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EFFORTS TO INCREASE THE EFFICIENCY AND EFFECTIVENESS OF STATE-OWNED ENTERPRISES IN INDONESIA

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I. Introduction

The foundation for the role of the state in our economy is rooted in Article 33 of Indonesia's Constitution of 1945, which provides for state control over land, water and natural resources, as well as branches of production vital to the state. Specifically Article 33 states that:

1. the economy shall be formed as a cooperative effort based on a set of principles;
2. fields of production essential for the nation's development and significant to the achievement of public aspirations shall be controlled by the State; and
3. Indonesia's land, water, and natural resources shall be controlled by the State and used to achieve the maximize the welfare for the people.

The Constitution recognizes three principal economic sectors (*"soko guru"*) in the Indonesian economy – the private sector, the state—owned enterprise (BUMN) sector, and the cooperative sector. These three sectors are expected to complement each other and support development efforts that will increase public welfare.

II. A Brief History of State-Owned Enterprises (BUMN) in Indonesia.

Indonesia attained its independence in 1945, and like many other emerging nations, it was eager to break with its colonial past where resources were often exploited for the benefit of others. Moreover, the government realized that it had to gain control over the means of production so as to ensure that resources were used to promote the national welfare and correct the distributional inequities that were the legacy of the colonial period. By the end of 1966 approximately 822 enterprises were under state control, of which the bulk, about 638, were nationalized former Dutch enterprises.(1)

The structure of the state—owned enterprises was made uniform under Law Number 19 of 1960, and those enterprises subject to that law were called "Perusahaan Negara." These state—owned activities operated in such diverse fields as automobile maintenance, theaters, bakeries, plantations, transport, banking, and so.

The coming of the New Order Government in 1966 marked a historic turning point for the Indonesian economy. Government found that the management, guidance, and

supervision of the State-Owned Enterprises needed to be overhauled. The Government, through Presidential Instruction (INPRES) Number 17 of 1967, which was followed by Law Number 9 of 1969, provided for three types of State-Owned Enterprises (BUMN): PERJAN, PERUM, and PERSERO. The respective characteristics and differences of each type of state-owned enterprise is shown in table 1.

One result of the restructuring effort that was brought about under Law Number 9 of 1969, was a sharp reduction in the number of state—owned enterprises. In 1969 there were 822 state—owned enterprises, over time that fell to less than 200 and today there are only 184 state—owned enterprises in Indonesia.

III. The Role of the State.

In 1983, as a part of the on-going process of reforming the State-Owned Enterprises (BUMN), the government issued Government Regulation Number 3, which stipulated that the aims of the state—owned enterprises were to:

1. contribute to national economic development in general and to state revenues in particular;
2. increase earnings and accumulate profits;
3. organize public utilities so that they will provide sufficient goods and services of a high quality meeting public demand;
4. undertake pioneering efforts areas which neither the private sector nor the cooperatives engaged;
5. organize business activities complementing activities carried out by either the private sector or the cooperatives so as to ensure that public needs, in terms of range and quality of goods and services provided, adequate to meet demand;
6. actively provide guidance to the private sector, particularly for small businesses and cooperatives; and
7. actively conduct and support government policies and programs in the economic sector and in development in general.

In effect, Government Regulation Number 3, clearly specified that State-Owned Enterprises should become "profit centers," but with some specific tasks. First, state—owned enterprises were to undertake "pioneering" projects, as for example in land, sea, and air transportation. They were also to take the lead in the development of "strategic" projects and projects which fulfill important public needs and which may require sizable capital investment and involve considerable risks, such as the establishment of steel mills, the opening up of new plantations in remote geographic areas, or the development of such technologically advanced activities as airframe manufacturing. State—owned enterprises were also to provide business assistance and guidance to small businesses operating in the private sector and to cooperatives and to support the implementation of government economic and development programs including efforts to increase non-oil exports and the development of tourism.

Table 1
THE MAIN CHARACTERISTICS OF BUMN BASED ON THE LAW NUMBER 9 OF 1969

DESCRIPTION	PERJAN	PERUM	PERSERO
1. Business objectives	Public service.	Public service <u>and</u> profits.	Primarily profit oriented.
2. Legal status	Not a separate legal institution but part of the Ministry's functions.	A separate legal entity; independent and subject to details of Law Number 9 and government regulations.	A legal, independent, institution based on commercial law and government regulations.
3. Ownership/assets	Entirely controlled by the Ministry.	Completely, but <u>not</u> directly controlled. Control is exercised through separated state assets.	May be completely or partially controlled through share ownership.
4. Supervision	Direct control – BPKP and BPK.	Supervision exercised through a Board of Commissioners — BPKP and BPK.	Supervision exercised through a Board of Commissioners – BPKP and BPK.
5. Status of employees	Civil servants	Employees of the state enterprise, subject to the definitions of Law No. 9.	Private sector employees.
6. Scope of business	Generally concentrated in public utilities	Generally found in business activities where state intervention is considered important or necessary, such as public utilities and certain services.	Any private sector activity.

In light of the roles set forth for state enterprises and their experience to date, it is fair to conclude that such enterprises have made a significant contribution to the national development effort. For example, sales by state—owned enterprises recorded an average annual increase of nearly 13% over the period 1989 to 1991, when sales rose from Rp 47.6 trillion 1989 to Rp. 68.4 trillion in 1992. As can be seen from table 2, sales from state—owned enterprises has grown by about the same rate as GDP, with the ratio of sales to GDP remaining at about one-third.

Table 2

Ratio of Sales by State—Owned Enterprises to GDP

Item	1987	1988	1989	1990	1991	1992 (*)
	(Rp. billions)					
GDP	124,816	147,105	167,185	196,919	227,163	252,832
Sales	34,794	40,008	47,694	62,293	61,791	68,446
Sale/GDP	27.9 %	28.2 %	28.5 %	31.6 %	27.2 %	27.1 %

* = Estimate.
Source: GDP date: Biro Pusat Statistik. *Pendapatan Nasional Indonesia: 1986-1991.*

The state—owned enterprises also have made a substantial contribution to the realization of state revenues with income taxes paid by state-owned enterprises increasing steadily. In 1989 the total taxes paid state—owned enterprises reached Rp. 1,093 trillion, in 1991/1992 this rose to Rp.1,450 trillion and for the year 1992/1993 it reached about Rp. 1,600 trillion.

Table 3

Percentage of Income Tax

1989/1990 - 1991/1992

In Billion Rupiah

Year	Income Tax			
	Total	Non-BUMN	BUMN	Percent (*)
1989/1990	2,555.5	1,462.8	1,092.7	42.8%
1990/1991	3,489.0	2,050.7	1,438.3	41.2%
1991/1992	5,050.0	3,450.0	1,600.0	31.7%

(*) Percentage of total income tax.

An additional source of income to the government from the operation of state—owned enterprises is the payment of dividends on the government's share of the enterprise profits.

As a number of state—owned enterprises have become more profitable, the dividend payments to government have increased. Thus, in 1989/1990 the government earned Rp. 958 billion as dividends; in 1990/1991 dividend payments reached Rp. 1,096 billion and in 1991/1992 they reached Rp. 1,311 billion. The expectation that the deregulation measures taken by government to free up various markets will allow the state—owned enterprises to continue to improve their profits, thus providing at least a modest return (estimated at around 4%) to the government for its investment.

Much of the dynamism of Indonesia's economic performance over the past few years has been the result of the rapid growth in manufactured exports. The state—owned enterprises have contributed to that development. Among the non-oil sector state—owned enterprises there are several, operating in the agriculture and industrial sectors, whose products are internationally competitive. In 1991 the total foreign exchange earnings by state—owned enterprises was Rp. 3.9 trillion and nearly Rp. 5.0 trillion in 1992, or about 10% of total exports.

The operations of the state—owned enterprises have also contributed to employment and productivity growth. Over the period 1987-1992, employment in all state—owned enterprises grew from 1.06 million to 1.13 million, or at an annual rate of about 1.3%. However, real output/worker grew faster, at about 1.6% per annum, reflecting the substantial productivity improvements attained by this sector. Of the total number of employees in the state—owned enterprise sector in 1992, three sectors account for two-third of the employment: about 46%, or 525,395, were engaged in the agriculture sector, about 11.0% were employed in financial services, and 10.9% were employed in the energy and mining sector. In addition about 9.1% were employed in the communications sector and 5% were found in industrial activities.

As noted above, Government has also charged the state—owned enterprises with the task of assisting small-scale enterprises and cooperatives. In line with this objective, state—owned enterprises are obliged to set aside up to 5% of their profits for distribution to small-scale entrepreneurs, defined as an company with assets of less than Rp. 300 million, and for cooperatives. From 1990 to the present, state—owned enterprises have been accumulated about Rp. 216.6 billion of profits and Rp.97.2 billion have been distributed to 12,241 small-scale businesses and to 3,233 units of cooperatives.

IV. Efforts Toward Privatization

A prime impetus for public enterprise reform worldwide has been the poor financial performance and the economic inefficiencies state—owned enterprises impose on the economy. Indonesia did not escape from this reform zeal and many academics and politicians in Indonesia urged the Government to privatize at least some of the state—owned enterprises. The reasons put forward for privatization in Indonesia are no different from those put forth in other countries. It was argued that state—owned companies suffer unacceptable financial losses, thus placing a burden on the national budget; that state—owned companies are less efficient than privately managed ones; that, on efficiency grounds, Government interference in the economy as a whole should be reduced so as to make the national economy more

efficient and, that because state—owned companies produce inferior quality goods, their output cannot compete in the world market.

Although not all of the above criticisms apply to all state—owned companies, the Government realizes that at least some public companies are inefficient and that the nation would be better served if such companies were subject to the rigors of the competitive market.

Privatization has been touted as a major boon to the public sector because it can raise revenues for government through the sale of assets while reducing the cost to the budget of keeping unprofitable enterprises afloat. Yet the reality of privatization is often more complex than this simple analysis would suggest. The government of Indonesia is attempting to learn from the privatization experiences of other countries, to see what has worked elsewhere and what has not, and what might work in the Indonesian environment and what might not. First, one must be sure that there are sufficient funds in the private sector to finance the transfer of shares in state—owned enterprise at a "reasonable" price so that sale of the asset yields a fair return to the general public. This of course depends to some extent on whether the financial markets are sufficiently developed to adequately price the asset and ensure its sale to the highest bidder. A second question to be considered, is where will the funds to buy state—owned enterprise come from? Government must ensure that the selling of public assets does not serve to increase the monopolistic tendencies in the economy. Third, government must ensure that the entrepreneurial and managerial capacity exist to maintain the asset.

Government must also decide which companies should be privatized. Obviously some companies, operating in well-developed competitive sectors can be sold; others, operating in monopoly areas, may need to be kept under government control, especially in the absence of effective anti-monopoly and anti-trust legislation. And finally, government needs to decide on how the privatization process should be undertaken so as to ensure an optimal outcome from the national perspective.

Only if one can satisfactorily address these concerns should privatization be implemented. In Indonesia, after the questions were considered, the conclusion was that privatization, in the sense of transferring more than 50% of the shares of a state—owned company to private owners, could not be undertaken during the past decade because the funds available from the private sector was still too limited, with private sector investment itself still highly dependent on the funds provided through state—owned banks, and because financial market instruments and institutions in Indonesia were not yet mature enough to efficiently handle any large scale privatization effort.

Given the above analysis the government has opted for the adoption of measures aimed at making public sector companies more efficient and effective. Companies are being restructured so as to make them more efficient. The restructuring allows the company to change the its legal status if that is deemed necessary to make them more productive, it allows companies to undertake joint operation or management contract with a third party if that will enhance its market share, access to technology, and in general improve performance. State—owned companies may also consolidate or merge with others state—owned companies

to strengthen their capital base or to extend their market share, and state—owned companies may sell shares through the capital market to raise capital. If none of these measures serve to improve financial and economic performance, state—owned companies may even be sold or liquidated.

Within the framework outlined above,

- 7 state—owned enterprises were sold;
- 5 state—owned enterprises are being liquidated;
- 6 state—owned enterprises are being merged;
- 3 state—owned enterprises have been privatized;
- 15 state—owned enterprises (*Perum*) have changed their status to become private enterprises;
- 6 state—owned enterprises have gone public; and
- 5 service enterprises [*Perjan* = Old State Companies (*PN lama*)] have became Public Enterprises (*Perum*).

In addition to restructuring, the government has also adopted a performance evaluation system which allows government to rank the performance of state—owned enterprises. Based on the management and financial reports submitted by the Directors the government evaluates "health" of each state—owned enterprise. The "health" of each enterprise is classified as belong to one of four categories: "very healthy," "healthy," "less healthy" and "not healthy" based on an analysis of rentability, liquidity and solvency, as illustrated in the table below.

Table 4

The Level Criteria of the BUMN Health

Health Rating	Percentage		
	Rentability	Liquidity	Solvency
A. Very Healthy	12%	>150%	>200%
B. Health	8% - 12%	100% - 150%	150% - 200%
C. Less Healthy	5% - 8%	75% - 100%	100% - 150%
D. Not Healthy	< 5%	< 75%	< 100%

To further improve the state—owned enterprise performance, such companies are required to submit long-term (five year) strategic plans that detail the company targets and the steps management intends to take to achieve those goals. Further, annual working plan and annual budgets must also be submitted. In addition the management of the company is obliged to prepare an evaluation of the company performance and the Board of Commissioners (*Dewan Komisaris*) of the company must submit an annual report to the Ministry of Finance. Steps have also been taken to increase the authority of the Board of Management.

Many functions previously handled by the Ministry of Finance have been transferred to the board. Thus the Board can now effectively manage it short term credit needs, dispose bad debts, and change the organizational structure of the company.

V. Performance of State-owned Enterprises (SOEs)

Following the adoption of the various policies toward state-owned enterprises including restructuring and annual evaluations of the activities of state—owned enterprise, the performance of the state—owned companies has improved. For example, in 1987 out of 183 SOEs only forty were classified as "very healthy." This has increased to 54 companies in 1991. At the same time the number of companies classified as "unhealthy" totalled eighty-eight in 1987, but this number decreased to 52 companies in 1992. The number of state—owned companies losing money was forty-two in 1987, but this gradually decreased to thirty-one companies in 1989, to twenty-seven in 1991, and to twenty-four in 1992. Put differently, by 1992 the number of companies that earned a financial profit totalled 160 out of 184 state—owned companies; that is 87% of all of Indonesia's state—owned enterprises were profitable.

VI. Conclusion

We can draw several conclusions from this broad review. First, the existence of SOEs in Indonesia is an outgrowth of the 1945 Constitution which provides for the State to control productive factors which are needed by the people. Second, privatization, which has been carried out in a number of developed as well as developing countries, can not easily be carried out in Indonesia because of limited private savings, and a relatively under-developed capital market combined with the still nascent financial market institutions that need further maturation. Third, to improve SOE efficiency and productivity, the government has adopted various policies which encourage state—owned enterprises to improve their economic performance. This has reduced their burden on the national budget and enhanced their contribution to the national economy. Finally, government will continue its efforts to ensure that the SOEs work as efficiently and effectively as any comparable private company.