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SURVEY OF RECENT DEVELOPMENTS

Prema-chandra Athukorala*

Australian National University

SUMMARY

Macroeconomic conditions have been improving slowly but steadily since the beginning of the year. The exchange rate had strengthened to below Rp 8,700/$ by mid June. Stock prices have also rebounded. Inflation has been declining since February after increasing steadily for almost two years. Real interest rates are now below pre-crisis levels. These developments have been supported by a combination of positive moves on the policy front and an improvement in relations with the international community. After several months of indifferent performance the Megawati government has made some progress in several key areas of the reform program, as evidenced by the long delayed divestment of Bank Central Asia, a flicker of life in the stalled privatisation program, some significant taxation reform, and the abolition of costly subsidies. In April 2002 the International Monetary Fund (IMF) approved the disbursement of a further $347 million loan, and the Paris Club of creditor nations agreed to reschedule $5.4 billion of Indonesia's debt service payments. Output grew by 2.5% in the year to Q1 2002. While this was lower than forecast, there is consensus among analysts that growth of 3.5–4% in calendar 2002 is within reach. Weak first quarter growth can be attributed partly to factors outside the government's control: severe floods in February and continuation of the global economic slump that began in 2001.

Nevertheless there is no room for complacency. The recovery has been fuelled mainly by consumer demand. Improvements in investor confidence have been reflected so far only in portfolio investment flows, while the net foreign direct investment outflow has continued unabated. Investment spending is still contracting, and the banking system remains fragile. There is little room for manoeuvre on the fiscal front because of the huge domestic debt service burden resulting from the government guarantee of bank deposits, and the planned budget deficit for 2002 may be exceeded unless more rapid progress with privatisation and divestment of bank sector assets can be achieved. Corruption in the customs service is creating a drag on recovery—especially for exporters and other producers dependent on imported inputs—while there seems to be an increasing tendency for the courts to be used as instruments of extortion, especially in relation to foreign companies. Much remains to be done in setting up a viable set of arrangements in relation to decentralisation, especially in delineating the boundaries of authority for different levels of government.

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POLITICS AND ECONOMIC POLICY

Indonesia's spell of relative political tranquillity continues. This has been made possible partly by avoiding some far-reaching reforms for fear of upsetting vested interests capable of causing trouble. But although the Megawati cabinet seemed to achieve little during her first half year in office, in recent months it has begun to move ahead with some reforms, albeit rather slowly.[1]

After two years of delay, the Ministry of State-Owned Enterprises finally announced in March the sale of a controlling stake in Bank Central Asia to a consortium led by an American firm, Farallon Capital Management, for $542 million. While the list of banks still to be sold is long, observers hailed this sale as an indication of government's preparedness to sell off nationalised banks to redeem some of its huge domestic debt, and to breathe new life into the banking system. The privatisation program, a key element of the IMF support package on which nothing had been achieved for almost two years, received a boost with the sale of an 8.1% stake in the state-owned international call operator PT Indosat in April. There have also been some significant achievements in the areas of tax reform and subsidy reduction, including the substantial dismantling of the controversial fuel subsidy that threatened fiscal sustainability and had been a major sticking point in Indonesia's relations with the IMF.

These achievements have been instrumental in restoring Indonesia's relationship with the international donor community. In its quarterly review in February the Consultative Group on Indonesia (CGI), which coordinates aid from foreign donors, concluded that the government had made good progress with macroeconomic policy, and had initiated some of the processes necessary to achieve structural reforms. The fifth performance review under the IMF's Extended Fund Facility program was completed in April, opening the way for the disbursement of an additional $347 million.[2] The positive assessment by the IMF was crucial for the subsequent Paris Club meeting, also in April, at which it was agreed to reschedule repayments on $5.4 billion of Indonesian debt. For the first time, creditors allowed Indonesia to delay repayment of interest as well as principal.[3]

The IMF and the government completed the initial round of discussions on the sixth review of the country's reform program in May. The review was to provide the basis for a new Letter of Intent (LOI) relating to the disbursement of the next IMF loan tranche, expected to be around $350 million. The IMF commended the government's 'strengthened performance under the program', while reiterating the need to maintain progress with privatisation and other reforms in the near future—noting that there was 'no room for complacency' (*IMF News Brief* No. 02/38, 26 April 2002). Recent months have seen a shift in the IMF's emphasis on what had been referred to as 'pervasive and counterproductive involvement … in "micro management"' (Pangestu and Goeltom 2001: 146) to providing broader guidelines for policy. This may reflect both improving confidence in the new Indonesian leadership and the IMF's own 'learning by doing' in relation to problematic aspects of its handling of the crisis so far. An additional factor may be the negative attitude of the planning minister, Kwik Kian Gie, who has openly argued for discontinuance of the IMF support program, although he has been strongly opposed in this by the coordinating minister for economics, Dorodjatun Kuntjoro-djakti (*JP*, 18/6/02).

Moody's Investors Service raised its outlook on Indonesia from 'stable' to

'positive' in late April, citing improved confidence in the country's debt situation after the Paris Club rescheduling, although the rating remains well below investment grade (*AWSJ*, 26/4/02). The agency stated that the Paris Club agreement and Indonesia's improved relations with the IMF meant that the country was unlikely to face a liquidity crisis in the near future. Moody's BBB rating on Indonesia's long-term debt remained unchanged, but the positive outlook signals the likelihood of an upgrading in the near future.

Despite these positive developments, much remains to be done in order to achieve lasting political stability, policy transparency and a standard of governance sufficient to provide a conducive setting for self-sustained growth. Problems persist on a number of fronts, including widespread corruption, difficulties with the decentralisation program, communal unrest in Maluku, continuing calls for independence in Papua and Aceh, and the need to contain radical Islamic elements.

Corruption

Corruption remains at the forefront of public debate, and there are some indications that it is on the increase. In 2001, Indonesia was ranked 88th worst in relation to corruption out of 91 countries surveyed by Transparency International, coming level with Uganda, and just ahead of Nigeria and Bangladesh (*Transparency International*, 27/6/01, http://www.transparency.org/cpi/2001/cpi2001.html). In 2000 it had been 85th on the list. Those who expected the shift of power to elected representatives and away from the president to have a significant impact on corruption after the demise of Soeharto have been greatly disappointed thus far. Indeed, there is little doubt that members of the legislature themselves regularly demand bribes to vote one way or another in relation to new legislation and to senior appointments to the bureaucracy, the central bank and the military.

In recent months the courts have been busy with a number of high profile corruption and other criminal cases. Central bank governor Syahril Sabirin was sentenced in March to a three-year prison term for his alleged involvement in the $80 million Bank Bali slush fund scandal (Booth 1999: 5). The case against Akbar Tandjung (speaker of the parliament and chair of the Golkar party), who faces the serious charge of having been involved in the misappropriation of funds from the state logistics agency, Bulog (McLeod 2000: 7) and of using the proceeds to help fund Golkar's election campaign in 1999, has now gone to trial. The start of the trial was expedited to forestall a proposed parliamentary inquiry into Akbar's alleged corruption. The former minister of trade and industry, Rahardi Ramelan, went on trial in March, charged with misappropriating a total of Rp 63 billion from Bulog (*JP*, 20/3/02). As much as Rp 40 billion of this is alleged to have gone to Akbar, making Rahardi a key to the prosecution's case against the Golkar leader. Also in March, prosecutors detained the Switzerland-based businessman, Hashim Djojohadikusumo, on charges relating to a violation of the banking regulations as long ago as 1994. Hutomo Mandala Putera ('Tommy Soeharto') has also been on trial over the murder in July 2001 of a Supreme Court Judge, Syafiuddin Kartasasmita, one of the judges who had found Tommy guilty in a previous corruption case.

But these steps have done little to convince the public of the government's commitment to attack cronyism and corruption decisively. The media have interpreted some of them as attempts to 'get only the weakest ones and those

with no political support' (*The Economist*, 23/3/02: 30) in an attempt to balance the need to assuage international opinion against the government's own domestic interests. Despite supporting the prosecution of Akbar, the president has resisted moves for a parliamentary investigation into the Bulog scandal, which would inevitably have been highly politicised. Megawati's PDI-P party may stand to gain from disarray in Akbar Tandjung's Golkar, the next strongest of all the other parties. On the other hand, there is a risk of Golkar striking back at PDI-P by calling into question various actions of the president or her associates, such as her decision to allocate some Rp 30 billion to providing improvements to military and police hostels (*Kompas Cybermedia*, 10/5/02). There have been criticisms of the conduct of Tommy's trial, and numerous delays, including those caused by the failure of key witnesses to appear (*JP*, 1/6/02); scepticism about the eventual outcome was boosted by the detention of his lawyer on suspicion of bribing witnesses (*JP*, 24/5/02). The central bank governor is one of a very few key figures to have been found guilty and sentenced to imprisonment, yet he still remains in office as he appeals the verdict. Finally, yet another example of the appalling state of the legal system emerged in June, when the bankruptcy court was able to be persuaded that Indonesia's fourth largest life insurer, PT Asuransi Jiwa Manulife Indonesia, should be found to be bankrupt on patently spurious grounds (box 1); within days, a Ministry of Finance official announced publicly that it was financially sound (*AFR*, 19/6/02).

Meanwhile 100 or more bankers allegedly involved in misusing Bank Indonesia (BI) liquidity support at the height of the crisis still enjoy their freedom. It is difficult for the public to understand how major figures such as Syamsul Nursalim and Usman Admadjaja, respective president directors of Bank BDNI and Bank Danamon, which between them are understood to have received some Rp 60 trillion in central bank funding (McBeth and Djalal 2002: 14), can remain at large.

Corruption and malpractice have once again become rampant in the customs service (*JP*, 28/5/02), and in recent months 'almost all industry associations and foreign chambers of commerce have urged the government to deal firmly' with it (*JP*, 5/2/02). Under Law 10/1995, a person who brings goods with false documents into the country can only be fined, while people who bring goods into the country without any documents face the prospect of both imprisonment and fines. This encourages smuggling by the use of false documents. A nationwide study of corruption conducted last year confirmed that the customs service and the tax office were regarded as the most corrupt public institutions in the country.

In February, news of the disappearance of 14 containers loaded with Rp 20.5 billion ($2 million) worth of luxury cars and electronic goods from the customs office at the port of Cirebon in West Java hit the headlines (*JP*, 25/2/02). Customs officers' detection of the attempt to smuggle these items had been hailed initially as a success in the war against corruption, but a team of local legislators found out several days later that the containers had disappeared from custody. They were later found in the warehouse of a local businessman alleged to have ties with the military.

A recent study by the Economic and Social Research Institute (LPEM) at the University of Indonesia found that undervaluation of imports had resulted in the loss of $1.2 billion in customs revenue

BOX 1 THE SAGA OF PT ASURANSI JIWA MANULIFE INDONESIA

Earlier chapters in the Manulife story have appeared in a previous Survey (Dick 2001: 30). The most recent instalment of the attempt by former domestic joint venture partner, the Dharmala group, to recover its position (having had its 40% stake sold at auction in partial settlement of its debts to Bank Indonesia as a result of the banking crisis in 1997–98) played out in June. Dharmala petitioned to have Manulife declared bankrupt, on the grounds that the firm had not paid a dividend in 1999. For its part, Manulife argued that no dividend had been paid because none had been declared: there is, of course, no legal obligation on any company to pay a dividend to its shareholders at any particular time. The absence of a dividend in the period just following the financial upheaval of 1997–98 is hardly surprising.

This episode is further evidence of a tendency to use the court system as a means of extorting payments of one kind or another from legitimate businesses, especially foreign-owned ones (see also the case of Kaltim Prima Coal, below). It hardly needs to be said that such cases weigh very heavily on the minds of foreign firms with activities in Indonesia, or others thinking of establishing such activities. As prominent foreign businessman James Castle put it: 'There is no legal recourse for companies. It's one of the fundamental reasons why there's no new investment coming in' (*Wall Street Journal*, 14/6/02).

This case has an additional disturbing element. During the Soeharto era, few businesses put much trust in the legal system, and a key to survival for foreign firms was to take on a domestic partner they felt they could trust—most often, one that enjoyed the support of the president or his close associates. The Dharmala–Manulife case shows clearly that this is a very risky strategy, because with changing circumstances the domestic partner can turn against the foreign partner unexpectedly, with devastating effect. This is a serious threat not only to foreign firms, but to Indonesian firms that want to form genuine and mutually advantageous relationships with foreign investors, thus increasing Indonesia's access to foreign know-how and capital. Ultimately it is a threat to Indonesia's recovery and further development.

for the year 2000 (*JP*, 5/2/02). (The study did not address additional losses arising from underpayment of luxury sales taxes imposed on imports, and income tax losses resulting from underreporting of incomes of firms involved in import trade.) Revenue losses aside, delays in obtaining clearances for imported inputs and/or the need to make under-the-table payments to expedite such clearances make exports less competitive and production for the home market more expensive. The study recommended that the government should reintroduce the system of pre-shipment inspection of imports that operated between 1985 and 1997 (box 2). This proposal has also received strong support from the Indonesian Importers Association.

PROBLEMS OF DECENTRALISATION

Now well into its second year of implementation, Indonesia's ambitious decentralisation program remains in a state of flux. By mid 2002, the government had

Box 2 The Pre-shipment Inspection System, 1985–97

In 1985, the Soeharto administration introduced a pre-shipment inspection (PSI) scheme in response to rampant corruption and inordinate delays involved in the operation of the customs service (Dick 1985; WTO 1999). Under the scheme, an appointed surveyor company (Société Générale de Surveillance, SGS) inspected import shipments at the port of loading. The PSI system minimised physical contact between importers and the customs service, thereby minimising the scope for collusion and corruption. It was praised for restoring a smooth flow of imports, with a high degree of transparency and certainty. The Indonesian Importers Association has recently asserted that it cut the costs of importation by more than 70%, while reducing the time needed to clear import shipments by 86%, by comparison with the previous system. Similarly, Dick (1985: 10) had reported that 20 signatures were replaced by one, that the time taken to clear shipments was reduced from more than a month to a matter of a few days, and that the cost of clearing shipments also fell dramatically, to about 20% of its previous level.

Despite the success of the new system—or perhaps because of it—the government decided in 1995 to transfer customs administration gradually back to the customs service.[a] In July 1995, the pre-shipment inspection of goods entering the country through seaports was transferred from SGS to its partly government-owned joint venture company, PT Surveyor Indonesia, while goods imported through airports were subject to an arrival inspection by the customs service. The contract with PT Surveyor Indonesia was terminated on 31 March 1997, returning full responsibility for import clearance to customs.

[a]Privatisation of this function of government had removed a significant source of rents for the bureaucracy.

completed the transfer of about two million employees to regional government payrolls, and significant progress had been made in setting up revenue sharing arrangements. However, considerable work remains to be done to establish the necessary fiscal, legal and administrative framework for successful decentralisation. The inter-agency decentralisation coordinating team has not yet made much progress in designing and implementing the national framework for strengthening the regions' institutions and capacities. Part of the explanation for the slow progress lies in the lack of consensus among the constituent parties of the ruling coalition about the desirability of the decentralisation law promulgated by the Habibie regime and of amendments to the law. Recently Megawati said that the government had no intention of rescinding the regional autonomy law, but insisted that it needed to be revised in order to maintain national unity. The government's move to revise the law suffered a severe setback, however, after Golkar joined other parties in opposition to the plan, arguing that it is too early to modify the law, which went into effect as recently as 1 January 2001.

The business community has complained repeatedly about the introduction of new regional regulations, especially in the areas of taxation and licensing and in-country movement of

goods. It has been reported that over 1,000 rulings relating to local taxes and charges have been issued by regional administrations since decentralisation began, placing a heavy burden on business operations (*JP*, 6/5/02). A new coal tax recently introduced by the South Kalimantan provincial government was annulled by the central government, and another 14 such taxes are being reviewed by it because of complaints from mining companies operating in the province. Investors have been besieged by fresh, sometimes competing demands from the regional authorities for equity stakes in companies operating in their territories. The adverse implications of these demands for the general investment climate are vividly illustrated by the case of PT Kaltim Prima Coal in East Kalimantan province. (The following discussion draws on *AWSJ*, 9/4/02, and *AFR*, 15/5/02.)

PT Kaltim Prima Coal

PT Kaltim Prima Coal (KPC), a joint venture of the British energy giant, British Petroleum (BP), and the Anglo-Australian mining company, Rio Tinto, operates Indonesia's largest coal mine in East Kalimantan (Klingner 1993: 173–4). The company has been in operation since 1991, and the output target for 2002 is 17 million tonnes, mainly for electric power companies and steel makers in Japan and other countries. With a total labour force of over 10,000 workers, the mine dominates the economy of the East Kutai district of East Kalimantan.

The original investment agreement signed by BP and Rio Tinto in 1982 called for the sale of a 51% stake in the venture to Indonesian interests by 2002. In March this year, KPC and the central government agreed to value a 51% stake at about $420 million, paving the way for a possible sale, but the selection of a potential buyer remains unresolved. The central government does not have sufficient funds to buy the stake on offer—indeed, this would be at odds with its commitment to privatisation of existing state enterprises—and the East Kalimantan provincial government insists that an investor nominated by that province should be next in line. PT Intan Bumi Inti Pradana, a company run by the property developer David Salim (a nephew of Liem Sioe Liong, founder of the Salim group) seems to have struck a deal with the provincial government to buy the shares on its behalf, under the condition that 5% of company dividends will be paid into the province's coffers.

Frustrated by the delay in finalising this transaction, the East Kalimantan government recently filed a criminal complaint against KPC, BP and Rio Tinto, accusing them of corruption by virtue of their not yet having sold the 51% stake, and seeking damages of $776 million for lost dividend income. The provincial governor also warned that local residents might try to blockade the mine if the shares were not sold soon. BP and Rio Tinto insist that they have no obligation to sell the shares to the provincial government of East Kalimantan or its nominee, since there is no such stipulation in its original agreement with the Indonesian government. A forced sale to a particular buyer would presumably result in a sale price far below the true market value, thus resulting in effective expropriation of the existing owners' property rights in KPC; clearly the decentralisation laws were never intended to encourage such actions on the part of regional governments. As the lawsuit waits to be heard, a Jakarta court has issued an attachment order at the request of the provincial government, preventing BP and Rio Tinto from selling or transferring any of their assets in Indonesia to other parties.

TABLE 1 *GDP Growth (Year-on-Year)*
(1993 prices, %)

	Dec-00	Mar-01	Jun-01	Sep-01	Dec-01	Mar-02
GDP	**6.9**	**4.8**	**3.8**	**3.1**	**1.6**	**2.5**
Expenditure						
Private consumption	4.7	4.0	4.7	5.8	9.2	9.9
Government consumption	12.1	6.0	4.2	11.9	11.0	10.3
Investment	24.6	18.9	7.7	–0.8	–7.1	–6.1
Exports	32.3	18.4	8.0	–2.6	–12.9	–6.7
Imports	50.1	50.7	37.2	–3.7	–29.8	–25.8
Sector						
Agriculture, livestock, forestry & fisheries	13.2	3.7	1.7	–0.4	–2.8	–1.8
Mining & quarrying	12.6	6.8	–0.3	–2.4	–5.9	–0.9
Manufacturing	4.4	4.2	4.8	4.7	3.6	4.3
Electricity, gas & water supply	7.7	7.3	9.9	8.9	7.6	9.8
Construction	4.7	6.2	5.7	3.5	0.7	1.0
Trade, hotels & restaurants	6.8	6.8	5.5	5.7	2.6	3.6
Transport & communications	7.8	6.4	7.0	7.6	8.9	8.9
Financial, rental & business services	3.6	3.9	3.4	2.7	2.0	2.3
Services	2.3	1.3	1.6	2.3	2.7	1.6

Source: CEIC Asia database.

This action alone could be seriously damaging to Indonesia's recovery. For example, BP plans to spend some $2 billion to develop the Tangguh natural gas field, and would be unlikely to proceed in the absence of protection of its legitimate entitlements by the courts. For that reason the central government intervened recently to have this asset released from the attachment order.

Far more decisive action than this 'bandaid' solution is needed in cases such as this, however, if Indonesia's reputation as a safe place for foreign investment is not to be ruined. For example, the original contract governing the KPC venture could be modified and extended by agreement between the shareholders and the central government. There is no obvious gain to Indonesia from a forced divestment (except if the sale is coerced at an artificially low price). A fair sale price would simply reflect the present value of future profits expected to be generated by the mine, and there is no reason to believe that the presence of any Indonesian entity as minority or majority shareholder would result in an improvement in the quality of management; quite the contrary. It would make more sense to renegotiate a higher level of royalty payments to the central government in return for leaving the existing shareholdings intact, bearing in mind that under the current decentralisation laws the local governments would benefit by virtue of their entitlement to a fixed share of these now higher revenues.

TABLE 2 *GDP Levels in Asian Crisis Countries*
(Q1 1996 = 100)

	Thailand	Indonesia	Philippines	Malaysia	Korea
Q1–96	100	100	100	100	100
Q1–97	101	108	105	108	105
Q1–98	94	103	108	106	100
Q1–00	99	100	113	117	120
Q1–01	100	105	116	121	124
Q1–02	–	107	120	122	131

– = not available.

Source: As for table 1.

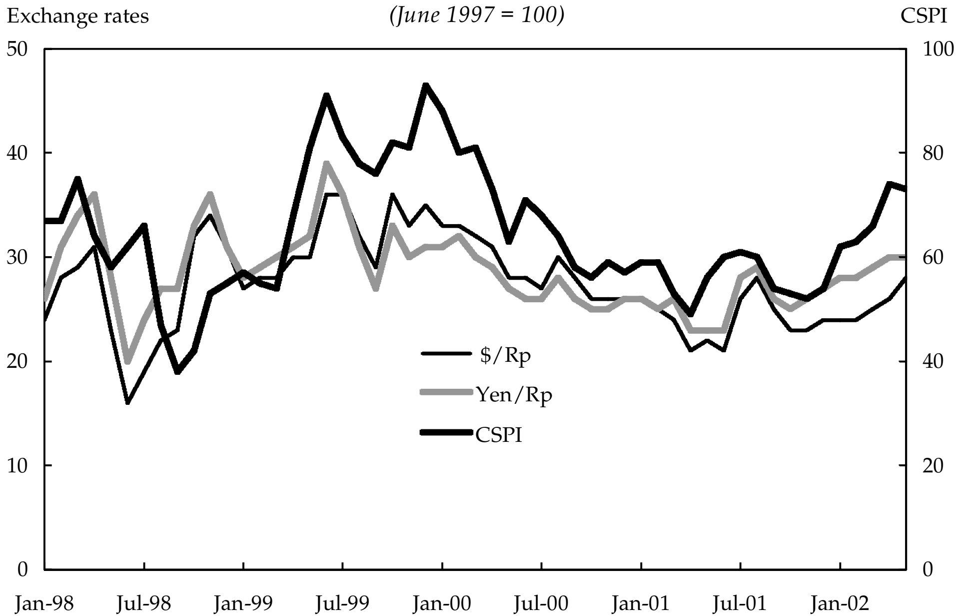
MACROECONOMIC CONDITIONS

Growth

The downward trend in quarterly year-on-year growth rates was reversed in the first quarter of 2002, when a rate of 2.5% was recorded (table 1). From a longer-term perspective, the cumulative impact of the crisis on Indonesia's growth has been significantly greater than that for the other crisis-affected countries in East Asia, with the exception of Thailand (table 2). Taking the first quarter GDP level in 1996 as the benchmark (on the grounds that Thailand's slowdown started in that year, eventually precipitating the region's crisis in 1997–98), Indonesia's GDP peaked in 1997 and then fell drastically in 1998, not recovering to the Q1 1996 level until Q1 2000. Thailand took a further year to regain this level, and still remains well behind Indonesia. The interruption to the other countries' growth was much less severe and more short-lived.

On the demand side, consumption growth has been the sole source of recovery for the past three quarters, in the face of continuous contraction in investment and surprisingly poor export performance (table 1). In the year to Q1 2002 private and government consumption expenditure increased by 9.9% and 10.3%, respectively—rates similar to those of the previous quarter. By contrast, investment continued to contract, albeit at a slightly lower year-on-year rate (6.1%) than in the previous quarter (7.1%). This continued contraction is considered by some observers as a mystery, perhaps the result of data problems (World Bank 2002).[5] However, the decline is consistent with continuing weakness in construction activity, and with falling imports of machinery and equipment. Faltering business confidence during the political transition in the second half of 2001 and the adverse impact of the global economic downturn on investment in export-oriented industries may have underpinned the decline. On the basis of improvements in recent months in some leading indicators, such as cement production, machinery and equipment imports, and sales of motor vehicles, it is expected that the national accounts for 2002 will show a mild recovery in investment (CSIS 2002; DRI 2002). Both exports and imports have registered negative year-on-year growth for the last three quarters, although the decline has been far greater for imports; this presumably implies a switch of consumption towards domestically produced goods and services.

FIGURE 1 *Exchange Rates and Share Prices (June 1997 = 100)*



CSPI = Composite Share Price Index.

Source: As for table 1.

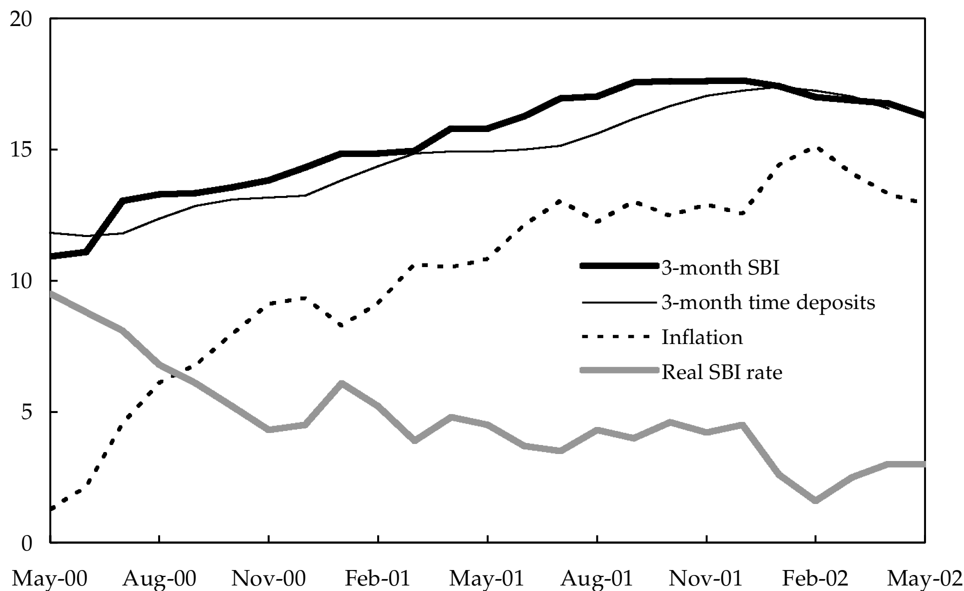
On the production side, all sectors other than agriculture, livestock, forestry and fisheries, and mining and quarrying recorded positive growth in the year to Q1 2002 (table 1). Deterioration in weather patterns following the exceptionally good weather in 2000 influenced agricultural growth (World Bank 2002). Liquefied natural gas production was adversely affected by the faltering security situation in Aceh. Manufacturing grew by 4.3% compared to 3.6% in the previous quarter. Disaggregated data for the manufacturing sector show that improved overall performance came from production for the domestic market, which more than compensated for contraction in export-oriented subsectors such as such as textiles and apparel, footwear, and electrical equipment and electronic goods. The manufacturing sector has been a prime mover of the recovery for the past two years, recording an average year-on-year growth rate of above 4.8%.

The year-on-year GDP growth rate for Q1 2002 (2.5%) is one percentage point lower than Bank Indonesia's prediction of 3.5% (Bank Indonesia 2002: iv). However, given earlier than expected recovery in the US and European Union economies, and the improved domestic investment environment, both the government and independent observers are of the view that BI's growth projection of 3.5–4.0% for calendar 2002 is achievable. When presenting the draft 2003 budget, the minister of finance, Boediono, told the parliament (DPR) that the growth rate could even accelerate to 6% in 2003 (*JP*, 23/5/02); this is only likely to prove realistic, however, if the reform process continues as scheduled, leading to a rapid recovery in investment.

Main Macroeconomic Indicators

The Exchange Rate. The rupiah has continued to strengthen from about Rp 10,400/$ in late January to below Rp 8,700/$ in mid June, still slightly

FIGURE 2 *Interest Rates and Inflation*
(% p.a.)



Source: As for table 1.

weaker than the level of Rp 8,550 attained in August 2001 following the inauguration of Megawati as president (figure 1). The recent strengthening partly reflects the weakening of the dollar against other currencies, but domestic factors—such as improving domestic business confidence based on the certificate of good housekeeping from the IMF and BI's success in meeting its base money targets since about August 2001—seem to have played important roles. The covered interest rate differential (the excess of the dollar interest rate over the rupiah interest rate adjusted for the swap premium) narrowed persistently during the three months through May, reducing the incentive for shifting portfolios from rupiah to dollar assets, which had remained strong throughout 2001.

The Share Market. The Jakarta Stock Exchange share price index has increased dramatically in recent months (figure 1), from 380 at the end of November 2001 to 531 at the end of May—a rise of 40%. This partly reflects the general trend in share prices in regional markets, brought about by the upturn in the US stock market after it fell sharply in the immediate aftermath of 11 September, and the earlier than expected slowing of growth among many regional economies. However, the upturn in Indonesia has been sharper than elsewhere in the region, reflecting improved domestic economic conditions.

Inflation. The rate of CPI inflation in February 2002 (15.5% year-on-year) was the highest since mid 1999. Some commentators have argued that this partly reflected the impact of upward adjustments in January of administered prices of a number of goods and services (such as fuel, electricity and clean water), and increases in private sector minimum wages and civil service salaries. Inflation had been increasing steadily since March 2000, however, and in fact has declined since February 2002; by May the rate was down to 12.9% (figure 2). For this reason alone the emphasis on the impact of administered price increases as an explana-

tion for inflation is unconvincing. A monetarist explanation for the halting of the steady increase in inflation would emphasise the implementation of tighter monetary policy since August 2001: the supply of base money in April 2002 was less than 2% higher than it had been nine months earlier, and its year-on-year rate of growth had fallen from 21% in November 2001 to only 9% in May 2002. An alternative explanation, which seems more plausible to the writer, is that the decline in inflation is more in line with the strengthening of the exchange rate brought about by improved market sentiment.

On the basis that the recent strengthening of the rupiah is expected to continue for the rest of the year (and beyond) as a result of improvements in the business climate, and given the success in recent months of BI's attempts to tame inflationary expectations by containing the expansion of base money, many analysts believe that the inflation target of 9–10% for 2002 is within reach.

Interest Rates. In line with the gradual strengthening of the exchange rate and declining inflation, interest rates began to fall from about March this year (figure 2). The nominal 3-month SBI (Bank Indonesia Certificate) indicator rate was 16.3% p.a. by late May, down from 17.6% at the beginning of the year; nominal time deposit rates have followed suit. Real rates—calculated using the contemporaneous CPI inflation rate—are now lower than their pre-crisis levels; for example, the real 3-month SBI rate in July 1997 was 5.4%, whereas in May 2002 it was just 3.0%.

Consumer and Business Confidence. The consumer confidence index (CCI) published by the Danareksa Research Institute (DRI) points to a persistent increase in consumer confidence from January this year. The index rose from 87.4 in January to 98.8 in April. (The CCI is constructed every month by interviewing at least 1,700 households in six main regions across the country. The index ranges from 0 to 200, with zero meaning 'very pessimistic' and 200 'very optimistic'. If the index is below 100, pessimistic responses outnumber optimistic ones, and vice versa.)

The Balance of Payments. Merchandise exports declined steadily during 2001, while imports declined by a smaller amount, generating a trade surplus of $22.6 billion, down from $25.0 billion in 2000 (table 3). The capital account was in deficit in both years. In 2000 there was persistent, large-scale private capital outflow, well in excess of net official capital inflow in support of the recovery program. In 2001 private capital outflow was smaller, particularly in the fourth quarter, but official capital flows turned slightly negative.

Fiscal Position

In May, the Ministry of Finance adjusted the budget deficit forecast for 2002 marginally upward from 2.5% to 2.6% of GDP, in line with the Q1 2002 national accounts data, which recorded slower than predicted growth; the budget spending and revenue estimates themselves remain unchanged.

Prospects for achieving the 2002 budget deficit target have improved somewhat on a number of fronts in recent months. The government stands to reap a revenue windfall through increasing oil prices, which have risen by roughly 30% in the last year,[6] provided production levels do not deteriorate. If the mild but steadily declining trend in interest rates since the beginning of the year can be maintained, the assumed average 14% rate on 3-month SBIs should be able to be met, if not improved upon, such that interest payments on variable rate bank recapitalisation bonds may be somewhat lower than expected. Ex-

TABLE 3 *Balance of Payments*
($ billion)

	2000	2001				
	Total	Q1	Q2	Q3	Q4	Total
Exports	65.4	15.4	15.0	14.2	12.9	57.5
Non-oil & gas	50.3	11.6	11.7	11.3	10.3	44.9
Oil	8.0	2.1	1.9	1.5	1.3	6.8
LNG & LPG	7.1	1.7	1.4	1.4	1.3	5.8
Imports	–40.4	–9.2	–9.5	–8.4	–7.8	–34.9
Merchandise trade balance	25.0	6.2	5.5	5.8	5.1	22.6
Services	–17.1	–4.1	–4.2	–3.3	–4.5	–16.1
Current account	8.0	2.1	1.3	2.5	0.6	6.5
Official capital	3.2	–0.1	–0.2	–0.2	–0.2	–0.8
Inflows	7.5	1.4	1.2	1.4	1.8	5.7
CGI	2.4	0.5	0.4	0.4	0.6	2.0
Non-CGI	5.1	0.9	0.7	1.0	1.1	3.8
Debt repayments	–4.3	–1.5	–1.4	–1.6	–2.0	–6.5
Private capital	–10.0	–3.1	–2.5	–2.5	–0.6	–8.6
Direct investment	–4.6	–2.2	–1.9	–1.1	–0.5	–5.7
Other	–5.4	–0.9	–0.6	–1.4	–0.1	–2.9
Capital account	–6.8	–3.2	–2.7	–2.7	–0.7	–9.4
Overall balance	5.0	–0.7	0.0	0.3	–0.9	–1.4
Capital & current account, net	1.2	–1.2	–1.4	–0.2	–0.2	–2.9
Errors & omissions	3.8	0.5	1.3	0.5	–0.8	1.5

Source: As for table 1.

trapolation of the recent trend in the exchange rate suggests that the assumed average level of Rp 9,000/$ can also be achieved; at the same time, the depreciation of the yen relative to the dollar during 2002 is helping to reduce the cost of external debt repayments: yen-denominated foreign debt accounts for around 30% of the total.[7] Following the introduction of the new gasoline and fuel pricing policy in January (Deuster 2002: 23), the estimated subsidy component of the budget should also remain on target.

These bright spots notwithstanding, whether the government will be able to achieve the 2002 deficit target remains in doubt because of lacklustre performance so far in the privatisation program and in IBRA (Indonesian Bank Restructuring Agency) asset sales. During the first quarter of 2002 only 13.3% of the combined revenue target of Rp 22.5 trillion from these sources was achieved, very little of which resulted from privatisation. The long awaited sale of the government's shares in Bank Central Asia (BCA) was arranged in March, generating some Rp 5.3 trillion in two tranches, but many analysts remain of the view that the privatisation and divestment targets will not be met. Shares in several other banks (Bank Niaga, Bank Internasional Indonesia

BOX 3 FURTHER BANK BAILOUT COSTS

Indonesia's sixth largest bank, Bank Internasional Indonesia (BII), which has been recapitalised twice already at a total cost to the government of Rp 21 trillion, is again insolvent. Its financial statements released in May showed a loss of Rp 4.13 trillion ($435 million), a negative capital adequacy ratio of over 47%, and bad loans amounting to almost 63% of the total. The government currently owns 75% of the bank. In May it decided to allow BII to go ahead with a rights issue to raise about Rp 4.33 trillion to build up its capital adequacy ratio to at least 8% (contingent upon approval from the DPR). It seems unlikely that the present private sector owners will want to inject more capital into the troubled bank: indeed, if the reported figures are accurate, they could expect to lose heavily by doing so. (For each Rp 55—i.e. Rp 47 + Rp 8—they subscribed in new capital, they would end up with equity of Rp 8.) It will then fall to the government to issue bonds to build up the bank's equity base, thus worsening its already precarious debt situation. Alternatively it could choose to close down the bank, but it would still need to make good the capital deficiency in order to honour its guarantee of the bank's liabilities; the net cost would be the same.

(BII), Bank Danamon and Lippo Bank) are to be divested, but BCA was regarded as the jewel in the crown; it is difficult to see that these other divestments will generate similar sums. Indeed, IBRA has recently put on hold its plan to sell a majority stake in Bank Niaga to a strategic investor, arguing that bids received in May were significantly less than had been hoped for. At the same time, it has become apparent that, far from generating revenue for the government from its sale, BII has become insolvent again and will instead require additional government funding (box 3). Moreover, funding for regional development, which accounts for 29% of total budgeted expenditure, is likely to exceed its target, given some slippage in the implementation of the decentralisation program.

In an unusual move, the minister of finance discussed the draft budget for 2003 with the DPR in May—more than five months before the budget is to be passed into law, and seven months before it will take effect. The intention may have been to seize an opportunity to present an optimistic fiscal outlook in order to boost improvements in consumer confidence and the business outlook further. In any case, there is probably much to be gained from keeping the general public informed as to the government's thinking on the macroeconomy, and from exposing its views to critical analysis by informed observers.

The deficit was predicted to fall to 1% of GDP in 2003, and GDP growth to rise to somewhere in the range 4–6%. Most analysts seemed to think that the outcome would be closer to the bottom of this range than the top. The other key budget assumptions for 2003 include an exchange rate of Rp 8,500–9,500/$, inflation at 7–9%, an interest rate on 3-month SBIs of 12.5–14.5%, and a world oil price of $19–22 per barrel. All of these seem reasonable; indeed, the exchange rate, inflation and interest rate assumptions may well prove overly conservative if BI continues to maintain slow

monetary growth. Presumably these assumptions will be revised in the light of changing circumstances in coming months.

Indonesia's fiscal sustainability hinges delicately on the massive government debt accumulated during the crisis. The total interest outlay on domestic and foreign debt accounts for about a quarter of projected budget expenditure for 2002. The government has suggested it hopes to bring total debts down to 60% of GDP by 2004. The assumptions underlying this projection are unclear, however. If real growth averages 6% and inflation 8%, for example, and if the principal outstanding and exchange rates remain constant, the target would be met, but it seems unlikely that average real growth at this rate can be achieved in this timeframe. Moreover, although the Paris Club meeting in April provided for postponing interest as well as principal payments from April 2002 to December 2003, this simply causes the principal amount outstanding to increase during this period. Finally, if the downward trend in inflation were to be reversed, it could be expected that the rupiah would weaken against other currencies, and nominal interest rates would begin to rise again. This would increase the rupiah value of existing foreign debt, as well as increasing the required budgetary outlays on interest payments.

PRIVATISATION: PROGRESS?

Privatisation of state-owned enterprises (SOEs) is a key part of the government's broader reform effort. Speedy implementation of the program, which aims to raise some Rp 6.5 trillion (about $740 million) in 2002, is considered vital both for improving overall economic performance (given the large size of SOEs relative to the economy as a whole, and the observation that the government is far less successful as a business manager than private sector owners), and for strengthening public sector finances (given the tight constraint on government spending resulting from the need to service the huge public debt). However, this is the area where the least progress has been made over the past two years in meeting the government's reform commitments to the IMF.

The sale of an 8.1% stake in the state-owned telecommunications company PT Indonesian Satellite Corporation (Indosat) through private placements has given some hope for better performance in the future. The total value of the sale was about Rp 1 trillion (about $110 million) (*JP*, 20/5/02). The Singaporean telecommunications giant, Singtel, is believed to have bought $5 million worth of shares, with the balance taken up mostly by institutional investors from the US—their first such involvement in the Indonesian share market for over two years.

The sale was not an unqualified success, however. The government's original plan had been to sell an 11.32% stake in the company, and it had to accept a price of only Rp 12,000 per share—lower than the previous trading price of Rp 12,600. Foreign telecommunications companies' reluctance to invest in the industry has been attributed to a lack of clarity about future government policy for the sector; concerns about worker protests intended to block privatisation of SOEs are also a strong deterrent (*Dow Jones Newswires*, 22/5/02). Following this sale the government retains a 57% stake in Indosat. It plans to sell a further 30% stake to a strategic investor in October, but whether this can be achieved seems very much open to doubt.

The smallness of the stake divested in May is an indication of the government's ambivalent attitude to the whole idea of privatisation. There are those

who believe that state ownership is no bar to efficiency, despite all the evidence to the contrary in the Indonesian context. Others fear opposition from workers concerned about the prospect of job losses, or from economic nationalists who dislike the idea that the potential buyers of SOEs are likely to be foreign, or from other self-interested entities such as the provincial government in West Sumatra, which continues to block the sale of the government's shares in PT Semen Gresik to the Mexican company, Cemex (Deuster 2002: 11). And of course there are others who see SOEs as cash cows, control of which offers the prospect of gain to private individuals and political parties. One of the arguments heard most frequently in opposition to privatisation is that the sale price will not be high enough in present conditions. In fact, what matters is not the price *per se*, but whether it can be expected to rise or fall in real, present value terms in the future; the latter seems more likely, so early divestment is preferable.

Finally, it can be noted that the government has also been involved recently in some reverse privatisation deals in which it has been buying out the shares of foreign partners in various subsidiaries of Indosat and PT Telkom, the other major state-owned telecommunications company (*JP*, 23/4/02; 30/4/02). It has been suggested that this is a necessary first step before divesting these subsidiaries in the future, but this seems a highly dubious argument.

TRADE

Threat of Renewed Protectionism

Further liberalisation of trade is another important aspect of Indonesia's current reform process. Besides tariff reductions, Indonesia has undertaken to remove all non-tariff barriers and export restrictions (other than those justified on health, safety or environmental grounds); in addition, local content requirements on production for the domestic market have gradually been phased out.

Resistance to further trade liberalisation and calls for higher tariff barriers have gained prominence in recent months, however. The agriculture minister, Bungaran Saragih, recently urged immediate measures to protect the domestic producers of food items—notably rice and sugar—on food security grounds. Refined sugar is already subject to 20–25% import tariffs and rice to a 30% tariff. In another push for protection, the Indonesian Farmers Association has asked the Ministry of Industry and Trade to increase the import tariff on chicken legs from 5% to 120%. According to BPS (Central Statistics Agency) data, total imports of chicken increased from 347 tonnes in 1998 to 14,017 tonnes in 2000 (*JP*, 23/5/02). The importation of chicken legs has become a controversial issue following a failed attempt by the previous government to ban chicken leg imports from the US, the world's largest exporter; such a ban would have violated WTO (World Trade Organization) rules.

Finance minister Boediono (who is in charge of import tariffs) and trade and industry minister Rini Soewandi (who is responsible for domestic trade and other aspects of international trade) have so far been resisting protectionist demands. Any increase in farm product tariffs would simply raise farmers' income artificially at the expense of consumers. The rice sector, which grew rapidly in the past with the extension of the irrigation infrastructure and the introduction of improved plant varieties and fertilisers, can no longer keep pace with consumption, which continues to increase along with population and rising incomes. Likewise, sugar cane areas in Java, where irrigation systems are most extensive, have been decreasing in

TABLE 4 *Composition and Growth of Merchandise Exports, 1990–2001*

SITC No.[a]	Category	Composition (%)		Growth (% p.a.)					
		1990	2001	1990–96	1997	1998	1999	2000	2001
0, 1, 4	Food, beverages & tobacco	9.4	6.3	10.1	–6.2	5.2	–1.9	–3.9	–7.1
2	Agricultural raw materials	4.8	3.4	16.6	–14.6	–10.4	–18.4	22.2	–10.5
3	Minerals (excl. oil & gas)	7.9	12.4	20.8	10.8	–19.4	14.2	13.8	0.3
33, 34	Oil & gas	43.1	22.5	1.2	–0.6	–30.7	22.3	45.5	–12.1
	Manufactures [b]	34.3	54.6	19.6	–11.7	–4.3	20.4	34.9	–10.8
	Total non-oil exports	56.9	77.5	17.5	–5.9	–7.3	13.4	26.7	–8.5
	Total exports	100	100	11.7	–4.7	–13.0	15.2	30.6	–9.3

[a]SITC = Standard International Trade Classification.

[b]SITC 5 through 8 less SITC 68.

Source: As for table 1.

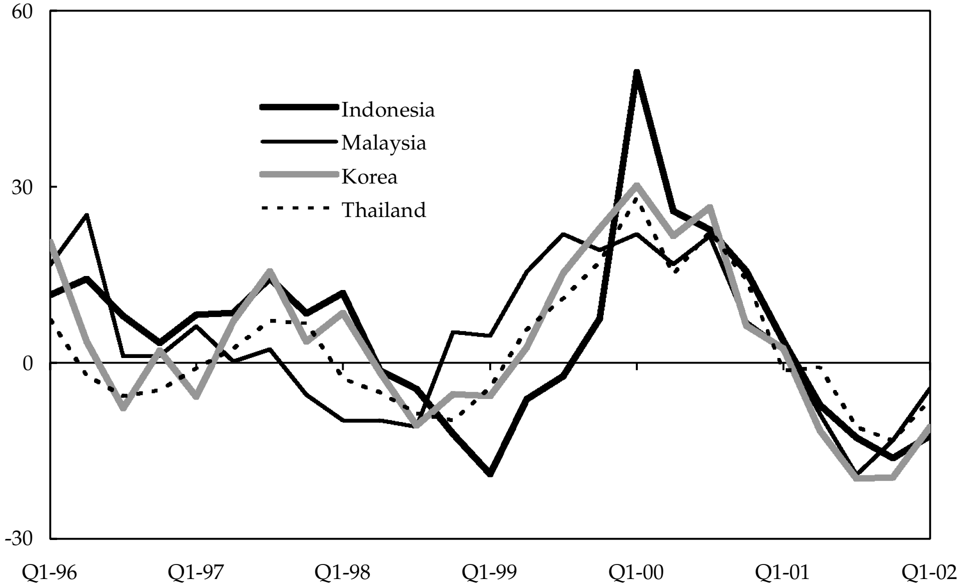
size, either because of farmers diversifying into other more profitable crops or because of the conversion of land to industrial and commercial usage. Increasing protection for these sectors would thwart the shift of agricultural resources into the production of higher-value products and activities such as cut flowers, vegetables and shrimp farming. Moreover, in a context in which smuggling seems to be rife, increasing tariffs without reforming the customs service would simply encourage even more smuggling, generating greater rents for smugglers and corrupt officials while leaving farmers' incomes virtually unchanged.

Export Performance

From about the late 1980s until the onset of the crisis in 1997, vigorous export expansion—with a heavy emphasis on manufactured products—was an integral part of Indonesia's rapid economic growth. By 1990 the share of manufacturing in total exports had surpassed that of agricultural goods, and was soon to overtake oil and gas. The dollar value of total non-oil exports grew at an average annual rate of 17.5% during 1990–96, with manufacturing exports growing even faster, at 19.6% (table 4). This impressive trend was dramatically reversed with the onset of the crisis. Total non-oil exports contracted by 5.9% in 1997 and 7.3% in 1998, and took two more years to regain their pre-crisis level. There was a further 8.5% contraction in 2001, however, largely reflecting the impact of the slowdown in the global economy. The average annual growth of total non-oil exports for the period 1997–2001 was a mere 3.7%. Within this, the average growth rate of manufactured exports declined to 5.7%.

The decline in the dollar value of exports was a pattern observed in all the crisis-affected countries (figure 3). This seems to reflect the ability of international buyers to push down dollar prices (in the context of huge windfall gains to exporters resulting from the massive depreciation of local currencies), which

FIGURE 3 *Growth of Export Value*
($, year-on-year, %)



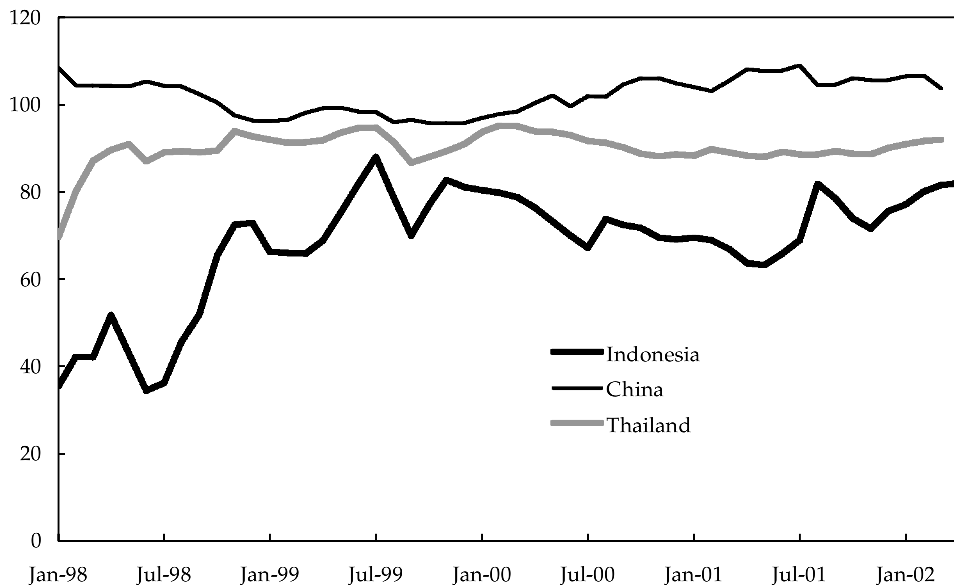
Source: Asia Recovery Information Center Database, www.aric.adb.org.

overwhelmed volume growth.[8] In addition, the crisis-driven collapse in domestic demand may also have encouraged exporters to pass on part of the gain from depreciation as lower prices in order to boost export demand (Rosner 2000: 63; Feridhanusetyawan 2002: 37).

However, the export contraction continued somewhat longer in Indonesia than in Korea, Malaysia and Thailand. Positive export growth resumed in these three countries within four to five quarters, aiding the recovery process; export dollar values exceeded pre-crisis levels by early 1999. Indonesia's export contraction continued for six quarters, and pre-crisis export dollar values were regained only in late 2000. This difference suggests the importance of supply-side factors in explaining Indonesia's post-crisis export performance. Differences in the structure of exports also play a role, however. The recent contraction in global demand for these countries' exports has affected them differently, depending on the peculiarities of their export composition. The export performance of Korea and Malaysia has suffered more than that of Indonesia and Thailand because of Korea's and Malaysia's heavy concentration on electronics and related products, which have been more influenced by the global slowdown than other products. Even so, Indonesia's export downturn in 2001 was somewhat more severe than Thailand's.

There is a dearth of studies on the determinants of Indonesia's export performance. Difficulties faced by exporters —particularly small and medium-scale firms—in obtaining trade financing, the departure of some foreign (particularly Chinese and Taiwanese) firms following the terrifying violence directed at the ethnic Chinese community in May 1998, endemic corruption in the customs service, and the negative impact on international competitiveness in low-skill industries of rapid increases in real wages, are often highlighted as key sup-

FIGURE 4 *Real Exchange Rate*[a]
(JP Morgan Index, monthly average 1997 = 100)



[a]The index measures domestic wholesale prices of non-food manufactures relative to trade-weighted wholesale prices (expressed in rupiah) of non-food manufactured goods in trading partner countries. An increase in the index implies real appreciation (decline in international competitiveness).

Source: www. jpmorgan.com

ply-side constraints faced by exporters (Manning 2002). Detailed research is needed in order to identify the nature and relative importance of these issues, with a view to informing the policy debate.

Supply-side constraints aside, figure 4 sheds some light, from a comparative perspective, on Indonesia's changing international competitiveness during the post-crisis era, using a measure of real exchange rates for Indonesia, China and Thailand. The initial improvement in international competitiveness brought about by the extraordinary depreciations of 1997–98 was far greater in Indonesia than in Thailand (or Korea, the Philippines or Malaysia). The depreciation also placed Indonesia in a much improved competitive position vis-à-vis China, which is perceived to be a major competitor for Indonesia in light manufactured goods exports such as apparel and footwear. Much of this newfound competitiveness was eroded in 1998, however, because of high inflation and the strong appreciation of the rupiah in the second half; this presumably reflected a realisation in the market that the initial response of investors to the emerging crisis had been overly pessimistic. The residual real depreciation still leaves Indonesian tradables producers better placed than those in Thailand, and even more so than those in China. There has been further erosion during the past year as a result of Indonesia's relatively high level of inflation, however, and if this trend is sustained (in the absence of renewed nominal depreciation), the residual advantage over Thailand and China will evaporate. It is important to note that Indonesia's

TABLE 5 *Share of Selected Asian Countries in US Manufactured Imports, 1999 – Q1 2002 (%)*

	1999	2000	Q1–01	Q2–01	Q3–01	Q4–01	Q1–02
Total manufactures							
Indonesia	1.01	1.13	1.15	1.1	1.16	1.04	0.95
China	10.76	13.15	11.77	12.47	15.18	14.17	12.35
Vietnam	0.03	0.03	0.03	0.03	0.03	0.03	0.05
ASEAN 3[a]	5.75	6.68	5.90	5.50	5.81	5.78	5.43
Textiles (SITC 64)							
Indonesia	1.33	1.56	1.51	1.45	1.36	1.45	1.27
China	12.72	14.64	13.26	16.28	14.89	15.22	15.77
Vietnam	–	0.01	–	–	–	0.03	0.03
ASEAN 3[a]	4.44	4.74	4.57	4.39	4.41	4.23	4.53
Apparel (SITC 84)							
Indonesia	3.6	0.33	4.79	4.15	5.48	4.08	4.06
China	14.4	16.61	14.86	14.88	23.59	15.73	13.78
Vietnam	–	0.10	0.10	0.11	0.10	0.08	0.28
ASEAN 3[a]	9.56	10.6	10.43	9.16	12.08	10.06	9.25
Footwear (SITC 85)							
Indonesia	5.43	5.35	5.97	5.97	4.65	4.76	5.45
China	61.2	66.98	73.6	72.63	77.26	59.35	67.88
Vietnam	1.07	0.91	0.99	0.99	0.85	1.05	1.18
ASEAN 3[a]	2.97	3.03	3.11	3.23	2.92	2.37	2.62

[a]Malaysia, Thailand and the Philippines.

– = zero or less than 0.01%.

Source: Compiled from US International Trade Commission website, www.usitc.gov.

manufacturing wage levels have increased in recent months at a much faster rate than the general price level. This implies that the deterioration of Indonesia's competitiveness over the post-crisis period in labour-intensive export lines such as apparel, footwear and electronic component production and assembly would have been greater than is depicted in figure 4.

The relevance of these observations for understanding Indonesia's future export challenge is reinforced by table 5, which summarises data on recent patterns of selected developing country exports to the world's largest market, the US. China's dominant share of total footwear imports to the US from all developing countries has increased even further in recent years, climbing to 77% before falling back to 68% by Q1 2002. Vietnam is also making some headway, starting from a very low base. Footwear imports to the US, unlike apparel imports, are free from quotas or other restrictions, so these figures show China's true strength under free trade conditions. The upshot is that when import quotas under the Multi-Fibre Arrangement are phased out by 2005, as agreed under the WTO Agreement on Textiles and Clothing, China, as a

new member of the WTO, will be a formidable competitor in apparel markets in the US (and in the European Union). If footwear is any indication, Indonesia and other developing countries are bound to lose market share unless appropriate policy actions are taken to improve their competitiveness and to remove supply-side constraints on export performance.

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NOTES

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1 It is important to note that even during the early months the president did not give in easily to populist demands. Economic policy decisions have more often been made in line with the contents of the Letters of Intent agreed with the IMF rather than reflecting popular calls for continuation of subsidies, greater protection, debt moratoria, and so on.

2 It is not widely appreciated that the flow of funds between Indonesia and the IMF is no longer a one-way street. Indonesia is already in the process of repaying some of the emergency loans it received early in the crisis. The amount of principal repaid in 2001 was approximately $1.7 billion.

3 Some Paris Club donors, especially Japan, wanted private sector lenders (who currently hold about $400 million worth of Indonesian sovereign bonds) to take part in debt rescheduling. But the other main donors, as well as the government itself, were not enthusiastic about this proposal because of the likely adverse effect on Indonesia's ability to raise funds in private capital markets in the future.

4 Privatisation of this function of government had removed a significant source of rents for the bureaucracy.

5 There are well-known problems with the expenditure-based national accounts data in Indonesia. Private consumption estimates are particularly prone to error, as they are not based on household surveys but are extrapolated from aggregate GDP estimated on the production side, with the help of a consumption function. The data collection system used for estimating investment is believed to give disproportionate weight to the modern business sector, which has been hit harder by the crisis than small and medium-scale business. Large swings in the changes in stocks item (not reported here), which includes statistical errors, may reflect the inaccuracies in the estimation of household consumption and investment.

6 ING Barings has forecast the price of crude oil to increase to around $35 per barrel by the end of the year, compared to the price of $22 per barrel assumed in preparing the budget estimates for 2002.

7 More recent movements in the yen/$ exchange rate have been in the opposite direction, however.

8 This is part of the well-known 'J-curve' effect of currency devaluation or depreciation.

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