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Mohammad Sadli

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Chairman, Indonesia Forum Foundation

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30 Heng Mui Keng Terrace
Pasir Panjang
Singapore 119614

E-mail: publish@iseas.edu.sg
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Professor Mohammad Sadli
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About the Author

Professor Mohammad Sadli is Emeritus Professor of Economics at the University of Indonesia and Chairman of the Indonesia Forum Foundation. Professor Sadli's economics education was from the Massachusetts Institute of Technology, and his doctorate from the University of Indonesia. His career with the Indonesian Government included holding the ministerial portfolios for Mining and Petroleum, and for Manpower. He was also the first Chairman of the Investment Board. After leaving the Government, Professor Sadli joined the Chamber of Commerce and Industry, first as Secretary General and subsequently as Chairman of its Institute for Economic Analysis, the Chamber's think tank.

RESTORING INVESTOR CONFIDENCE IN INDONESIA

Introduction

Economic recovery in Indonesia started during the second half of 1999, if recovery means that the economy is no longer contracting. During the height of the crisis in 1998, the economy contracted by almost 14%, which was the most severe contraction in East and Southeast Asia. The deeper and more complicated crisis in Indonesia, as compared to South Korea or Thailand, facilitated, and was made worse by, the sudden fall of President Soeharto who had reigned for 32 years with an iron hand. He left the country completely unprepared for leadership succession or for an orderly transition to a new political system.

A new democratization followed the collapse of the old regime which had lost grass roots support. The “*Pax Soeharto*”, or the strict maintenance of peace and order, ceased to function. The military and the police lost their composure and confidence, harassed by the people from below and finding no anchor with the new power holders at the top. Their new stance became: “when in doubt, sit still and do not use force”.

The powerful bureaucracy, the linch-pin of the Soeharto regime, lost its legitimacy because of its complicity in the widespread corruption. Found guilty by association, Golkar, the ruling party, had to let go of its supremacy after 30 years in power. Partai Demokrasi Indonesia-Perjuangan (PDI-P), the party of Megawati Sukarnoputri, became the largest party after the 1999 election (although Golkar is the second largest party). On the other hand, the PDI-P has never been in government and lacks the skill and experience to function as a new political mainstay. With only one-third of the votes in parliament it also cannot rule by itself. Its charismatic leader has two major drawbacks to becoming leader of the nation: first, she is a woman in an

overwhelmingly Moslem country, and second, many commentators question her administrative abilities.

Since President Soeharto stepped down Indonesia has had two presidents, B. J. Habibie and Abdurrahman Wahid, whose reigns have not been secure. The first was short lived and the second has been wobbly thus far. The society and economy have been in virtual turmoil. The recovery of the economy has been the tardiest among the crisis hit Asian countries. The question is whether Indonesian society will heal itself, or experience social and political disintegration leading to a possible break-up like that of the Soviet Union and Yugoslavia. Of course most domestic observers are partisan and prefer to see a happy ending in the future. But nobody can guarantee such an outcome.

The Political Landscape

The general expectation of Wahid's new cabinet in 2000 was for truly professional appointments which could earn the broad respect of the political elite and the informed public. That turned out not to be the case, both in economic and in political terms. This will affect the political climate, especially with respect to executive-parliamentary relations, and also with media reactions. The market reaction to the new cabinet was instant and negative. The rupiah rate of exchange fell almost 400 points, from Rp8080 to Rp8450 to the US dollar. People feared the beginning of another free fall, but that did not happen.

The ministers appointed reflected solely the personal choice of Abdurrahman Wahid. Rizal Ramli, the new Coordinating Minister for Economic Affairs, is a man in whom Gus Dur sees a comrade-in-arms who can perform and deliver. Ramli has a PhD in economics from Boston University, but his undergraduate background was from the prestigious Bandung Institute of Technology (ITB), from which a number of graduates have ended in ministerial positions and in the higher echelons of Golkar during the Soeharto years. Rizal Ramli had been a student activist who was briefly in gaol during Soeharto's time. Standing up against an unpopular and a very powerful regime has enhanced his political prestige. A number of his fellow activists came mainly from the Indonesian Moslem Students Association (HMI). Akbar Tanjung, the chairman of parliament, is a good exponent of this movement and is also a graduate of the ITB.

But not having come from a University of Indonesia or Gajah Mada University background, Rizal Ramli may lack broad based team support, since the upper echelons of the main economic agencies come from those two leading national universities. However, this may not become an unbridgeable gap, since the upper bureaucratic echelons will remain loyal to the government of the day. It is up to the incumbent minister whom to trust and seek to work with. Rizal Ramli had a reputation as an intelligent economist when he was working as chief of the economic think tank, Econit.

The cause of this immediate negative market reaction mentioned above was the appointment of the new Minister for Finance, Prijadi Praptosuhardjo. President Wahid could not have picked a worse man in Prijadi Praptosuhardjo, who is best known as a disgraced former member of the management board of Bank Rakyat Indonesia (BRI) who did not pass the Bank Indonesia's fit-and-proper test for the top position. The president insisted that he has known him for 16 years as a good man, citing, for example, his decision as a BRI director to extend credits to cooperatives and micro enterprises, including Nahdatul Ulama's (NU) *pesantren* (schools). Gus Dur was already feuding with the leadership of the Bank Indonesia (in particular its governor Syahrial Sabirin) and the matter of Prijadi failing the fit-and-proper test added fuel to Gus Dur's displeasure. Now Prijadi, as Minister For Finance, must oversee the state banks as well as cooperate with the central bank on monetary and fiscal policies. Past events may not forebode well for the future of this cooperation.

The gyrations of the rupiah's rate of exchange, however, became muted in the few weeks after the announcement of the new cabinet. The sensitivity to political and other events was reflected in only minor swings, for example, when the new economic coordinating minister was "misquoted" in an interview with the *New York Times* (corrected again in the afternoon), or when a statement of central bank governor Anwar Nasution on intervention of the central bank in the currency market was misquoted and retracted. On the day of the start of the Soeharto trial the rupiah also weakened slightly.

After two weeks the rate of the rupiah did not fall back to Rp8450 per US dollar, but it did not strengthen to the pre-cabinet level of around Rp8100. The rate now wobbles slightly around Rp8350 per USD. This "relative stability" is important as unpleasant political surprises and continuing political instability will produce another

sharp fall of the rupiah. On the other hand, the rate remains undervalued, or weak, as a reflection of the risks and uncertainties in the situation.

This relative stability was already apparent in the period of the first Wahid cabinet, when Kwik Kian Gie (a PDI-P politician and Rotterdam-trained economist) was the economic coordinating minister and Bambang Sudibyo (a PAN politician and a Gajah Mada professor of accounting) the finance minister. The successive Letters of Intent with the International Monetary Fund (IMF), stressing macro-economic prudence, and the new law on the (LoI) independence of Bank Indonesia, had a lot to do with the stability. It can be expected that Rizal Ramli will continue to abide by the first priority of the Letters of Intent and maintain macro-economic stability. The Bank Indonesia will continue with its chief mission of achieving monetary stability (through control of the base money or inflation targeting). Inflation, however, will rise during the year 2000, especially if domestic fuel prices will be raised on October 1 to reduce the large subsidy. Inflation may reach 9% for 2000.

The first acid test of political determination for the new cabinet will probably concern these fuel price adjustments. It was part of a former LoI, and already a commitment of the previous cabinet. But parliamentarians have not forgotten that Soeharto fell in 1998 after he reduced fuel subsidies. On the other hand, the government under the new central bank law cannot ask Bank Indonesia to print new money for government capital. Without a reduction of the large subsidies, the leeway for government spending will be severely cut and the new economic czar will have little room to manoeuvre.

The new Abdurrahman Wahid government will remain weak politically for the following reasons:

First, it will not have the support of the major parties and blocs (PDI-P, Golkar, PPP, and the Central Axis) in the parliament. Hard criticism of Gus Dur from the “young Turks” in the major parties will continue unabated and the test case will be the proceedings on the enquiries of “Bulog-gate” and “Brunei-gate” cases, which will possibly be followed by pressure for a statement by the president about an alleged extra-marital affair before he became president. These cases are not serious enough to impeach the president, but may weaken his political standing.

Second, the new arrangement where Vice President Megawati Sukarnoputri is assigned the management of day-to-day affairs of government and the chairmanship of cabinet meetings has yet to prove itself. But she is powerful because she can rein in or let loose many of the young Turks in parliament. She may not have the best insight, or perhaps neither the keen interest, in economic affairs, while none of the economic ministers is a ranking member of her party. Everything depends on the emerging “chemistry” between her and Rizal Ramli, and they may find that they need each other. In the meantime, the president retains the final authority and the question is: how much will he interfere? Perhaps, the best alternative would be that in practice the two coordinating ministers carry most of the burden of practical decision making, and the President allows this to occur.

Third, in the final analysis the political risk will lie with the behaviour of President Wahid. Unnecessary political crises have been caused by his erratic behaviour. Hence the crucial question is whether or not Gus Dur can really change his habit of frequent whimsical interventions. The “weak” composition of the cabinet may become a blessing in disguise because Rizal Ramli will be the “economic czar” and Susilo Bambang Yudhoyono the political and security chief as the other coordinating minister. If Rizal Ramli can strike up a good working arrangement with the IMF, and prioritize the chief objectives of the Letters of Intent, then monetary stability will be maintained and the recovery of the economy will proceed, albeit still at a slow pace.

For the investment climate the new cabinet is a mixed blessing. On the one hand, there is no change in the national leadership. Continuity is always better than unsettling change. Political democracy is in safer hands with Gus Dur. He also remains committed to the attraction of new investments. The new cabinet and political arrangement with the vice president, however, is no clear-cut guarantee for the improvement of the security conditions on the ground, affecting investors in manufacturing, plantations and mining. The promotion of a general, Susilo Bambang Yudhoyono, as the Coordinating Minister for Political Affairs and Security may be a good thing but is also no automatic guarantee of security (considering his stance as a mines’ minister dealing with the problems of Newmont Minahasa gold mining and the various foreign coal mining operations in Kalimantan). But the solution of this security

problem, including the improvement of law enforcement, is one of his major stated priorities.

Hence incoming new investors will still face the same quandary: should they wait a little longer for better political conditions, or invest now? The political parties in parliament are giving the new cabinet 100 days of grace. For new investors it may not be worthwhile to wait for another three months to make the decision. A minimum of economic stability (including single digit inflation) and growth (around 4% per annum) will be available in the foreseeable future. The domestic market remains large for consumer goods and its medium to long term prospects are good. New incoming investors could also avoid the pitfalls of the old investors who came in during the “bad” days of Soeharto when labour unions were suppressed and local people were denied proper protection and compensation for land. The costs of entry may now be a bit more expensive, but there will be less future risks and uncertainties.

Waiting for another three months may not solve the situation as other political uncertainties may loom, for instance, a possible change in national leadership in the years to come. Candidates for new investments must also consider that most old investments have prospered during much of their time, except during the height of the crisis in 1998. There is a good chance that the monetary and economic stability of the country will improve in the longer term because of the trauma of the past and the ensuing learning effects. The central bank has legally become much more independent, and the monetary instability has had a traumatic effect and will be avoided in the future. The nation is ready to embrace policies guaranteeing economic and price stability. The reforms in the economic institutions and corporation towards better governance are also important by-products of the crisis.

Consumption and an export led recovery

The recovery of the Indonesian economy was started by the resumption of consumption. After withholding consumption during the height of the crisis, consumers started to spend their money, from their current income and their past savings. During the first quarter of the year 2000, the Dana Reksa Research Institute, which initiated a Consumer’s Confidence Index, reported increasing spending rates. This index, however, has dropped slightly since April 2000, although still remaining

above 50% (meaning more than half of the respondents replied positively). It started to strengthen again in July, but the figure is still less than 60%.

The recovery, which was started through consumer spending, received support from a good export performance. Overall export figures for 2000 indicate a strengthened position, but this is because of very buoyant oil prices. It may reach US\$60 billion, which is a bit higher than the pre-crisis level of US\$55 billion. Non-oil exports also picked up during the year because of the weak rupiah.

Recently there have been signs of a resumption of construction. GDP figures for the second quarter of the year 2000 indicate positive growth for the construction sector. Growth in the agriculture sector in this quarter was negative, but this is a seasonal phenomenon. In spite of this, the quarterly growth figure was 4.1%, hence giving promise for a 4% growth rate of GDP for 2000. This figure earlier showed up in optimistic predictions, although the worst scenario figure was closer to 1%. If the economy improves after the post MPR political reshuffle, then perhaps it can enjoy a growth rate closer to 5%. For 2001 the growth rate could well be better than 5%. If all this comes true, it forebodes well for Indonesia's future.

Investments had always been strong during the Soeharto reign

Indonesia had been an attractive target of investments for most of the Soeharto period. During the first period of the Soeharto government, foreign investments took the lead. But during the mid-term and after, domestic investments advanced. On the other hand, the real distinction between foreign and domestic investments became blurred. This was due to the absolute freedom of the foreign currency regime during Soeharto's reign. Most of the huge domestic investments in real estate, property and other new business sectors, increasingly dominant during the last ten years before the crisis, were mostly financed by credit from outside the country. The result was that after the crisis had hit the economy, the foreign indebtedness of the business sector had swollen from an unknown figure to over US\$70 billion in 1999. Because of incipient repayments it has now been reduced to US\$65 billion. For a value comparison, the pre-crisis GDP was over US\$200 billion.

No more huge investments financed by overseas credits

This source of investment financing has dried up, and the repayments of many old credits are still being worked out. The economic recovery, marked by the promising growth rates of four to five percent for the years 2000 and 2001, has been led by domestic consumption and exports, not by investments at this stage. Before the crisis the investment rate was over 30% of GDP, fueled by large capital inflows. Currently this is probably not more than half that figure. Could investments go up to more than their previous levels in the near future? And could the recovery be sustained only on the strength of consumption and exports?

Why have investments not been more forthcoming during the recovery period so far? There are many simple answers. Most of them relate to the investment and business climate, which has been deteriorating since the crisis. First of all, the large flow of overseas credits has dried up and this will not be restored in the near and medium term, at least before there is an agreeable settlement of the old debts. Such rescheduling and restructuring workouts have been slow in materializing due to the continued weakening of the rupiah and to policy ambiguities.

Domestically, the government, with IMF prodding, is trying to reform the corporate and the banking sectors. Prudential requirements must be upheld and the very lax banking supervision cannot be tolerated anymore. Political power is now much less concentrated, and checks and balances, complete with NGO and governmental watchdogs and whistleblowers, will hopefully rein in grand corruption. Because prudential requirements will be more observed, debt-to-equity ratios will be held more prudently. The result will be no further grandiose investments with largely borrowed money.

However one cannot be too sure about business behaviour. There were recently three newspaper stories that relate to this issue. One reported a Singapore financed scheme to tap water from upstream in a river in the Riau province and to pipe it to Singapore. A second news item mentioned a Japanese consortium offering to build a railway in the same province to haul produce from palm oil and rubber plantations to the harbour. A third mentioned a Korean consortium offering to build over 1000 km of roads in Papua at no expense to government coffers. The consortium is, however, asking for the right to exploit the land resources alongside the highways. Old and

conventional economists like myself can only shake their heads, but it is essentially greed that propels business.

Another mystery is how much the domestic conglomerates, mostly controlled by Indonesians of Chinese origin, still have their wealth intact and placed outside the country, while their Indonesian companies have mostly landed in Indonesia Bank Restructuring Agency (IBRA) (or government) hands, at least temporarily. If most of those conglomerates' fortunes are still intact and potentially augmented by borrowing capabilities, can they be expected to engage in another investment spree? Will greed overcome present danger signals? There will certainly be no immediate herd effect, but some of the old conglomerates have put a portion of their money to some use again, including Lippo, Ciputra, Sinar Mas and Liem Sioe Liong groups. Their skills in "financial engineering" will come in handy as they are adept at not using their own money.

For the time being, the domestic political climate will not work in favour of the large conglomerates. At the moment, the small and medium scale enterprises (SMEs) are the "golden boys". Indonesian politicians, and a large part of the intellectual community, like to visualize a future economic paradigm based on SMEs, and on distribution and equity rather than on capital accumulation by large firms and high growth rates. In a scenario building exercise, where more than 500 people were involved through workshops in 14 provincial cities, the preferred scenarios were the ones based on a democratic political system and distribution orientated economic policies. Policies which are giving preference to economic growth through capital accumulation by large companies or conglomerates are not rated as desirable.

The Gus Dur government, however, openly favours investments from both inside and outside the country. The way this government handles the banking restructuring, the assets disposal of IBRA, and the resolution of the large corporate overseas debts, in the eyes of many NGOs seems to give power back to the conglomerates and/or to sell the country to foreigners. Yet the Gus Dur government is seen by many Indonesians as empowering the masses, and the NGO movement felt a chill when Gus Dur was threatened by an impeachment. Many are staunch public supporters of Gus Dur as president.

Ambivalent attitudes

Hence an ambivalent attitude towards large scale investments by large companies, foreign as well as domestic, will linger on. Any government responsible for the well-being of the nation, however, will soon discover that without adequate economic growth, of at least 6% per annum, lasting full employment and poverty reduction will be an illusion. In the first twenty-five years of the Soeharto government, with more than 6% growth per annum, the human development index and the Gini income distribution coefficient improved.

The NGOs and youth movements have rejected outright political scenarios based on creeping authoritarianism, regardless of whether or not their economic policies are growth orientated or populist. Regimes like those in China, Cuba or Myanmar are not viewed favourably by many. Perhaps in the next ten years such a style of government will not be a very realistic proposition anyway. But under a more democratic government, like the present leadership of Gus Dur and Megawati, can it afford to shy away from growth friendly economic policies? Widely accepted is an economic policy stance which is “market friendly”. There is more national consensus on this. Hence political and economic governance should achieve optimal economic performance on the basis of market and competition friendly economic policies. But as such it is still more a rhetorical proposition rather than a realistic one.

In the meantime, there is a search for practical policies to achieve a better balance between economic growth and equity, through: healthy competition; the upholding of prudential requirements; more effective governmental and central bank supervision on banks and the corporate sector; implementing a new anti-monopoly law on competition; a better working judiciary and a new bankruptcy law; and more checks and balances in the political and economic system, including a better functioning of the rule of law. Of course all these objectives will not take root in just a few years, but there is a learning process in the new civil society. It is still concentrated in Jakarta, but through the pervasive mass media it may filter down to the periphery.

Indonesia is still reasonably safe to visit and travel

Under the circumstances Jakarta is still a reasonably peaceful and orderly place for most people most of the time. Flights from Singapore, Hong Kong and Tokyo are full

with business travellers. Taxis and hired cars of reputable companies are still safe for those businessmen and women travelling around Jakarta. Going on business trips to provincial cities is still comfortable and safe. Garuda planes are often full and their on-time departure record is improving. There are many good provincial hotels, which are comfortable and still inexpensive. The conventional telephone system for local and long distance calls is working and amplified by the now ubiquitous hand phones that boast good national area coverage. A businessperson from Singapore can use his or her hand phone in many places in Indonesia.

Adequate infrastructure facilitating recovery

In fact it is the adequate infrastructure that was put in place during the Soeharto era and is still functioning, that is facilitating the business recovery.

The small and medium scale enterprises are thriving because they were not hit so hard by large debts when the crisis struck. Those who were damaged will get relief in the form of being excused from paying interest arrears. This is because these SMEs enjoy domestic political support and support from international aid donors. But most small-scale enterprises, now alive and well and enjoying improved export volumes, have never been dependent on bank credits anyway. Now their foreign buyers, disguised as tourists (i.e. without a business visa), visit them to place orders and pay up to 50% in advance. Modernity is also catching up with them as they increasingly use telephones, fax machines and internet facilities. In Jepara, Yogyakarta, Bali, and other places, small scale service companies handling domestic freight and overseas shipping have sprung up in the same neighbourhood as the producing shops and the whole system of communication, transactions, payments, insurance for breakages and so on, is running smoothly.

What can be done at the national level

The improvement of the investment climate still needs to undergo vast change at many levels. The strengthening of the government and the consequent reduction of policy confusion and ambivalence must be done at the national level. The new division of labour between Gus Dur and Megawati, and the revamped cabinet, must be given a chance. For the investors the new policy regime is important. There will not be basic

changes but there are a number of policy ambivalences, ambiguities and confusions that can be straightened out. These often reflect conflicts between goals, for example those of open (global) competition and the protection of domestic interests, or populist policy pressures and even handed, rational, policy making. President Wahid himself (and Habibie before him) has contributed to the confusion. For instance he once said that state plantation companies should cede 40% of their land to the people. The Habibie government ruled that both new plantations and the extension of leases should include 40% ownership for cooperatives. Land pressures and such ambiguous policy statements may spell the end of conventional and large plantations in the future, in favour of more small-holders' crops.

Local problems of investors

Improvement of the situation at the local level is still an uncertain proposition. So far the central government has no firm grip on the condition of law and order at the local level. For various reasons, the effectiveness of police interventions, the local government, and the military cannot be counted upon. The implementation of the laws on local autonomy, starting next year, will add to the confusion for investors at least in the short term.

Investors also face difficulties at the site of operation. Manufacturing enterprises may have industrial relations problems. Mining operations have been disturbed by illegal miners and striking workers. Plantation companies complain about large-scale pilfering and outright plunder; many of them reported red figures for 1999 because of loss of production as a result of such actions.

However manufacturing companies suffering from industrial actions are actually a small minority. Most by far still enjoy industrial peace. The celebrated case of labour troubles at a major Japanese industry is the Sony plant in Jakarta, but significantly the company is not quitting Indonesia. Most foreign investment manufacturing companies are still free of labour unrest.

The complaints of mining and plantation companies are more widespread and they occur more in locations outside Java. The central government has been mostly ineffective in handling these disturbances, mainly because it cannot rely effectively on its law enforcement agencies, namely, the military, the police, and the provincial or

district government. As part of this general paralysis, people are taking the law into their own hands.

Actually, in many such local cases, interference by non-local actors have been cited. Local workers have been agitated by outside agents, who are often activists from new labour unions elsewhere in Indonesia. This is a consequence of the new liberal freedoms. Before, there was only one trade union, and it was sanctioned and controlled by the government. On the other hand, the leaders of the new unions, sitting in Jakarta, often have no grip on their activists operating at local levels. This has been the case with a large foreign coal mining company (KPC) operating in East Kalimantan. Even Caltex, the biggest American oil company operating in the Riau province, has had its share of such problems. In this case industrial action was not directed against Caltex *per se* but to its numerous Indonesian sub-contractors. Nevertheless overall operations were somewhat disturbed.

In the case of Newmont gold mining in Minahasa, North Sulawesi, their dispute was with the head of the Minahasa district, which wanted compensation for the removal of overburden and the use of building materials. This case was settled “out of court” and the company agreed to pay compensation for matters which were not part of the original contract of work signed with the central government. The Jakarta government was ineffective in giving protection to the company. By design or by default, this inability has been more common and the affected company has had to take care of its own problems. In September both *Dow Jones* and *Jakarta Post* news items reported another work stoppage for Newmont because 40 landowners, demanding greater compensation for past acquisition of their land, managed to block the operation of a rock crusher. Newmont appealed to the local authorities for intervention. The blockade was removed on 8 September.

Through dialogue and bargaining, rather than by stiff adherence to the contract with force of law, settlements can be achieved. Of course there may be some cost, but it will be an investment in the future. In the future, mining and agribusiness companies will have to deal much more with local governments than with the far away central government. To defend against unrealistic demands and threats the local company can ask local authorities and respected local leaders for mediation to arrive at fair deals, recognizing, if and when necessary, wrong doings in the past. The possibility that local

actions might have something to do with long standing feelings of injustice, over events that occurred during authoritarian times, must be kept in mind. Often such alleged injustices have to do with compensation for the acquisition of land. Hence in the end it is more a matter of money and compensation than of principles.

But in Central Kalimantan, Palangkaraya, the sentiments of the local elite against gold mining by foreign companies have assumed a matter-of-principle stance. Rightly or wrongly, this elite is convinced that the region does not need foreign gold mining operations as the local people can do the same with panning. Therefore foreign gold miners will not have the sympathy of the local elite. Whether gold can be mined by simple panning or whether it requires heavy machinery for the moving and crushing of rocks will decide the acceptability of foreign investment in this sort of case.

In other cases the interest of local people may show itself when there is a serious show-down with a foreign operation. When Kalimantan Prima Coal (KPC) threatened to close its mining operation because of continued industrial action, the local community (the inhabitants of the new township Sengata Baru, built by KPC), realizing that their welfare was threatened, came to the defence of the company. In the end normal operations could be restored after the local government and the police became more resolute. The police threatened to evict striking workers who were creating obstacles to operations. How does one explain the change of heart by the local authorities after months of inaction? At one point the government may, or will, say: “enough is enough!”, after the central authorities have shown patience and tried to understand the reasons for the popular demands or complaints.

This only underlines the new reality which dictates that large mining or agriculture companies have to regard the local community and local government as important stakeholders and to strike a mutually beneficial deal with them. The old guideline is that it was sufficient if the company befriended central government, paid taxes properly, and left the responsibility of community welfare to the government, central or local. The nature of this bargain is undergoing rapid change.

Different prescriptions for old and new investors

The overall conclusion may be that the current investment climate in Indonesia is not good enough to expect normal flows of direct investment, portfolio investment and

bank credits. But such a generalization hides good opportunities, different prescriptions, and/or compulsions for different actors.

Most, if not all, existing investors are not packing up, going home or moving to another country. Most foreign investment companies in manufacturing have done well over the duration of their investment stake in Indonesia. However, many of those supplying the domestic market have been hurt in the crisis. Some who are dependent on exports also felt the pinch of shrinking export markets in East Asia and aggressive competition from China, South Korea and Taiwan. But most of these companies will stay for the long haul as they still have confidence in the growing market, and the investments in goodwill and knowledge of the local scene will further reduce the degree of risk.

This author is an external board member of a Japanese upstream synthetic fiber making company, a Canadian shoe manufacturing company, another large Canadian company in nickel mining, and an American pharmaceutical company. They are all in the process of expanding their capacities. If at times they have not done so well, this has been more to do with market conditions rather than political or security risks.

The large (domestic) Chinese conglomerates are in a more precarious position with a large debt overhang. This was largely their own fault because of reckless overexpansion and disregard for prudential rules. Many also made the strategic mistake of aligning themselves with the former first family — the Soehartos. The role of the Chinese in the economy is very problematic. The majority of indigenous Indonesians (*pribumi*) have ambivalent feelings about them, and these have been strengthened by the crisis and the perceived causes of it. But in the final analysis, the country and the economy cannot do without the skills and capital of the Indonesian Chinese. Any future government will have to come to the same conclusion. Foreign investors, especially those from Japan and other East Asian nations, will also look at how the country treats the Chinese. If (domestic) Chinese investments are not welcome then these East Asian investors will also not feel secure.

The Gus Dur government harbours the best short and medium term prospect for these Chinese investments. He is a democrat at heart and upholds the principles of non-discrimination and inclusion. But he may not be able to control all feelings of strident economic nationalism. Gus Dur, as an exponent of the NGO movement, is also

“populist” at times. Hence the search is for “constructive populism”, including making the best of what is called “the people’s economy” (*ekonomi rakyat* or *ekonomi kerakyatan*), that is, empowering of the small entrepreneur or company. The recent upsurge in “SME development policy”, with international assistance and encouragement, is an example of this idea.

New Economic Paradigm?

The best prospect for the new economic paradigm is that it is, in the first place, “market friendly”; and secondly, that a competitive market should be upheld by rules, regulations and effective government supervision. Domestic as well as international competition should foster productivity and efficiency. The principles of non-discrimination, accountability and transparency should be upheld. On the other hand, “weak” economic sectors or actors should be given adequate protection. The principle of transparency should favour an open Malaysian-style *bumiputra* (indigenous) “entitlement”, “empowerment”, or affirmative action policy. In Soeharto’s time, non-transparent, ambiguous and covert policies, secretly aimed at the same objective, led to nepotism and cronyism.

Summary and Conclusions

Investments have fallen sharply since the economic crisis. The present economic recovery is led by domestic consumption and exports, not by investments at this stage. Recent statistics issued by the Investment Board, however, indicate that there has been some rebound in foreign investment approvals during the first semester of 2000 (655 projects totaling US\$2,325.1 million) as compared to the first semester of 1999 (519 projects, stated at US\$1,849.8 million). Bank of Tokyo-Mitsubishi management in Jakarta claims that one-third consist of Japanese investments.

On the domestic investments side, however, there was a decline in value but not in number of projects. Total investments for first semester of 2000 are in 146 projects, totaling Rp12,914.8 billion, while during the first semester of 1999 there were approvals for 106 projects with total stated investments of Rp19,255.6 billion. Hence in the domestic scene there has been a shift to smaller projects in all three categories

(new projects, expansions and change of status from foreign to domestic investment), which is very plausible.

The major causes of decline in investments have been: (1) the drying up of bank credits both from inside and outside the country; (2) the uncertain political climate; (3) insecurity on the ground because of lawlessness and the emergence of new and more aggressive labour unions; (4) policy confusion between central government general policies on one hand and some sectoral and functional ministries on the other (for example, conflict between the new environment policy and the respect for old contracts or investment permissions). Looming in the near future are the consequences of the devolution of power to districts and provinces. This raises the unanswered question of which authorities will have to approve new entries.

In the short run, improvements of the investment climate can only come from a change in the make up of the central government, as has been forthcoming after the General Assembly (MPR) session in August 2000. This can instill greater confidence in the market and hence produce a more stable rate of exchange for the rupiah and less under valuation. Through better policy coordination and greater professional input in policy making (including fewer interventions by the President) policy consistencies may be improved and the ambiguities suppressed. The sorting out of investment policies and administration in connection with regional decentralization, however, will only be resolved during the year 2001 at the very earliest.

Lawlessness and the lack of security, with respect to large investments in mining and agribusiness in the regions, however, will probably be overcome more slowly. The return of effective law and order to Indonesia, which is still undergoing major political and social transformation, is very hard to predict. The best assessment is that things will somehow improve, but at a slow pace. A greater understanding of the still ongoing political and social processes can help the investor reduce his or her risks while maintaining confidence in the future of the country and its market. The same may be true with respect to industrial peace because the dust of the new labour relations law has to settle. During the time of uncertainty companies have to “mend their fences”. They have to improve community and industrial relations through dialogues, interactions, a recognition of changing times, and more effective public and social relations. In the end they may have to pay more, or endure increasing costs, but

Indonesia still being a poor country (hence with cheap labour), increases in the cost of labour, personnel and community relations may not make Indonesia internationally uncompetitive (except perhaps *vis-à-vis* China). The domestic market is still huge and some protection will always be available. Most foreign investment companies have also, in relative terms, much greater costs for raw materials, imported inputs, amortization and interest payments, rather than “personnel costs”.

New investments (aside from extensions) in mining will not be forthcoming in the new future. A new mining law is being drafted but the existing draft accommodates too many demands from the environmental movement and the demands of a “people’s economy” (which usually means the demand for partnership with cooperatives, and for early divestments). Moreover, the role of the central government, and the district and provincial governments, in the approval system is still unclear.

New investments in large-scale plantations may also not be attractive because of the pressures from local people and the people’s economy movement. The production pattern consisting of “nucleus and plasma” relationships for plantations may be more promising as the “plasma” part consists of small-holders in cooperation with the conventional (nucleus) part controlled by the investor.

Investors already in the country for a long time see things differently, and have different interests, than the new entrants. Existing foreign investors are usually sticking it out because they have to protect their existing investments and the majority can still cope with the reigning uncertainties without damaging their profit-and-loss position irreparably.

New investors can find bargains in the sale of current assets. The crisis has produced many winners and losers. Some of the winners can buy out some of the losers, as can be seen today in the banking, real estate, hotel, and retail sectors. More of the economy may end up in foreign hands, but the alternative is to prolong recovery.

Indonesia is, in the end, still part of Southeast and East Asia, a very dynamic region which will recover from the crisis. The investment behaviour in this region has been marked by contagion and emulation. Hence what is happening, for example, in Thailand, will sooner or later repeat itself in Indonesia, as long as Indonesia maintains an open economic system. That was the case in the plunge towards the crisis, and it will be repeated in the eventual recovery of the Indonesian economy.

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