The rates of increase in 1989 and 1996 are also characterized by lower rates on the outer islands, including Sulawesi, Sumatra and Kalimantan, than those in the provinces on Java Island. This is due to the fact that frequent labor disputes concerning wages in the West Java province from the end of the 1980s to the beginning of the 1990s have caused the government to consciously raise the minimum wage in these provinces, resulting in the expansion of regional differences among minimum wage levels.

Table 7-6 illustrates shifts in the highest and lowest wage levels by industrial sector at five-year intervals during the 20-year period between 1980 and 1994. As illustrated, the highest wages in 1994 of 4.506 million rupiah were received in the commerce/banking/insurance sector, and with a differential of 57 fold, the lowest wages of 79,000 rupiah were in the other/public officials sector. In 1980, this differential stood at 14 fold, with the difference between the highest and lowest wages in both sectors expanding by more than three times over 20 years. The commerce/banking/insurance sector has seen the highest surge in wages during this 20-year period with an increase of 11.4 fold in the highest wage and even a 6.7-fold increase in the lowest wage level. In contrast, increases in the lowest wages have stalled in the other/public officials sector, with the highest increase during this 20-year period remaining at less than two fold.

Wage levels in the agriculture/forestry/marine sector were the lowest of all sectors in 1980 and 1985, remaining lower than those in the other/public officials sector in both these years. Wage levels in this sector, however, exceeded those of the public official sector in both 1990 and 1994, exceeding even the lowest wages in the manufacturing and electricity sectors in 1994.

Increases in wages in the manufacturing sector, which are said to have increased due to the investment boom, were unexpectedly low. The

Table 7-6 Shifts in Wage Levels by Industrial Sector in Indonesia

(monthly totals; unit: rupiah)

	1980			1985			1990		
	Highest	Lowest	Differ-ential	Highest	Lowest	Differ-ential	Highest	Lowest	Differ-ential
Agriculture, Forestry, Marine	191,411	17,606	11	320,979	38,688	8	1,050,965	100,590	10
Mining	448,725	60,069	7	690,147	95,896	7	2,269,215	218,241	10
Manufacturing	496,738	42,137	12	798,678	83,291	10	1,997,947	171,957	12
Construction	370,994	29,015	13	635,958	53,129	12	1,879,124	221,240	8
Electricity	231,719	21,050	11	517,672	60,901	9	821,069	105,751	8
Commerce/Banking/Insurance	361,254	42,112	9	724,383	90,117	8	1,967,498	227,611	9
Transportation	382,665	41,972	9	612,592	85,724	7	1,172,333	133,671	9
Services	322,339	33,270	10	441,213	71,597	6	1,775,659	157,585	11
Other/Public Officials	291,500	26,500	11	368,660	46,327	8	461,900	69,200	7
Average	344,149	34,869	10	567,809	69,519	8	1,488,412	156,205	10

	1994			94/80		94/90	
	Highest	Lowest	Differ-ential	Highest	Lowest	Highest	Lowest
Agriculture, Forestry, Marine	1,835,324	240,439	8	959%	1366%	175%	239%
Mining	4,495,389	413,807	11	1002%	689%	198%	190%
Manufacturing	2,920,324	195,527	15	588%	464%	146%	114%
Construction	2,656,364	289,882	9	716%	999%	141%	131%
Electricity	2,744,415	172,865	16	1184%	821%	334%	163%
Commerce/Banking/Insurance	4,506,183	326,146	14	1247%	774%	229%	143%
Transportation	4,310,603	466,757	9	1126%	1112%	368%	349%
Services	2,509,258	234,683	11	778%	705%	141%	149%
Other/Public Officials	559,700	79,700	7	192%	301%	121%	115%
Average	2,948,618	268,867	11	857%	771%	198%	172%

Source: *Nota Keuangan* 95/96 issue

highest wages in this sector increased by less than five fold during the 20-year period from 1980.

In addition, growth among the highest wages in manufacturing remained at slightly less than 50%, even during the four-year period from 1990 to 1994 when the Indonesian economy was most active. In contrast, highest wages surged two to three times in the electricity, commerce/banking/insurance and transportation sectors during this period.

With economic development, not only regional differences, but differences among industries, accordingly expanded in Indonesia, with differences between the highest and lowest wages widening within these industrial sectors as well.

(2) Expanding Economic Gap

In addition to the widening of income gaps, Indonesia is still faced with an impoverished class in excess of 27 million. The majority of this class comprise residents of agricultural regions outside Java Island. Indonesia's total population surpassed 200 million at the beginning of February 1997, and more than 10% of the country's population struggle to eke out a day-to-day living. The government's current 25-Year Long-term Development Plan aims to decrease the number of Indonesians living in poverty to 10% of the current number, 2.5 million, by 2019, the final year of the current plan.

In December 1996, the Indonesian government passed a presidential ordinance making payments of 2% of profits as a donation for countering poverty mandatory for corporations and individuals whose annual post-tax profits exceed 100 million rupiah (approximately 5 million yen). Although the economic community has expressed basic approval of the elimination of poverty, those actually making these donations is extremely low, and concern has also been expressed that this policy will adversely affect the enticement of foreign capital into the country.

In Indonesia, which is simultaneously beginning to face massive poverty and will face high real unemployment, emotionally-charged arguments concerning the rapidly increasing number of foreigners usurping employment opportunities from Indonesians continues. The newest unemployment data (unemployed being defined as those who are employed for less than one hour per week) issued at the beginning of November 1996 reveals 6.3 million unemployed (6.3%) in contrast to 86.4 million fully employed workers. The unemployment rate stood at 3.17% in 1990, indicating that even if only official government statistics are considered, unemployment has doubled. New university graduates account for 220,000 of the unemployed, but conditions continue in which two out of three new graduates cannot find employment each year.

A symposium focusing on foreign workers held in Jakarta in November 1996 revealed that 57,000 foreigners currently receive $2.4 billion in compensation in Indonesia. Compensation for the 2 million Indonesians working overseas, however, totals $600 million, leaving a differential of four fold. It was announced at this symposium that foreign workers in Indonesia will total 225,000 in 2000 with annual foreign currency losses of $11.8 billion if nothing is done to change this situation. In January 1997 Marzki, Director of the Indonesia National Alliance of Workers (FSPSI), advocated regulation of foreign workers in Indonesia. Possibly in response to this opinion, the Minister of Labor stated in December 1996 that an ordinance from the Ministry of Labor would establish a monthly charge of $100 to be levied on all foreigners living in Indonesia from January 1997. The $60 million in funds which can be procured annually from employed foreigners will be allocated for job-training programs for university graduates. Furthermore, an agreement between the Minister of Labor and the Minister of Cooperative and Small Enterprises was signed in January 1997, stipulating that strong administrative guidance in establishing unions should be provided to every company in order to improve the welfare of employees.

The expansion of the gap between rich and poor is serious enough in Indonesia to necessitate the implementation of this type of policy targeting foreigners. An intensified antiforeign sentiment which could not be ignored led to the strengthening of foreign capital regulations by the Indonesian government in response to anti-Japanese riots in 1974. The majority of high wage-earners in Indonesia comprise overseas Chinese (financial groups) and foreigners (local foreign-capitalized corporations). Overseas Chinese, representing 3% of the total population, control 80% of the economy and have traditionally been a symbol of wealth in Indonesia, at times becoming the object of criticism and resentment. The overseas Chinese population is also the ultimate target of the frequent riots occurring throughout Indonesia. Although it is rumored that conflicts within the Soeharto administration are rooted in these riots, the foundation of these conflicts lies in the increasing economic dissatisfaction of low wage-earners. The anti-overseas Chinese riot which took place in Medan in April 1994 also represented a demand for companies to adhere to recommendations by the government to raise minimum wages.

The government is fully aware of the present necessary dependence of Indonesia's continued sustainable economic growth on foreign investment and domestic companies, mainly involving overseas Chinese financial groups. Public sentiment, however, will not allow this to continue. The Indonesian government's attempts to surmount these difficulties in the face of an election year, occurring once every five years, must for the present continue to be closely watched.