FINANCIAL MARKETS PROJECT

FINAL EVALUATION

Indonesia

Project No. 497-0360

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Office of Economic and Institutional Reform
Center for Economic Growth
Bureau for Global Affairs, Field Support & Research
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Submitted by:

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EXECUTIVE SUMMARY

A. *Purpose of the Activity Evaluated*

This report provides USAID/Indonesia with a final evaluation of the Financial Markets Project (FMP). The FMP was authorized in August 1988 and was amended in August 1991 and August 1993. The project had an original anticipated completion date of August 1994, total expenditure by USAID of $9.0 million and host country funding of $4.7 million in cash and in-kind contributions. The first project amendment added $5.0 million and subsequent amendments added another $0.6 million and extended the Project Assistance Completion Date (PACD). Total USAID expenditures under the project are $14.6 million and the PACD is now June 1995.[1]

The FMP sought to increase the availability of long-term investment capital in Indonesia and assure that sufficient funding was available to support broader, more diversified, and rapid economic growth. This goal would be accomplished primarily by developing more open, efficient, and transparent financial markets, with a broader range of investment options. More specifically:

- Increasing the availability of financing options for debt and equity securities.
- Improving financial market regulations.
- Improving market mechanisms for trading, clearing, and settlement of funds and securities.
- Restructuring and privatizing state owned enterprises, so their securities could contribute to improved securities market liquidity. (Restructuring SOEs was also viewed as the best way to encourage public sector deregulation and improve public finances during a period of declining government revenues.)
- Improving monetary management to ensure monetary stability and an attractive investment climate.

B. *Purpose of the Evaluation*

The purpose of this evaluation is spelled out in the delivery order initiating the work and reproduced here in Appendix A. In summary, the evaluation is requested to:

- Assess the extent to which the project contributed to achieving more attractive and better managed financial markets and the availability of more investment funds.

- Assess the relationship between any increased availability of debt and equity instruments to poverty alleviation in Indonesia.

[1] Details on the FMP structure, estimated costs and other issues are found in the original and amended project papers (PPs).

- Review events in the Indonesian financial sector since the project began, identify remaining problems and make suggestions for future project design.

C. *Findings and Conclusions*

In our view, a project should be evaluated on the basis of whether it used its resources effectively to contribute toward the achievement of certain stated and broad-based goals. On the whole, we feel the project has used its resources effectively to contribute to development of the local financial markets in the ways envisioned. The project's major achievements are:

- In the capital markets, the FMP contributed to developing new regulatory and operational infrastructure that has increased market confidence and efficiency. (See Table 4 on Page 24.) BAPEPAM is today a self-standing regulatory agency, separate from the stock exchange and clearing corporation. An extensive body of rules and regulations have been adopted, BAPEPAM's ability to draft and implement rules and work with market institutions has improved considerably, a new Capital Markets Law has been drafted which will strengthen BAPEPAM's enforcement capabilities, and corporate disclosure and public information is more extensive and of higher quality. Since the project started in 1990, the stock exchange has blossomed. As of May 1995, market capitalization was Rp. 1 trillion (from Rp. 14 billion in December 1990), 222 companies were listed (from 122), daily average trading value was Rp. 78 billion (from Rp. 30 billion) (see Appendix E, Table 1). The market is increasingly used to raise new funds; in 1994 alone, there were 50 new Initial Public Offerings (IPOs), 30 Rights Issues, and 7 new bond offerings, which combined raised over Rp. 11 trillion in new funds (see Table 2 on Page 20A). The FMP contributed to these ends through helping to build important market infrastructure.

- In the money markets, the FMP contributed to developing a new credit rating agency and new commercial paper regulations, introducing a new system for auctioning money market securities (SBIs), strengthening BI's institutional capabilities, forging relations with central bankers in the ASEAN region and globally, and designing a new electronic funds transfer system (See Table 5 on Page 33).

- In privatization, the FMP contributed to designing privatization policies, preparing models for selecting IPO candidates and intermediaries, identifying specific IPO candidates, assisting with transaction-specific matters, and building capabilities within the MOF Directorate of State Owned Enterprises in the process.

In sum, financial market infrastructure, regulation, and management is viewed as having improved measurably in the past few years, and achieved a new stage of development in the past two years. This has contributed to the continued inflow of new market borrowers and investors, the growing ability of Indonesian firms to access offshore capital markets, and the introduction of some of the world's most sophisticated foreign investment houses to the Indonesian market.

It must be recognized, though, that the FMP can not take credit for all of this work; the financial sector development process had momentum from several sources, not just the FMP (see Table 1 on Page 6). Indeed, it is difficult to isolate how much any one project contributes to development partly because so many other reforms and activities may precede it or occur simultaneously.

It must also be recognized that several objectives of the original project paper have not been met. These include in the capital markets: primary and secondary bond market activity is still limited. An active domestic investor base has not been developed--foreign investors drive the equity market--and retail investment is virtually nonexistent. In the money markets, although Bank Indonesia has taken several steps to move toward market-determined interest rates on money market instruments, and while monetary management and stability has improved, rates are not fully free but are still somewhat controlled by the central bank. As a result, secondary market trading of central bank certificates (SBIs) is limited. In privatization, only two firms have been privatized to date. In most of these cases, the FMP could not have influenced the reasons underlying the lack of development or could only have done so by diverting resources from activities that may have been more critical to financial market development in the longer run.

In terms of economic growth and poverty, while there are little if any direct impacts from financial market development on poverty alleviation, the FMP has contributed to development of the financial markets which seems to have contributed to economic growth which, in turn, contributes to poverty alleviation. The capital markets provide capital for economic expansion that might not be available otherwise, or only at greater cost. New, smaller, though not small, and more labor intensive firms are using the capital markets today. Improved corporate disclosure has made companies more aware of the importance of managing their economic resources more effectively to achieve profits and return on investment and equity. Bank Indonesia (BI) continues to improve at monetary management, creating a stable environment that supports financial transactions and economic growth.

D. Lessons Learned and Recommendations for Future Action

Several comments can be made about project design:

1. Reliance on long term advisors helps focus advisor activities and build institutional knowledge and relationships. Each of the FMP components had a long term advisor who developed strong working relationships with his/her Indonesian counterparts. These relationships helped focus consulting efforts on areas of greatest importance and need.

2. Long term advisors need to be given flexibility in their work, so they can build close and effective working relationships with their clients.

3. More is not always better. Project papers frequently set out quantitative measures of project success, such as the number of money market brokers, the number of companies privatized, and the number of regulations written. But higher numbers do not always mean "more" development. Indeed, in some cases, pushing to achieve higher quantity of output can harm the quality of development, and reduce its sustainablity. For example, an advisor, feeling pressed to produce a large number of regulations, drafts regulations alone instead of guiding and training local counterparts on how to draft; more regulations are drafted and adopted than the local regulatory agency can understand or implement intelligently; more firms are privatized than the local capital markets can absorb, obstructing capital market activities; or more brokers are incorporated than can be supported by local financial market transactions.

4. The need to build relationships and consensus among several involved parties often lengthens the development process. This must be recognized and accepted or project achievements will be constrained.

5. Project design should focus on a few major issues, and the general activities that address them, rather than concerning themselves with many of the details of how things are to get done.

6. Realistic budgets should be assessed before a project is begun. Negotiations and adjustments during a project's tenure cause uncertainty that can stall project activities.

The following are lessons learned about project implementation:

1. The utility of host country contracts should be questioned. In Indonesia, where host institutions often already possess contracting ability, the use of an HCC may simply overlay the bureaucratic processes of AID onto the host institution.

2. When it becomes clear that major components of a project must be dropped, there should be formal ways of reviewing the reasons for change and the consequences for the remainder of the project.

3. When major expenditure shifts occur within a project, careful documentation should be prepared and filed.

In regard to recommendations for the future, the financial markets are moving ahead rapidly. In some respects they are entering a new phase of activity. Continued work is needed to keep the financial markets growing in size and improving in quality. Key areas that should be focused on include:

- In the capital markets, BAPEPAM will have to prepare and implement a wealth of new rules, and redraft existing rules, to implement the Capital Markets Law and to cover the new automated trading, clearing, settlement, and depository functions. Training will be critical; BAPEPAM must develop greater depth of staff to handle analytical, operational, and enforcement activities that will arise as the markets become increasingly more sophisticated with time. More training is needed among private sector participants as well. Efforts are needed to encourage more debt offerings and a domestic investor base. The latter may be spurred by introduction of open-ended investment funds with the new Capital Markets Law, but only if fund managers are trained on how to operate properly in the market. Securities firms will need to be encouraged, and trained, in marketing and research to draw forth more domestic and more retail participation in the market.

- In the money markets, BI should continue moving toward market-determined interest rates and building the electronic funds transfer system. The new credit rating agency (Pefindo) may need guidance and assistance in designing and running its operations to be an effective institution as quickly as possible.

- In privatization, new firms need to be identified as privatization candidates, and restructured to be prepared for privatization transactions. Staff of the Directorate of State Owned Enterprises must continue to be trained so they can ultimately take over the work on their own or be strong counterparts for private sector entities that the Directorate might hire to assist with transactions in the future.

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SECTION 1: Purpose

The purpose of this report is to provide USAID/Indonesia with a final evaluation of the Financial Markets Project (FMP). The FMP was authorized in August 1988 and was amended in August 1991 and August 1993. The project had an original anticipated completion date of August 1994, total expenditure by USAID of $9.0 million and host country funding of $4.7 million in cash and in-kind contributions. The first project amendment added $5.0 million and subsequent amendments added another $0.6 million and extended the Project Assistance Completion Date (PACD). Total USAID expenditures under the project are $14.6 million and the PACD is now June 1995.[2]

As noted in USAID's scope of work (see Appendix A), "The emphasis of this evaluation will be to analyze the relationship between the availability of debt and security instruments to the success of Indonesia's poverty alleviation policies. The analysis should be broad enough to consider the effect of improvement in financial markets on the lower income populace through facilitating economic reform and continued rapid economic growth. This evaluation will review what has taken place in the Indonesian financial sector since this project intervention was initiated, systematically collect information about the extent to which this intervention made a difference to the economic development of Indonesia, suggest what problems remain, and speculate about alternative designs for similar programs or projects in the future. The intention is to contribute to more informed future decisions, rather than to try to arrive at definitive conclusions that FMP led to specific results which would not have occurred in its absence."

[2] Details on the FMP structure, estimated costs and other issues are found in the original and amended project papers (PPs).

SECTION 2: The FMP's Economic, Political, And Social Context

A. *Economic Growth*

Over the past twenty five years, Indonesia's record of growth and poverty alleviation has been impressive. In the mid-1960's, the country's annual GDP per capita hovered around \$50, one of the world's lowest. Since then real GDP has grown steadily, at an annual average rate of about 7%. Per capita income has risen at an average rate of about 4.5%, about \$750 today. Clearly, Indonesia is still a poor country, but continuation of its long term performance will soon raise it to middle-income status.

The benefits of growth in Indonesia have been widely shared by most segments of the population. Income distribution, measured by income shares or aggregate measures such as the Gini index, is relatively egalitarian. While one must place generous confidence intervals around measures such as the Gini index, the estimates show it falling from about .38 in 1978 to .32 in 1990. A declining Gini index indicates more equality. Not only does the trend show improving equity in income distribution, but the level of inequality is low as well. Few countries have Gini indices as low as .30. Gini indices in the U.S. usually fall in the range of .40 to .43.

In Indonesia, the Gini indices are based on measurements of consumption, not income *per se*. The increasing equity in consumption has occurred despite a high concentration of ownership and market power in the modern business sector. Large business groups or conglomerates control a large (but unknown) proportion of business activity. The World Bank's rough estimate is that the largest 200 groups control about one-third of the non-oil, non-smallholder-farmer GDP.

As one would expect in a country with a relatively low level of income inequality, the high growth of the recent decades has reduced poverty considerably. In 1970 about 60% of the population was classified as living in poverty. Today the number of people in poverty is under 15% of the population and falling (World Bank, 1994). The absolute numbers of people in poverty fell from about 73 million in 1970 to about 27 million in 1990. This is not to say that there are not severe pockets of poverty or regional poverty problems; there are. But overall poverty reduction has been impressive.

One of the key factors in Indonesia's success is that the growth that has occurred has taken advantage of the country's abundant labor supply. About 50% of the labor force is still engaged in agriculture, down from 65% in the 1970s. The proportional shift of labor to non-oil manufacturing has been accompanied by increased productivity in that sector, while agricultural productivity has not fallen. While a smaller proportion of the labor force is engaged in agriculture, the absolute number of workers there has grown. The most frequent problem in poor countries, as the number of agricultural workers rises, is that productivity falls. This has not happened in Indonesia. The World Bank (1994) has estimated that for Indonesia to absorb new entrants to the labor force, overall non-oil GDP must grow at about 6-7% per year and non-oil, non-agricultural GDP must grow by about 7.5-8.0% annually in the 1990s. The latter grew at 8.2% over the 1986-92 period. Assuming that non-oil GDP grows by 7% and that the associated rate of poverty alleviation continues as it had in the late 1980s, the population living in poverty would decline from 15% in 1990 to 10% by 2000. In the United States about 12.5% of the population lives in poverty. Of course, the definition of poverty changes from country to country, but the World Bank (1994:43) remarks that "this [Indonesia's poverty alleviation] would be a remarkable achievement by any standard".

The success of Indonesian development can be attributed to strong macroeconomic management, despite serious challenges. Indonesia suffered oil shocks in 1980-81 and 1986, but unlike many other oil exporters was able to adjust monetary policy and manage exchange rates to minimize adjustment costs. In making these adjustments, the build-up of external debt was reasonable and manageable. Budget deficits have been low, and enforced by an agreement between the MOF and BI to not engage in inflationary finance. Small deficits have been financed by external credits. Spending discipline is helped by an open capital account, which subjects Indonesian budgets and their financing to the rigors of international capital markets. Thus, the task in Indonesia is to sustain an already successful macro environment and strengthen the structure supporting favorable changes already underway.

B. *The FMP and Economic Growth*

In its focus on sustainable development, World Development Report, 1991 identifies four key elements:

- Stable macroeconomic management
- Investment in human and physical infrastructure
- A competitive climate
- Institutional development.

Drawing on these themes, extensive work by the World Bank (1994) on Indonesia identifies several thrusts that are of interest to our evaluation of the FMP. Among others, those thrusts include:

World Bank Objective	*FMP Component*	*FMP Activity*
Stable macroeconomic management	MMC	• Develop indirect instruments to better manage monetary policy • Deepen and broaden the money markets to support improved open market operations
Investment in human infrastructure	All	• Train regulators • Train financial market participants
Competitive economic environment	PC CMC MMC	• Reform and privatize SOEs • Improve market outcomes by improving market infrastructure (trading systems, rules, etc.) • Raise the efficiency, quantity, and quality of investment
Institutional Development	CMC	• Strengthen securities industry participants and mechanisms

* MMC = money market component; CMC = capital market component; PC = privatization component.

Other elements for sustainable development could easily be identified. However, since our focus is on the FMP, it is encouraging to see that many of the items identified in these lists are also objects of the FMP. Indeed, one could build the case that much of what the World Bank (1994) has identified as key to sustaining Indonesia's development was already identified by the designers of the FMP in 1988.

C. *Financial Sector Development and the FMP*

Indonesia began important macroeconomic and financial reforms well before the FMP began to offer TA. In particular, important financial sector reforms were begun in 1982 when BI began to cut back on the use of directed credits to channel funds to "priority areas". At the same time interest rate liberalization was begun along with other measures to mobilize domestic resources. A far-reaching set of reforms was begun in October, 1988. Table 1 on Page 6, indicates the major events in the reform packages of the late 1980s and early 90s. In general the reform packages included:

- Banking licenses were made available to new banks that could meet capital requirements.
- Licenses for acquiring foreign exchange were simplified.
- Domestic banks were allowed freer branching.
- Joint ventures with foreign banks were permitted.
- Limitations on bank activities were lessened.
- State enterprises were allowed to hold up to 50% of their assets with private banks.
- Reserve requirements were lowered.

The main impetus behind the banking sector liberalization was the government's determination to reduce the country's reliance on oil revenues and to diversify the economic base. A more diversified economy would demand a stronger, more robust, and hence diversified, financial system, one that offered the range of funding and investment tools needed to mobilize sufficient amounts of domestic and foreign capital (foreign capital was seen as an important need) and attract firms that could most effectively use that capital for productive investment.

In addition to banking, developing the capital and money markets is important to developing a more diversified financial sector. Equity financing was viewed as particularly critical. In 1988, the Indonesian capital markets were moribund. There were only 24 companies listed on the Jakarta Stock Exchange, daily trading value was Rp. 122 million and market capitalization was Rp. 449 billion. The Exchange was a government entity, operated and regulated by the Ministry of Finance through BAPEPAM. In December 1988 several regulatory changes were adopted to encourage equity market development, including: removing unnecessarily onerous issuing and disclosure procedures, removing tax disincentives, and encouraging foreign investment. In 1989, further revisions were made to encourage foreign participation in the local equity markets.

The results of these measures were dramatic. On the banking side 75 new banks were licensed between 1988 and 1991; 1100 new bank branches were created, raising the total to 3,700. In the equity markets, the number of companies listed on the Jakarta Stock Exchange rose from 24 in 1988 to 139 by the end of 1991. Market capitalization jumped from Rp. 449 billion to Rp. 25 trillion, average daily trading value from Rp. 122 million to Rp. 32 billion, and average daily trading volume from 27,000 shares to 7 million shares (see Appendix E, Table 1). This activity was driven largely by the influx of new foreign money, in response to the regulations encouraging foreign participation.

During the past five years, financial sector development has focused on building market infrastructure including regulatory, institutional, and human resources to improve the quality as well as quantity of activity. In both banking and capital markets, liberalization occurred before prudential regulations, operating standards, and well functioning transaction mechanisms were in place. As a result, both banking and financial markets sectors went through periods of sagging confidence, and sagging market activity. Since 1990, the focus has been on building this infrastructure. On the banking side, prudential regulations were adopted in February 1991. On the capital markets side, The Capital Markets Decree was adopted in 1990 which set comprehensive regulatory standards for the local capital markets, the Jakarta Stock Exchange was privatized (April 1992) and a new clearing corporation, PT KDEI was established (1992).

Since 1991, the capital markets have skyrocketed. By May 1995, market capitalization quadrupled to Rp. 100 trillion, 223 companies were listed and average daily trading volume was about Rp. 130 trillion -- almost 5 times the 1991 average. The capital markets now are more widely used as an alternative funding source, supplementing and in some cases substituting for bank loans.

Meanwhile interest in privatizing state-owned enterprises (SOEs) has been growing. There are over 180 SOEs in Indonesia, employing over one million people and representing about 15% of GDP. Activities in oil-related SOEs account for about half that amount. A Presidential decree in 1988 ordered financial assessments of SOEs and the development of a program for their restructuring. Restructuring could include privatization among other measures. Measures for monitoring the progress of SOEs were put in place. A restructuring plan was put in place in 1989, to be completed within two years. Restructuring has not proceeded as planned. The plan called for 52 public share issues and 16 joint ventures. Only one SOE, a cement manufacturer (Semen Gresik), went public in 1991. A second SOE, PT INDOSAT, went public in 1994, with listings on both the Jakarta Stock Exchange (BEJ) and the New York Stock Exchange (NYSE).

TABLE 1
CHRONOLOGY OF FINANCIAL SECTOR REFORMS, 1983 - 1994

June 1983	Elimination of asset ceilings for all banks and controls on state bank interest rates for time deposits and loans; narrowing the range of priority and program loans eligible for Bank Indonesia subsidized refinancing ('liquidity credits').
February, 1984	Reintroduction of Bank Indonesia Certificates (Sertifikat Bank Indonesia, SBIs) for undertaking open market operations; introduction of discount windows for banks at BI to assist their liquidity management.
January, 1985	Introduction of system under which money market securities (Surat Berharga Pasar Uang, SBPU) - consisting of promissory notes issued or endorsed by banks and NBFI's, and bank endorsed trade bills - could also be used by BI to supply liquidity to the banking system. Rediscount facilities for banks also set up by BI to help with both day-to-day reserve management and maturity management.
July, 1987	Introduction of managed auction system for issuing SBIs and purchasing SBPUs.
December, 1987	Simplification of procedures for issuing and listing securities on the Jakarta Stock Exchange; removal of the prohibition on foreign investors purchasing shares in publicly listed companies; introduction of bearer securities; scope for new companies with no profit history to raise capital on the Parallel Stock Exchange; removal of the previously imposed 4 per cent limit on daily price fluctuations in the secondary market.
October, 1988	Introduction of measures to foster competition, including: removal of most restrictions on entry for foreign and domestic banks, and on domestic bank branching; allowing public sector entities to place up to 50 per cent of their deposits outside state banks; allowing NBFIs to issue certificates of deposit; permitting banks and NBFIs to raise equity capital in the stock markets; easing entry to leasing, insurance, venture capital, consumer finance, factoring and securities activities; reducing bank reserve requirement from 15% to 2 per cent; improvements in other aspects of bank soundness requirements; imposition of tax on bank deposit interest to eliminate previous tax advantage of interest earning over income from securities; simplification of procedures for issuing securities; establishment of privately owned parallel stock market with less strict listing requirements; pennission in principle for the establishment of other private stock exchanges
December, 1988	Allowed firms to undertake a "company listing" (all shares issued by the firm could be listed on the stock exchange rather than just those newly issued).
March, 1989	Privately owned Surabaya Stock Exchange established.
March, 1989	Issue of several decrees clarifying various aspects of the October 1988 package with regard to NBFIs, legal lending limits, joint venture capital ownership, bank mergers, the definition of bank capital, reserve requirements, bank investment in equities, and exchange rate risk exposure of banks.
September, 1989	Foreign investors permitted to buy up to 49 per cent of issued securities of companies listed on stock exchanges.

December, 1989	Operation of Jakarta Stock Exchange by BAPEPAM ended; BAPEPAM became a regulatory and supervisory agency. Right of PT Danareksa (the national investment trust) to buy up to half of all new issues revoked.
January, 1990	Further narrowed the range of lending programs (in particular, those oriented to small borrowers) eligible for BI liquidity credits. All domestic banks required instead to direct 20 per cent of their loan portfolios to small firms and cooperatives. Foreign and joint venture banks required to extend at least 50 per cent of their loans to support export-oriented activities. Adjustment of legal lending limits requirements.
December, 1990	New prudential rules, capital requirements and standards for capital market participants introduced.
February, 1991	Various measures introduced to improve prudential standards in banking-among other areas, requiring banks to strengthen their capital base in accordance with Bank for International Settlements recommendations and to provision for loan losses.
November, 1991	Imposition of ceilings on public sector-related offshore borrowing (including by the state banks). Improvements in the foreign exchange swap mechanism.
April, 1992	Jakarta Stock Exchange privatized.
April, 1992	Promulgation of new Banking, Insurance and Pension Fund Laws sponsored by the Department of Finance, and the Workers' Social Security Law, sponsored by the Department of Manpower.
May, 1993	Modification of banking prudential standards to stimulate lending in the short run, and to set out phased deadlines for meeting the legal limits. B. Ruru, the chairman of BAPEPAM announced that the requirement price of new shares issues could not exceed thirteen times earnings.
June, 1993	Deregulation in automotive sectors. Tariff reductions.
October, 1993	Deregulation in 6 sectors, including export-import, tariff and import regulation, investment, license for investment, and pharmacy.
January, 1994	MOF increased the maximum P/E ratio for new issues from 13 to 15.
May, 1994	Deregulation in foreign investment: Foreign investors are allowed to hold 100% ownership of a business (PP No. 20/94). Foreign investors are also allowed to invest in broadcasting field.

SECTION 3: Description of the Financial Markets Project (FMP)

The FMP has three main components:

- *Capital Markets Component* (CMC). The CMC focused on encouraging long-term investment by developing improved market policies and infrastructure. It had two main subcomponents: (1) establishing regulations and strengthening regulatory capacity to build capital market stability and public confidence; and (2) improving securities trading capabilities and structure to make trading more efficient, less costly, and more transparent. Training was also given to all capital market participants. This assistance was intended to increase the volume of listed securities, investments in stocks and bonds, and broker-dealer activities. The Project Paper anticipated that the CMC team would assist both public sector regulators as well as private sector entities such as the stock exchange, clearing corporation, and broker-dealers. Technical assistance (TA) under the CMC was to be offered through BAPEPAM, the Ministry of Finance's capital markets supervisory agency.

- *Money Markets Component* (MMC). The MMC would provide TA to Bank Indonesia (BI), the country's central bank. The MMC mandate was quite broad, but generally focused on: (1) strengthening monetary management and implementation of monetary policy by developing a wider variety of debt market instruments and improving the market infrastructure (regulations, trading structures, etc.) for those instruments; (2) building BI's institutional capability; and (3) advising BI on bank regulation and supervision.

- *Privatization Component* (PC). The PC would provide TA to the Directorate of State-Owned Enterprises (SOEs) at the Ministry of Finance (MOF) covering almost all areas having to do with privatization including: (1) developing a policy framework, (2) preparing criteria for issuing IPOs and restructuring companies; and (3) assisting with transactions.

In addition to the three specific components listed, the project provided resources for training which were available to each component.

The capital markets and privatization components were carried out by Price Waterhouse (PW), the first under a host-country contract and the second through a buy-in to the Privatization and Development (PAD) project, both offered through the Ministry of Finance. PW performed the Capital Markets Component work primarily in cooperation with BAPEPAM and the Privatization Component with the Directorate General of State Owned Enterprises. The Money Markets Component was carried out under a host-country contract offered by BI to Deloitte & Touche Tohmatsu International (DT).

The project ran into start up problems, mainly concerning funding, which altered the focus and delayed implementation. The original project paper (1988) anticipated that the work would begin in mid-1989 and that a total of $9 million would be spent by USAID. USAID did not have the $9 million appropriated but intended to build financing for the project as time went on. The lack of funding created some uncertainty about project focus and scope and delayed implementation. As a result, the components all began well after the time originally planned, partly because of contracting delays that resulted from having to eliminate tasks because money was not available to do all that was specified (see Table on next page).

In addition, the $9 million was sufficient only to begin the Capital Markets Component and the Money Markets Component. There was not enough to fund the Privatization Component, and this was set aside. (It was later funded through a 'buy-in" to the Privatization and Development (PAD) Project, which was justified by a 1991 project amendment (see Project Paper Supplement, August 26, 1991. The "buy-in" added $5 million for privatization work. A second project paper amendment added another $0.6 million and extended the PACD to March 1995.)

The Money Markets Component was delayed further for other reasons, which caused it to lose on funding. Since the CMC was started first, and budgets were being cut to make both components fit the total $9 million, the CMC, including the training component, ended up with the lion's share of the total $14.6 million funds (71% of the total, compared to 8.3% for the MMC and 18.7% for the PC). By the time the MMC began in April 1992, money remained for only one resident advisor. Funding for the 60 persons months of short term expertise anticipated in the original Project Paper was not available. Overall, the Capital Markets Component began two years before the other two components--April 1990 versus April 1992. It ended December 31, 1994, while the Privatization Component ended in February and the Money Markets Component in March of 1995. Funds were allocated as noted below:

Capital Markets Component		$8.0 million
Money Markets Component		1.0
Privatization buy-in		2.5
Training		2.8
CMC	$2.364	
MMC	0.164	
Privatization	0.239	
Other		0.3
Total Project		$14.6

The Money Markets Component of the project was later extended until November 1, 1995, with funding from another USAID project.

SECTION 4: Team Composition and Study Methods

A. Evaluation Team

The evaluation team was composed of Dr. William Loehr, Economist and KPMG-Barents Group Senior Associate, Ms. Alison Harwood, Financial Markets Specialist and KPMG-Barents Group Director, and Ms. Efti Kocher, Financial Research Specialist. Mr. Loehr visited Indonesia from April 24 through May 13. Ms. Harwood was in-country from May 1 through May 25, and Ms. Kocher worked on the evaluation during the period of April 24 through May 25. The team discussed tentative conclusions and development of the report with AID before Mr. Loehr departed Indonesia on May 12.

B. Study Methods

The starting point for any evaluation is to be clear about what the project should reasonably be expected to do. In our view, the question that needs to be asked is whether the project chose reasonable and important objectives and then used its resources effectively to achieve them. The question should not be whether the project succeeded in developing the Indonesian financial markets to a preconceived and specified quantitative level. That implies that the project significantly controlled development of the Indonesian markets, which clearly is not the case. Many political, social, and economic factors influence the pace and direction of financial market development. Additionally, the evaluation should consider the long-term impact of the project, not just what was achieved by the project's end. We should ask whether the project helped move the financial markets significantly beyond where they were when the project started, to a point that justifies the money spent and that leaves the markets on the right path for further, sustainable development.

The FMP dealt mainly with developing financial market infrastructure, with a particular focus on the legal, regulatory, institutional, and human resources elements. Thus, many judgments about the FMP's effectiveness had to be based on non-quantifiable information. Our approach was to review FMP reports and workplans and interview key persons from institutions that received assistance from FMP, including BAPEPAM, BI, BEJ, KDEI, and the MOF. We also met with market participants such as money market and capital market brokers. A complete list is in Appendix D.

It was particularly difficult to evaluate the project's impact on poverty alleviation. We examined any direct interactions that might occur between individuals in "poverty groups" and the markets affected by the project, though these are practically non-existent. We also considered indirect impacts through improved economic growth, as this is the primary route through which the poor are affected -- i.e. development of capital markets, increased investment, improved growth and poverty. We find that while no specific empirical model can be built, the logical connections are clear. Furthermore, there is a consensus among all participants that the FMP helped alleviate poverty in this way.

In evaluating the FMP's implementation and progress, we examined each of the three main components (capital markets, money markets, privatization) in terms of whether they:

- Defined useful, relevant, and important objectives
- Outlined plans for achieving those objectives
- Used resources effectively to achieve those objectives
- Tracked achievements.

In terms of the project's impacts, we evaluated:

- The major achievements
- Whether the achievements had important impacts
- How well achievements matched objectives
- Whether training resources were well used
- What outside factors affected project impact and whether the effect was positive or negative
- Whether project achievements are likely to be sustainable.

Again, it must be recognized that the project did not drive all financial market development. Its purpose was to provide technical assistance to help guide and shape that development, but within a context defined by the Indonesian government. As long-term advisors, the access of FMP consultants to their clients depended not just on their ability to give technical advice, but on their ability to respond to client demands and interests. One must accept that the Indonesians might select a course of action that differed from FMP advice. Often, adaptability and flexibility are key to the effectiveness of long-term advisors.

Finally, in our conclusions we offer recommendations for further financial reform in Indonesia and for the design and implementation of projects like the FMP.

SECTION 5: Findings and Analyses

A. The Evaluation Questions

1. "Has the FMP achieved its goals, purposes and output?"

Yes. The FMP's goal was to help increase the availability of long-term investment capital by supporting the development of fair, well-regulated, and transparent financial markets. The purpose was to increase the number of debt and equity securities and commodity contracts available to investors, and to increase the trading volume of these instruments. The work on commodities contracts was removed from the FMP at the outset. On the other dimensions, we would say that performance met expectations. For details on expectations versus output, see the Logframe in Appendix B.

2. "What people-level impact has the FMP had on contributing to the GOI's extensive poverty alleviation policies, as well as poverty alleviation itself. What are the interrelationships, if any, between financial markets development and poverty alleviation?"

Generally speaking, development of financial markets affects poverty alleviation in indirect ways--largely by contributing to macroeconomic stability and economic growth. Financial market development increases corporate access to funds that can be used for economic expansion. It also, through improved public disclosure requirements, improves corporate governance and economic management. Both contribute to more rapid economic growth, which in turn contributes to poverty alleviation.

More specifically, the first point to make in considering whether the FMP contributed to poverty alleviation in Indonesia is to say that there are few directly traceable effects of the FMP on poverty groups, or indeed on any specific group. One link is that monetary stability preserves the deposits of the poor and in Indonesia some poorer elements of society hold deposits. Other than that:

1. Low-income groups do not participate in the stock or money markets.

2. There is little activity in the over-the-counter (OTC) market, which is designed to admit firms too small for the BEJ. Even there the definition of "small business" includes firms with up to $10 million in capitalization.

3. Direct employment benefits are minimal since the number of persons employed in the securities industry is limited compared to the total population.

With few if any direct effects on poverty alleviation, we have to consider whether there are any indirect effects. In our view, the main indirect effect is through economic growth-- that is, the FMP contributed to financial sector growth which in turn contributed to economic growth which in turn helped alleviate poverty. However, in each case it is difficult to quantify the relationship. In assessing this linkage we would say:

- *It seems clear that the FMP contributed to financial market growth and efficiency in Indonesia (see individual project component sections), but it is difficult to estimate how much.*

There are several reasons why estimation of the FMP's contribution is difficult: (1) Indonesia began important macroeconomic and financial reforms well before the FMP began to offer TA, so that several positive changes were already in motion when the FMP started. We have already noted the important financial sector reforms started in 1982 (see Section 2) and their positive impact on the growth of new financial institutions and access to financial services. They also appear to have increased efficiency. [3] (2) Major reforms come from a political process where projects like the FMP may be influential, but are by no means determining factors in how activities move forward. (3) The FMP is only a small part of overall financial reform efforts. Each ministry and BI are actively engaged in pursuing a number of interrelated initiatives. (4) FMP is not the only project in Indonesia and AID is not the only actor. Inputs come from the World Bank, the IMF, MOF contracts with HIID, and others. All are working on related factors.

- *It seems clear that financial sector growth contributed to economic growth, but that too is difficult to quantify.*

The positive relationship between financial market growth and economic growth is well documented in the development literature. For instance, in one of the most important books of the decade, Fry (1988, revised 1995) concludes, after an extensive empirical review, that the promotion of competition in financial systems and efficient financial intermediation are key to improving economic growth and probably improve income distributions. He also notes that to achieve these aims, countries must promote a variety of financial intermediaries and institutions offering a range of financial services, a legal framework ensuring the enforceability of financial contracts, and regulatory and supervisory systems that ensure the stability of the system" (1995: page 352). Macroeconomic stability is essential as is a sound regulatory framework and effective bank supervision.

We can isolate limited ways in which the FMP's contributions to financial sector growth may have contributed to economic growth. For instance, the FMP likely contributed to greater issuance of public equity offerings. As shown in Table 2 on Page 20B, since 1990, about Rp. 30 trillion in new securities have been issued in Indonesia, including Rp. 24 trillion raised on the BEJ. Market participants report that these funds are used for expansion and that these funds might not have been available from other funding sources or only at considerably greater cost. That suggests that companies are growing partly because they used the funds for

[3] Because they were rather abrupt, and because Indonesia moved from a situation of financial repression to one with much greater emphasis on free markets, Hanna was able to show using before and after comparisons that bank efficiency had improved and domestic savings and investment had increased (Hanna, 1994).

investment purposes. Higher corporate profits lead to higher tax revenues, and more funds available for social services.

In addition, the FMP may have contributed to better corporate management. By requiring better accounting standards, improved disclosure makes companies more conscious of how well they are actually doing and encourages them to manage their operations better. With improved corporate management can come better use of economic resources and higher economic growth. But it is difficult to take the argument further than that. Better disclosures improve tax disclosure and tax revenue as well.

More generally, it is difficult to know how much any financial sector reform contributes to economic growth, partly because so many other economic reforms are happening at the same time. Furthermore, most of the FMP activities produce so-called "joint products" That is, while producing one output, another output is simultaneously produced. For example, the MMC helps produce a secondary market where banks can match their asset and liability maturities. Jointly, the secondary market creates a tool for the exercise of monetary policy. Is the MMC's objective to assist the banking community or BI in its conduct of monetary policy? Similarly the Privatization Component produces greater SOE efficiency, but it also produces relief for the national budget. For these reasons the FMP interventions are macroeconomic interventions. They are meant to improve upon the efficiency of the overall economy, not just a narrowly defined portion of it.

- *The connection between economic growth and poverty is well documented, but it too is hard to quantity.*

The overwhelming evidence supports the view that economic growth is a means toward poverty alleviation and increased equity (see Fields, 1995, for a survey). Indonesia's relatively high rate of growth has gone hand-in-hand with poverty alleviation for the past 25 years (see Fields pp. 94-95 and World Bank 1994a). Indeed, in Indonesia as elsewhere, the main threat to people in poverty is a lack of economic growth and it is for this reason that macroeconomic policy should promote stability and be tailored to promote growth as well.

While the empirical tests on Indonesia's financial sector reforms did not directly address the question of poverty alleviation, the kinds of results that have been found are consistent with improvements on that dimension. As Fields points out (1995:84) the main asset of the poor is their labor, and the best poverty alleviators are those that increase the return to that asset. The fact that manufacturing became more labor intensive after the financial reforms in all likelihood increased the return to labor. Furthermore, increased exports have been shown to be one of the key ingredients in poverty alleviation and the flattening of income distributions in the so-called "miracle countries" of Asia (World Bank, 1993).

Overall, we would say that an empirical link between the FMP and poverty alleviation cannot be made, but logic and experience tell us it exists nevertheless through important but indirect channels such as:

- Improved macroeconomic management, which creates a stable and attractive investment climate.
- Greater corporate investment, particularly by foreigners since they are the main equity market investors (see discussion in Section 5B on the CMC), which improves growth prospects.
- Higher corporate profits from investment, which means more tax revenues that can be used to support poverty alleviation programs and services.
- Greater employment opportunities because firms are expanding.
- Improved export performance (export expansion is usually associated with poverty alleviation and more even income distributions).
- More privatization, which improves competition and efficiency, therefore lowering prices to final consumers and which reduces pressure on the public budgets, lowering tax burdens and/or releasing resources for improved public expenditure on social programs.

In sum, although it is difficult to make strong empirical links, some of these indirect and intractable factors may justify, and indeed encourage, projects like the FMP. The impact of the main efforts of the FMP have probably not yet been felt. None of the major thrusts of the work begun by the FMP are complete. The Capital Markets Law is still under legislative review, large-scale privatization has not yet occurred and money market development is still in its infancy. The FMP will help maintain, and hopefully deepen, the reforms that have already occurred.

In addition to the pure economic effects of the development measures, other outcomes can occur that contribute to the quality of life for the poor in a country. For instance, financial markets promote public disclosure, corporate transparency, and public accountability from companies that borrow in the public markets. In addition to forcing companies to manage their affairs better, this also helps raise people's expectations of what they can demand from corporate institutions, with a spill over to what they can demand from the government as well. Economic empowerment and economic democracy can contribute ultimately to greater political democracy.

3. "Have project inputs, including host country contributions, been used effectively?

In general project inputs have been used effectively. The long-term advisors provided by the project were highly appreciated by their Indonesian counterparts. Priority areas of work seem to have been reasonable and accomplishments were in line with expectations. Several factors which may have reduced effectiveness include the following:

- The original project design had to be scaled down because of budgeting constraints.

- One capital markets advisor often disagreed with other advisors working in Indonesia. Although particular problems were rectified in later years of the project, the differences of opinion limited coordinated action among FMP advisors and non-FMP advisors working on similar areas. More coordination and exchange among advisors would likely have strengthened FMP's impact.

- Compared to the original project paper, the money market component was restricted because USAID could not fund the short term expertise.

- The training component may have overly emphasized international travel and general financial market courses. Numerous lower level BAPEPAM staff were sent overseas. Although overseas training at any level has its advantages (i.e. it builds confidence and contacts), it can be less useful in the long run than more focused locally provided courses when funds are finite and somewhat constrained, and training needs are extensive. During the latter year of the project, more local-based training was provided.

4. ***"What are the lessons learned from the FMP? Are its activities sustainable? How relevant is the project in the context of USAID's overall strategies for sustainable development?"***

This question is really three questions rolled together. They should be answered separately.

4a. ***"What are the lessons learned from the FMP?"***

See Section 6 for a discussion of lessons learned about projects in Indonesia, project design, and project implementation.

4b. ***"Are its activities sustainable?"***

We believe that on balance many of the activities are sustainable, though sustainability is by no means assured. In the Capital Markets Component, the following observations indicate that progress will be sustained:

- BAPEPAM needs to continue to build its rules, rule making and enforcement capabilities; it will obtain assistance on these areas from a new World Bank project that provides approximately $5 million for TA to strengthen rulemaking and enforcement and approximately $4.5 million for training. The USAID funded ELIPS project will also provide support on rulemaking and training.

- A growing number of large scale international brokerage houses are forming joint ventures with local firms. They will have an increased stake in assuring that Indonesia's capital markets remain in good standing, will contribute to increased competition and efficiency by introducing and forcing other firms to meet higher standards of operation, and will help supply skills missing in Indonesia.

- The BEJ and KDEI have been privatized and have the financial resources to obtain assistance for training, improving operations, etc.

In the Money Markets Component, activity is also likely to be sustained for the following reasons:

- The number of traders, mostly banks, have grown, which are prepared to handle money market transactions.
- While money markets are not now broadly based, there is a policy driven demand for them.
- BI is pursuing several initiatives to improve the market (e.g. stimulating electronic transfer and training for improved bank supervision).
- BI has its own training program; The FMP did not provide much training money to get this going.
- BI has established relations with central bankers and regulators around the world, and built strong ties with ASEAN central banks, and can obtain insights from them on important central banking matters.

Sustaining privatization is not assured since to date there have been only two SOE's that have been partially privatized. Thus, unlike the other two components, favorable outcomes cannot be extrapolated from past successes. Nevertheless, there are signs that privatization could pick up momentum.

- The GOI's interest in privatization has picked up since the Directorate for SOEs was reorganized in 1993 and likely because of the reiteration in Repelita VI that the GOI will not provide funds for SOE expansion.
- The most recent privatization, PT Indosat, was generally successful.
- The GOI will probably keep the PW advisors to assist with on-going privatization policies, strategies, and transactions and building the MOF's institutional capabilities for privatizing companies.

Political will is an important factor for continued privatization, as is the sufficient number of "ready" privatization candidates -- companies with future profit capabilities which will sell well in the local and possibly foreign markets, and whether investors will be content purchasing only portions of the privatized company (and hence having little if any control). Investors will have to be satisfied that the company will have sufficient efficiency and profit improvements even if the government remains in control.

4c. "How relevant is the project in the context of USAID's overall strategies for sustainable development?"

USAID's strategy for promoting sustainable development was spelled out in the original Project Paper and in the mission's CDSS for the period 1989-93. Points emphasized were:

- Structural, long-term support for increased employment and incomes.
- Measures to increase efficiency and productivity of the economy.
- Support for a shift of resources from the public to the private sector.
- Promoting a more open, market- and trade-oriented economy.

In its most recent statement on strategy (CPS, March 1995), AID states that its number one strategic objective is "to promote sustained economic growth". It notes in discussing this strategy that "with limited resources in a vast economy, policy-based assistance is the only way to exercise influence on national aggregates" (page 20). Three components of the AID strategy have been determined:

- Indonesia has to maintain a high rate of growth of output.
- Indonesia must continue to accelerate its integration into global and regional open trading systems.
- The maturity of bilateral Indonesian-American economic relationships should be encouraged.

In our judgment, because the FMP has contributed to institutional development and given the strong linkage between financial markets and economic growth, the FMP has contributed to USAID's strategic objectives as stated in 1988 and continues to contribute to them as stated in 1995.

5. ***"What is the impact of the achievements of the FMP on Indonesia's financial markets, the GOI's restructuring program, and overall economic development?"***

- On financial markets, the FMP has improved the regulatory framework and competency, corporate transparency, critical institutions such as BAPEPAM and Bank Indonesia, and monetary management, among other areas. In these ways, the FMP contributed to greater investment in the local financial markets, which supported greater economic growth and development.

- On the GOI's restructuring program, the FMP helped develop important privatization policies and strategies, guidelines for selecting IPOs candidates and intermediaries, and supported particular transactions.

- On economic development, the FMP likely contributed to increased investment in money and capital markets, improved corporate management which means better use of economic resources, and increased employment.

6. ***"Have increases in investment and savings occurred by increasing the types of securities available? If so, has the development of financial markets increased the level of equity finance relative to debt finance and has this stimulated the development of small and new businesses?***

According to available data, gross national savings remains about the same today (28-29% of GDP) as in 1989, and investment is also fairly constant at about 30% of GDP. While the percentages remain about constant, they are very high by developing country standards. Also, the share of the private sector in investment has increased slightly in recent years. However, there has been a sizable inflow of foreign money into Indonesia because of the equity market development. Foreigners hold about 30% of all listed equity (and account for about 70-80% of all trading).

There has been little new domestic money entering the local securities market for several reasons: high rates on lower risk domestic bank deposits discourages investing in equity; institutional investors (i.e., pension funds and insurance companies) are unfamiliar with equity holdings and traditionally have kept their money in time deposits and real estate; retail investors are unsophisticated and lack attractive vehicles (such as open-end investment funds) for investing in the local, securities market. As discussed in Section 5B on the Capital Markets Component, introduction of a new Capital Markets Law and new pension fund and insurance regulations and laws set the stage for developing a domestic investor base, but efforts must be made to educate and attract the funds to the securities market.

The development of financial markets has increased the level of equity finance in Indonesia. As noted, about Rp. 25 trillion in equity was raised publicly in Indonesia between 1990 and 1994. It is not clear whether the level of equity to debt financing has increased.

Small and new businesses are not being assisted by capital market development, mainly because small businesses are too "small" and new businesses lack the profit history to meet BEJ listing requirements. Some observers argue that development of the domestic financial markets in Indonesia has allowed larger firms to shift away from local bank borrowing, opening the door for smaller and newer firms to get more bank financing, but we do not have any proof that is the case. Small businesses may be assisted by PT Bahana, the government-owned venture capital firm and by planned development of the Over-The-Counter market, if it is pursued strategically and aggressively.

7. ***"Are there indications that the flow of funds from investors to users of funds has become more efficient?"***

Yes. It is easier to use the equity markets today to invest as there are more brokers available to take orders, more information about the market, and better regulations to protect investors. At the start of the FMP, there was limited understanding of the local Capital Markets, few experienced brokers, and decentralized clearing and settlement. The flow of funds will improve with automation of the trading, clearing, settlement, and depository environment as that will reduce errors in reporting and settlement, making it easier to transfer funds for securities. We can look at the value and number of securities offerings from 1990 through 1994 (See Table 2 on Page 20A and Table 3 on Page 20B).

8. ***"Has financial market development led to increased economic stability?"***

Financial market development has increased economic stability by increasing and diversifying economic activity. Increased diversification reduces risk. Financial market development reduces risk in other ways:

- Improved financial markets help Indonesia diversify from an oil producing, agricultural country, to one producing many diverse, manufactured items for export.
- Increases in the type of financial instruments and volume of financial transactions makes monetary policy more efficient as an economic regulator, as does the improved information on companies and markets.
- Improved policy making means that fewer "severe actions" (such as the 1991 monetary shock) need to be taken to achieve policy objectives, destabilize financial markets and reduce public confidence.
- Increased financial options allow investors to diversify their portfolios to minimize risk.
- Improved access to equity finance allows firms greater financial stability, compared to conditions where the only financing alternative is bank borrowing.

9. "Has privatization led to the deregulation of the public sector?"

Not yet. Only two partial privatizations have occurred--Semen Gresik in 1991 and PT Indosat in late 1994. The main reason for the limited activity is that privatization is driven by budgetary rather than efficiency concerns. However, privatization should improve SOE competitiveness and management. Once companies are publicly listed, they will have to improve their disclosure and improve their operations, to assure they can attract and retain investors. The momentum behind privatization has increased recently, and it is possible that as many as 20 SOEs will begin IPOs by the end of 1996.

10. "Have FMP activities had any impact on the more equitable distribution of financial sector resources?"

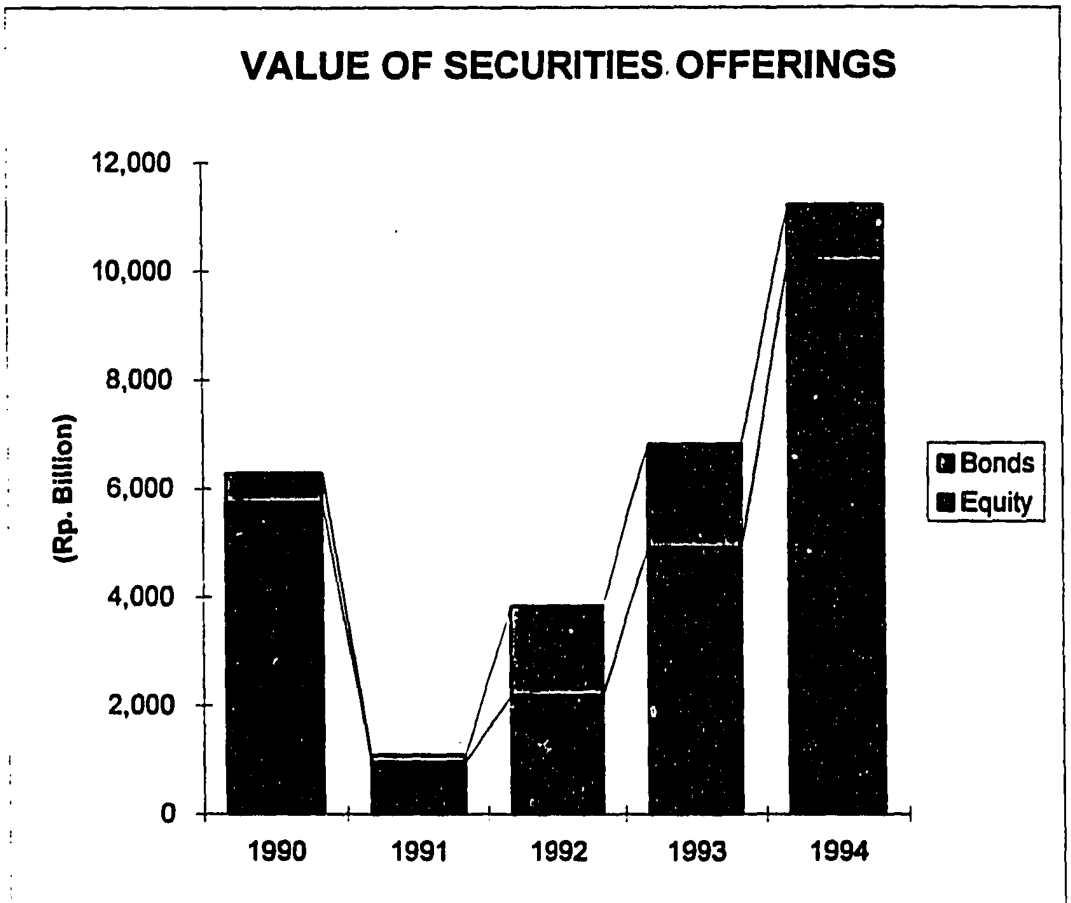
As noted above, on the borrowing side some smaller companies may have better access to bank funding, as a byproduct of increased reliance by larger firms on domestic and foreign securities markets. A broader range of companies issue equity today than in the past. On the investor side, domestic investors are still not active in the local equity market, which remains dominated by foreigners. Thus local parties, particularly retail, are not benefiting from equity market gains. Introduction of open-end investment funds could attract more retail investors to the market. Limited inflation from better monetary management means that the financial wealth of smaller investors is not wiped out. Of course that is true for larger investors as well.

11. "Are there positive or negative effects resulting from the project that were completely unanticipated?"

Table 2
VALUE OF SECURITIES OFFERINGS*
(Rp. billions)

	1990	1991	1992	1993	1994
Equity	5,749	967	2,186	4,903	10,160
Cummulative	5,749	6,716	8,902	13,805	23,965
Bonds	535	125	1,642	1,905	1,049
Cummulative	535	660	2,302	4,207	5,256
Total Value	**6,284**	**1,092**	**3,828**	**6,808**	**11,209**
Cummulative	**6,284**	**7,376**	**11,204**	**18,012**	**29,221**

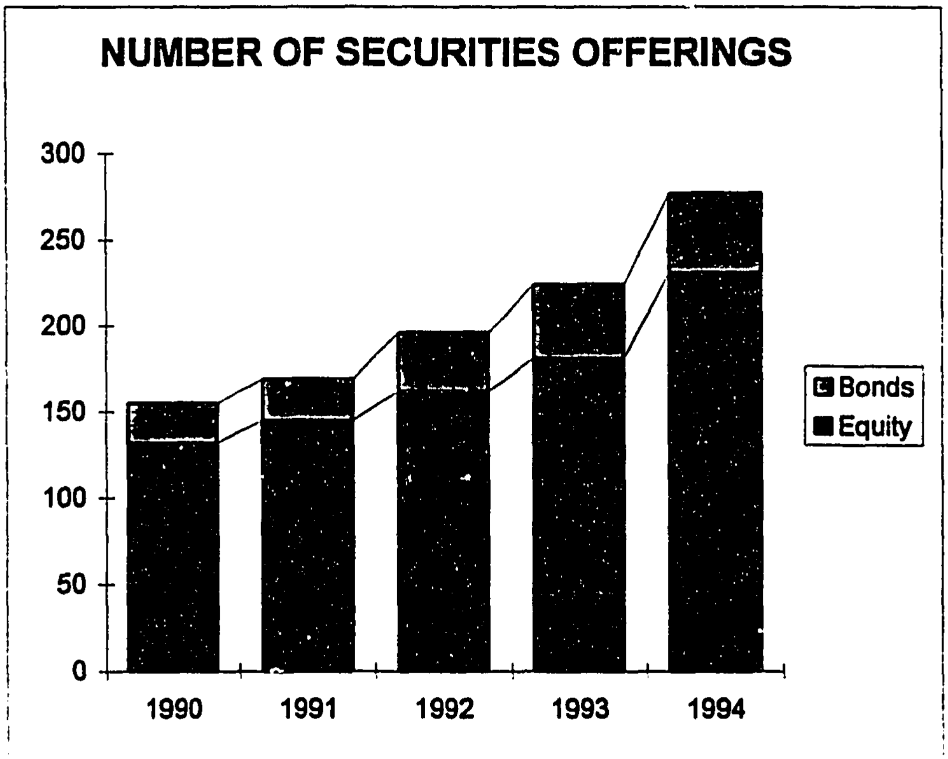
*Includes IPOs and Rights Offerings



Source: Capital Market Supervisory Agency, Weekly Statistics

Table 3
NUMBER OF SECURITIES OFFERINGS

	1990	1991	1992	1993	1994
Equity	132	145	162	181	231
Bonds	23	24	34	43	46
TOTAL	**155**	**169**	**196**	**224**	**277**



Source: Capital Market Supervisory Agency, Weekly Statistics

On the positive side, public disclosure in the capital markets creates a climate of openness and transparency that can spill over into other areas. It affects public attitudes about openness, transparency, rights against the government and corporations, even though the smaller investor is not in the market. It improves overall economic management. Some people also say that development of the market has had beneficial environmental outcomes. Firms raise money and buy new technology that is environmentally sound. Or some foreign funds will not buy the shares of companies that are known to pollute a lot, pointing to the public accountability issue. On the negative side, there are some who argue that financial market development has increased income inequality, but we did not investigate this point.

B. The Capital Markets Component

1. Introduction

The Capital Markets Component (CMC) is the centerpiece of the Financial Markets Project as it focused most specifically on the project's ultimate goal of increasing long term investment--by increasing debt and equity instruments and helping to create a well-functioning, efficient, and fair securities markets. Through TA and training, the CMC was intended to develop policies and build market infrastructure (regulatory, operational, human resources) to strengthen:

- Market regulations and rulemaking capacity.
- Securities industry operation, particularly trading, clearing, and settlement mechanisms.
- The skills of market regulators and participants.

The original Project Paper included building a commodities market as well. As the mid-term evaluation stated, this objective was dropped after negotiations between GOI, USAID and the contractor concluded that this component would be a low priority in funding. In our view, this was a good decision. It was more important for the advisors to focus on the securities market. Their development demanded considerable attention.

On the whole, the project appears to have been most successful in providing technical assistance to BAPEPAM for building a regulatory framework for the Indonesian capital markets and developing BAPEPAM's ability to draft regulations. BAPEPAM's improved understanding and oversight of market regulation has helped strengthen public disclosure and public confidence in market operations and fairness. That in turn has helped attract foreign funds to the Indonesian capital markets and allowed for more offshore borrowings by Indonesian companies. The securities industry segment had more limited results, partly because fewer resources were dedicated to it. The training component was on the whole successful but as stated in the mid-term evaluation, might have spent less money on overseas programs, leaving more for local, technical, and on-the-job training.

2. *Implementation*

The CMC received the bulk of the FMP funding--roughly $8.3 million of the $14.6 total, spread over a four year contract. Assistance was offered to the Ministry of Finance, largely through BAPEPAM, under a Host Country Contract.

As described in the methodology section, project implementation should be evaluated according to how well the project focused on important areas, outlined plans intelligently, set reasonable goals, used its resources effectively to achieve those goals, and tracked its achievements. (Whether it reached its objectives is discussed in Part 3 below.) On the whole we would say that the team satisfied these requirements.

- The project focused on important areas, set reasonable goals, and worked towards achieving them. During the project's life, the team focused most of its efforts on rulemaking and building regulatory capacity. In the last two years, the team focused almost exclusively on developing a draft Capital Markets Law and continued completing the rule book and building BAPEPAM's regulatory capacity. This was an intelligent use of the team's resources. BAPEPAM's regulatory strength is critical to building and maintaining the market confidence needed to encourage foreign and domestic participation. The team's ability to identify and work on important goals partly stemmed from its close working relationship with BAPEPAM.

- The team laid out plans and objectives and tracked achievements more fully and more clearly in the project's later years. At the same time, advisors left themselves the flexibility needed to support BAPEPAM's on-going and *ad hoc* needs.

- Generally the team used its resources well. It consisted of one full time, long term advisor who assisted with the securities market operations and regulations and two long term but part time advisors who worked approximately 6 months per year on regulations and other legal matters. Short term TA was provided by several well qualified personnel. The team reduced its support of private sector entities (i.e. BEJ and PT KDEI) because BAPEPAM's needs were extensive and critical, the CMC's funding was constrained, and the BEJ and KDEI could afford their own advisors.

The project faced a few implementation problems. As noted earlier, it began late, as it took 20 months to conclude contract negotiations due mainly to funding issues. In the post-evaluation period, the few implementation problems that arose resulted from having to wait for conclusions of the mid-term evaluation to see if new activities should be incorporated into workplans for the remainder of the project and to find out whether project funding would be extended.

The capital markets did not achieve all elements of the logframe outlined in the Project Paper. As discussed elsewhere in this report, a foreign aid project should not be expected to drive a country's development process. The process is complicated and influenced by many factors, directly and indirectly related to the work at hand. BAPEPAM faced numerous demands and could not always address all that the Project Paper originally outlined. Long term advisors frequently have to be "reactive" to the demands of those they are advising; their ability to be proactive is often constrained by time demands on the advised persons. This is especially true for an agency like BAPEPAM which has been leaden with a large volume of work.

3. *Impact*:

As shown in Appendix E, Table 1, the Indonesian capital markets grew significantly during the project's life in the number of listed companies, market capitalization, and average daily trading volume and value. The CMC contributed to the market's development along these lines in several important ways, though it is difficult to say exactly how much.

Rulemaking and Rulemaking Capacity: The CMC focused most of its resources on developing rules and regulations and strengthening BAPEPAM's rulemaking capabilities. This was BAPEPAM's area of greatest need. It also was the way by which CMC resources could be used most effectively as it is critical to building the market confidence needed to encourage foreign and domestic investment and market issuance. As detailed in Table 4, the team contributed significantly to developing:

- A body of important rules and regulations for market standards, procedures and investor protection.
- A draft Capital Markets Law that will strengthen BAPEPAM's enforcement capabilities significantly.
- BAPEPAM's rulemaking capabilities so it can continue to prepare rules to meet market demands.
- Publicly disclosed information for market participants and issuers.

In speaking with market regulators and participants, it is quite clear that they see BAPEPAM and the regulatory environment as having improved considerably in the past few years and give the CMC credit for contributing towards that end. BAPEPAM is seen as being considerably more capable in understanding the range of issues that need to be addressed, setting and having put into place appropriate and useful rules, and being responsive to market developments. The agency's growth has helped increase public confidence in policymakers and, in turn, inflow of funds to the market. The Capital Markets Law, now in draft form, will add to this confidence by strengthening BAPEPAM's enforcement capabilities and allowing the agency to investigate and take stronger action against firms which fail to comply with market laws and regulations. To date, BAPEPAM's enforcement has been limited to administrative sanctions, such as fining issues or securities firms that do not file reports on time.

The growth in BAPEPAM's rulemaking capabilities partly reflects broader experience gained with time; BAPEPAM staff have learned by doing. The CMC contributed to this end by working closely with and guiding BAPEPAM staff on a daily basis over a period of several years. In later years of the project, the advisors shifted from drafting regulations for

BAPEPAM to coaching BAPEPAM in drafting the regulations themselves. This was a critical change, one that made the advisory team contribute more to BAPEPAM's self-sustainability, rather than just to assuring that a large number of rules were finished. The work on the draft Capital Markets Law exemplified this shift. A core team of BAPEPAM staff worked with staff from BI, the MOF, and other ministries to draft the law. Instead of having the CMC advisors draft sections of the law, the BAPEPAM core team drafted first and used the CMC for advice on particular issues, concerns, and phrasing. This approach was also used when drafting regulations.

Table 4:
Major Achievements in Rulemaking/Capacity Building

- *Rulemaking:* During the post-evaluation period, CMC advisors assisted in drafting and reviewing several key regulatory issues, including Conflict of Interest, simplifying issuing procedures, regulations for the credit rating agency (PEFINDO), and new rules concerning automated trading as that was to be introduced in 1995.

- *Capital Markets Law:* CMC advisors assisted BAPEPAM's core team in preparing a draft Capital Markets Law that could be submitted to Parliament. The original intention was to submit the Law by the end of 1993, but that deadline was repeatedly pushed forward and the Law was submitted in February 1995.

- *Strengthening BAPEPAM's rulemaking capacity:* It is critical that BAPEPAM staff develop the ability to draft their own regulations, to understand fully the regulations on their books, and to understand the impact of the regulations on the market. If they cannot do these things well, the sustainability of the project will be in serious jeopardy. In the past two years, BAPEPAM's abilities in these respects have improved considerably, as reported by both BAPEPAM officials and market participants. The CMC contributed to this end by:

    - Working with BAPEPAM staff to guide them through the rulemaking process, both in terms of identifying what kinds of rules need to be written for a particular policy and how to put the policy into a rule. In earlier years, the CMC team would draft rules themselves and review them with BAPEPAM. In the later part of the project, they shifted from to advising teams of BAPEPAM staff on drafting the rules themselves.[4]

    - Obtaining information for BAPEPAM on regulatory approaches, not just in the U.S. but in neighboring countries, which the Indonesians feel is sometimes more relevant to their own activities. BAPEPAM feels that it has the capacity to draft regulations but not to research regulations because they do not have the international contacts and networks.

    - Encouraging BAPEPAM to communicate with market participants. (see discussion below).

- *Developing Sources of Public Information and Communication*: The CMC assisted BAPEPAM in improving public information. The Public Information Services Office (PISO) was introduced in August 1993. PISO provides a computer base and library of important documents received by BAPEPAM from, and responses from BAPEPAM to, parties under BAPEPAM's jurisdiction (issuers, stock exchanges, clearing corporations, investment funds, and securities companies). BAPEPAM now consults with market participants on drafting new rules--an approach encoded in the Rule of Rulemaking that was prepared with the assistance of the CMC. It is the model used in the U.S.; securities market regulators need to review whether the rules they are drafting may have unintended adverse consequences. Often regulators cannot know this because they do not know the insides of market activities.

[4] Part of the reason for the shift was the PW realized, in late 1993, that the FMP was not going to be extended beyond December 1994. That raised questions about sustainability. So wanted to work more on getting BAPEPAM staff to draft. But probably too came from the Chairman of BAPEPAM, who considers this important.

Another important change in BAPEPAM's rulemaking is that BAPEPAM seeks public comment from affected market participants when drafting a regulation--a direct outgrowth of the CMC, which encouraged BAPEPAM to develop a "rulemaking rule" that requires BAPEPAM to seek public comment when drafting rules. Interaction with the public helps assure that rules are adopted that do not have unintended negative consequences. In earlier years, rules were issued and had to be retracted and redrafted because of unintended effects, which confused the market and reduced confidence in BAPEPAM's capabilities. The market-interaction approach is used in the U.S. and is successful, so long as the regulator knows how to assess whether the comments made by regulated parties are insightful or just promote their own interests. BAPEPAM seems to be developing the ability to evaluate this. Finally, the CMC advisors have provided information on rules and rulemaking for countries other than just the U.S., for example from neighboring ASEAN countries that BAPEPAM sees as having more relevant experience than the U.S.

Public disclosure and public information is a second key area that has undergone important change in the Indonesian capital markets. Availability of public information is extremely important to the well-functioning of a capital market. The theory of financial markets is that the public makes its own decisions about investment based on publicly available information and takes responsibility for those decisions. In recent years, BAPEPAM has taken considerable strides to broaden and improve the quality of publicly available information, with the help of the CMC. Today, corporations are said to take the disclosure process seriously and prospectuses are much improved over the past few years. Some of the improved disclosure is due to foreign investors; foreign firms drive the Indonesian equity market. If Indonesian companies want to attract foreigners in the primary and secondary markets, they must have good documentation. But it is also due to the sense that BAPEPAM is better at recognizing and responding to problems with prospectuses. The improvement in corporate transparency and quality of information has several important implications:

- Markets operate on information and transparency. Investors shy away from markets with poor information, from fear that they cannot adequately evaluate the risks and returns. Conversely, they will be increasingly attracted to a market that they think has good disclosure.

- It forces companies to manage their economic resources more efficiently. Public disclosure demands improved accounting standards and organization of financial statements, which helps companies gain a better understanding, and concern for, how well they are really managing their resources.

- It provides the foundation for eventual listings and borrowings offshore by Indonesian companies. Firms cannot list offshore if the quality of their local markets and local information is perceived as low. These offshore borrowings also help heighten international awareness of Indonesian companies and Indonesia more generally, which helps when competing for the pool of international funds. They also raise the perception of the quality of Indonesian companies with foreign investors, which in turn helps draw more foreign funds directly into Indonesian markets.

In addition to improved quality of corporate documents, there has been a sizable increase in the volume of information that BAPEPAM makes available to the public concerning the market participants it licenses and registers. Most notable is introduction of the Public Information Services Office (PISO) in August 1993. PISO provides a computer base and library of important documents received by BAPEPAM from, and responses from BAPEPAM to, parties under BAPEPAM's jurisdiction (issuers, stock exchanges, clearing corporations, investment funds, and securities companies). The CMC helped BAPEPAM create PISO.[5]

Overall, the view today is that the Indonesian markets are operating at a higher standard than a few years ago, with improved regulation and more available and more credible information on market activities and institutions. This has helped strengthen investor interest, and sustained a sizable number of new listings and offerings. It has also allowed for more offshore borrowings.

Securities Industry Development: The CMC was also intended to provide TA for developing securities market infrastructure, particularly trading, clearing, and settlement mechanisms. Significant strides have been made in this area over the project's life, but many of them were not assisted extensively by the CMC. The PT KDEI is now clearing and settling for all shares and has prepared rules for a new depository function (but must wait until the Capital Markets Law is enacted to proceed). The BEJ will begin automated trading in late May. These operational developments should increase trading, clearing, and settlement efficiency, making for faster, more accurate, and more reliable transactions. That should increase investor interest in the market and create higher transaction volume. Automated trading may also result in reduced transaction costs, making brokers more profitable and perhaps more willing to work to develop a retail clientele.

The CMC put considerably fewer resources into this area. In the first half of the project, one long term advisor helped formulate the integrated trading, clearing and settlement system and assisted the BEJ in some of its automation plans during the second half, though to a minimal extent. In the second half of the project, the CMC provided two short term advisors to the PT KDEI on depository policy and design. Several sources reported that this assistance was insightful and useful.

The CMC's limited focus on this area is partly due to: (1) the demands of BAPAPEM which absorbed project resources; (2) a view that the BEJ and PT KDEI were private entities with their own capable advisors; and (3) differences of opinion among CMC advisors on technical matters which made moving forward as a team difficult. The mid-term evaluation discusses how differences of opinion among CMC advisors and between one CMC advisor and other advisors caused a reduction in the CMC's work on institutional infrastructure building for a period. Much of this trouble was reduced after the mid-term evaluation period,

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5 BAPEPAM also worked with the IAI to develop accounting standards for capital market participants, but that was done under a World Bank project.

but it continued in a more limited way. One CMC advisor still had difficulty working with other advisors, which obstructed what might have been useful exchanges, and more coordination with other advisors and an overall greater impact of the FMP on Indonesia's financial market development.

Training: Training is particularly critical for developing the capabilities of market regulators and participants. It helps assure that people across the capital markets, both regulators and market participants, understand and can perform their roles accordingly. The CMC's training segment was scaled down by necessity in the post-mid term evaluation period because it began running out of funds. As a result, it focused during that time on the less expensive local, targeted courses and on building internal BAPEPAM capabilities. However, these are exactly the types of efforts needed to develop BAPEPAM's skills.

As noted in the mid-term evaluation, the training program in the earlier years exhausted a lot of its resources sending people to *overseas* conferences and classes. Moreover, several of the classes offered early on, and overseas, addressed areas that were either broad or beyond what BAPEPAM and market participants needed to address at the time (such as derivatives, warrants, etc.).

In some respects it is difficult to judge the total impact of these overseas classes; they were useful for the directors to gain insights into overseas markets, to publicize their own markets, and to build relations with other SEC and capital market executives. BAPEPAM developed strong relations with the International Organization of Securities Commissions as a result of these programs. Overseas training also helps build confidence and knowledge of lower level staff and provides an opportunity to see first hand how another SEC operates. But in the final analysis, overseas training is expensive, and can divert resources from more critical areas of need. And again, it appears that many of the courses given were what might be called overview courses, rather than ones which addressed specific, operational, and institutional areas.

After the mid-term evaluation, the CMC provided more local, hands-on, as well as in-house, training to BAPEPAM staff, although it still continued to expend considerable resources on broad, overview courses. Retention and distribution of information throughout BAPEPAM on training programs attended by different staff were likely higher in the later years of the project because Chairman Ruru, who took over BAPEPAM in April 1993, required that persons trained give presentations to BAPEPAM staff on what they learned. This likely not only helped disseminate information throughout the agency, but also helped ensure that the trainee absorbed the material.

Objectives Not Achieved: As with the other components of the project, certain objectives laid out in the project paper were not achieved during the project's life. In most aspects, the reasons for the lack of development concern issues that could not have been influenced by the CMC. These are:

- *Limited development of domestic debt markets:* Indonesia's debt market remains quite small, with limited new issues (Table 2 and 3) and almost non-existent secondary market trading. The main reasons for this limited activity are: (1) high interest rates, which discourage firms from assuming long term debt obligations; (2) pension funds (particularly state-owned funds) are major investors in the bond market. They lack a trading mentality, have long term liabilities that they seek to match, and so hold the securities until maturity which limits market liquidity and discourages other investors from buying bonds from fear they will not be able to resell the bonds without taking a loss. The project was supposed to help improve the capital market activities of pension funds and insurance companies, but it did not really address this area, possibly because of difficulty in finding the resources to do so. (3) Limited information on credit risk. The bond market has been dominated by state-owned issuers who are perceived as being government guaranteed and so having little credit risk. Introduction of the new credit rating agency, Pefindo, may help increase issuance by private corporations but that is not yet clear.

- *Limited domestic investment in equity and limited retail investment.* Domestic investment in the local equity market by both institutional and retail parties remains limited. Foreigners own about 30% of all shares (and account for about 70% to 80% of all trading). The remainder is tightly held and infrequently traded by domestic institutions such as corporations, pension funds, and Danareksa. Retail investment is limited because: (1) Investors can obtain high, and relatively low risk, returns from bank deposits; (2) High cost of a share transaction because the required lot size is high; (3) Inability to invest in open-end investment funds Most retail investors prefer open-end funds because they can resell their shares to the fund to redeem their investment and avoid the risk of having to sell to another investor and taking a sizable loss, which they have with a closed-end fund. Open end funds are prohibited in Indonesia; (3) Limited marketing by securities firms to educate and encourage a domestic investor base that has limited experience and understanding of equity market transactions.

- *Limited market strategizing.* There may be insufficient consideration to where the entire capital market is going in designing a comprehensive market strategy. This may be because each institution that might do the strategizing (regulators, private sector entities) is focused on its own operational demands; the foreign advisors tend to become institutional-focused as a result. BAPEPAM perhaps should be guiding this effort, and the FMP was supposed to assist the agency in that endeavor; FMP resources seem to have been diverted elsewhere. There may be a view among FMP advisors that the strategizing should be done by private sector entities, not BAPEPAM.

- *Limited access to funds by small borrowers:* The FMP project paper stated that one objective of developing capital markets was to provide funding for small and medium-sized borrowers. The Indonesian capital markets as they exist today do not support that corporate segment. Companies must be at least in operation for 3 years, have had net profits for past 2 years, have minimum total assets of RP. 20 billion, and a minimum stockholders' equity of RP. 7.5 billion, among other features that exclude small firms.

4. Summary and Observations

Although the Indonesian capital markets have progressed significantly, supported by the CMC's assistance, the uniform view is that BAPEPAM, the SROs, and the markets still have a long way to go and that the capital markets are entering a new stage which will demand new and extensive training and technical assistance. BAPEPAM will have a large job to keep strengthening the quality and quantity of market activity. For example:

- The new Law requires redrafting existing regulations and preparing a whole host of new regulations to cover new activities. It also means developing enforcement mechanisms and capabilities.

- BAPEPAM must oversee, and approve rules and regulations for, the new automated trading, clearing, settlement and depository operations.

- Introduction of new instruments, particularly derivatives products, are expected in the coming term, starting with warrants and then futures and options. They will require new rules, strong surveillance practices, and time to address the new and challenging problems that usually accompany introduction of new products.

BAPEPAM reports, and we agree, that the agency needs extensive training to strengthen its ability to meet these new challenges, to create more depth in rulemaking and to develop enforcement capacity. Training should focus less on building global and institutional contacts, and more on providing intensive, hands-on education to senior and mid level staff. BAPEPAM is concerned that the ELIPS project will only provide training to lawyers, in both content and enforcement of regulations, and that the new World Bank projects will focus mainly on degree training. Thus, the agency is concerned about building staff capabilities in the future.

5. Recommendations:

In sum, the CMC contributed significantly to building better capital markets. Capital market infrastructure has developed significantly and has moved the markets to a new level of activity. However, more work is needed for the future to keep the markets moving along a rapid and well intentioned path. Section 7 provides recommendations on areas to focus on in the future.

C. *The Money Markets Component*

1. *Introduction*

As with the CMC, the overall objective of the Money Markets Component was to increase the level and quality of investment in Indonesia. This would be achieved by strengthening monetary management to ensure macro stability and create a more attractive investment climate, and by contributing to the range of instruments available for funding and investment. Towards these ends, the key outputs of the MMC were:

- Work with BI to create a wider variety of bills, notes and bonds that could be used to improve monetary management.
- Developing BI's institutional capacity, so it could manage money markets and open market operations more effectively.
- Assist BI in bank supervision and regulation.

2. *Implementation*

The original Project Paper anticipated one long-term advisor and 60 person months of short term TA. Assistance would be offered to Bank Indonesia under a Host Country Contract. Total expenditures were approximately $1 million for technical assistance and $160,000 for training.

Project implementation got off to a slow start because of contracting problems. Bids were solicited, a firm was selected, but during negotiations it was decided that the selected firm could not provide the services required. The project was then re-bid and the contract offered to Deloitte & Touche Tomahatsu. By the time the contract was in place, the MMC was already about two years behind the schedule originally anticipated. It also was restructured from the original project paper to take account of the fact that funding would not be available to support the short term technical assistance originally envisioned. The long-term advisor arrived in-country in April 1992. The change in project status created some problems for the long-term advisor as he had taken the assignment on the assumption that short-term TA support would be available to carry out specialized technical functions. Instead, rather than setting priorities for and organizing specialized services to be combined with his own, the advisor became the sole consultant to BI.

The specific tasks to be addressed under the MMC fall into one of five task areas:

1. Managing the MMC contract
2. Assisting BI in improving monetary management
3. Assisting BI with bank supervision
4. Improving banking services (i.e. check clearing, funds transfer)
5. Strengthening BI's institutional capabilities.

All MMC workplans and quarterly reports revolve around these five areas. This list is remarkable in that it could accommodate almost anything that one could think of associated with central banking. Bank supervision and banking services were not areas specified in the Project Paper. However, these are key topics of concern to central banking and indeed the contract with Deloitte & Touche specified that the long-term advisor would work on issues of interest to BI. Bank supervision was particularly important when the advisor arrived. Indonesia was experiencing its first bank failure in 1992--of Bank Summa--which raised serious questions about bank solvency, supervision, the process of liquidation, and deposit insurance.

The MMC advisor gained considerable leverage in employing FMP money, largely because he was able to secure technical assistance from persons working for U.S. federal agencies who could not accept salary, but just expenses paid by FMP. Contributing agencies included the Federal Reserve, SEC, Controller of the Currency and the FDIC. The MMC advisor also organized several conferences with little cost to FMP. For example, a conference in Bali on credit rating cost a total of $125,000. FMP contributed just $23,000, mainly to cover travel costs. The MMC advisor arranged for the remainder to be paid by other sources, most notably BI. Similar leverage was created with other conferences as well. The MMC received only $164,000 for training (less than 6% of the FMP total training expenditures).

3. *Impact*

Some of the MMC's impact can be simply stated. The MMC improved central banking in Indonesia. The simple statement has considerable complexity behind it. One of the pressures felt by a long-term advisor is to be responsive to the terms of reference but also the host institution. Without the latter, the advisor loses the confidence of his host and little can be done thereafter. For this reason, the MMC's involvement in questions of bank supervision and bank services are so important. They are what central bankers must deal with every day. Many of the activities falling below these headings may not be monumental in themselves, but together they create a significant contribution. These are activities that a long-term advisor to a central bank simply "must do."

Despite its extremely broad mandate, the MMC had some important accomplishments that were well within the terms of reference. Table 5 on Page 33 lists the major accomplishments:

- Monetary Management--helped change BI's monetary policy auction.
- Market Instruments--helped draft commercial paper regulations.
- Market Institutions--assisted in creating a credit rating agency.
- BI's Institutional Capacity--helped forge important professional and educational contacts with central banks and the federal agencies around the world.

The MMC, like most such efforts, did not accomplish all it set out to do, and in some cases the utility of what was done was questioned and revised. For instance, the utility of the extensive trips by BI personnel can be questioned. Surely visits to some central banks, particularly regional ones, can be justified on the dual grounds of cost and substance. However, while the substance of visits to distant central banks may be sound, the costs of visiting countries like Chile and Argentina raise questions of cost effectiveness. The check-clearing facility specified in the PP was not formed, as it was decided that the system would have limited usefulness because checks are not used extensively in Indonesia and technology exists and is available in Indonesia for automated payments. Instead, several banks were linked to BI through an interbank communications network--in a pilot exercise. That link has worked well and may form the basis for an electronic funds transfer system (EFTS) which will make paper-based checks completely outmoded. Thus, Indonesia will essentially skip the "checks and check clearing" phase.

A main objective of the FMP was to increase the range of money market instruments traded and market depth to improve monetary management and open market operations. The country's monetary management does seem to have improved, but the range of money market instruments has not increased significantly and there has been some, but not complete, movement to open market operations. (The MMC contributed to introduction of the new stop out rate system for auctioning SBIs).

In thinking about monetary policy in Indonesia it should be noted that with an open capital account and flexible exchange rates, monetary policy tools can be weakened; attempts to control demand through monetary adjustments can be quickly offset by international capital flows. If BI tries to tighten the money supply by selling SBIs, interest rates will rise. Higher interest rates invite capital inflow, which increases the supply of foreign exchange. Increased foreign exchange eventually ends up at BI, which pays out Rupiah for it. That increases the money supply, offsetting the original contraction. Net changes in the money supply result only if there is friction in the system, which creates a range of interest rates, within which capital flows are small. Outside the range, capital flows either in or out can offset monetary policy. BI can create friction by such measures as adjusting the reserve requirements of banks or limiting their foreign exposure by changing regulations. BI might also widen the bid/offer spread in foreign exchange transactions.

The lack of new instruments is due to reasons which are completely outside the purview of FMP. The money market continues to be dominated by SBIs and SBPUs and there still is limited secondary market trading (we have already explained why open market transactions are weak tools in the Indonesian context). The main reason for this is that BI still does not want interest rates to be completely market determined partly to maintain monetary stability. Several Indonesian officials fear that allowing interest rates to be determined by market forces will result in an unacceptable level of volatility. Another reason is that BI wants to be able to keep SBI rates low, to keep its own costs low. Because Indonesia does not finance its deficits with domestic debt issues, there are no typical money market instruments for monetary management such as Treasury bills. The SBI was created for monetary management purposes. It is issued by BI, which buys and sells SBIs to adjust the money supply. SBI interest is paid for from BI's budget, not by the Treasury. High SBI interest rates are very costly for the central bank.

Table 5:
Key Achievements of the MMC

- *Monetary Management and Market Operations* : Helped change BI's monetary policy auction procedure. The main tool of monetary management is securities issued by BI, called SBIs. SBIs had been auctioned on an open-ended basis, where the interest rate at which the obligations would be discounted was fixed and BI would sell all it could at that interest rate (a so-called "cut-off rate"). The result is not a market rate since BI determines the rate. The new system is a "stop-out rate" (SOR) where a quantity of SBIs is offered for sale and that quantity is sold at the discount rate that is offered.[6] This system can result in a market-determined interest rate. While this system *can* result in a market rate, it does not. (see our comments below).

- *Market Instruments:* Designed commercial paper (CP) market regulations. While this effort was centered at BI, a largely private sector team was assembled to discuss and then create the instruments and regulations needed to run an effective CP market. The team included representatives from BI, the MOF, and private financial institutions. A full set of implementing regulations exist and are waiting for approval by BI. Nevertheless, the CP market continues to grow and today about 100 firms issue CP -- far more than 2 years ago. PEFINDO will be very important for providing the information needed to allow a CP market to prosper.

- *Market Institutions:* Assisted in creating a private credit rating agency, PEFINDO. PEFINDO's creation was an expected project output in the original PP. It is something of a model of reasonable public sector intervention in promoting the private sector. Once the institution was established and private parties were convinced of its usefulness, controlling interest was passed to the private sector. Stockholders still include the MOF and BI, but no stockholder possesses as much as 10% of ownership. The FMP advisor played a central role in creating PEFINDO.

- *BI's Institutional Capacity:* The MMC played a strong role in forming and strengthening important international/regional institutional ties that helped improved BI's knowledge:

  - Helped form the ASEAN Credit Rating Association, which shares information that will be useful for PEFINDO's development. The association now meets twice per year and has created training programs for its members.

  - Organized conferences to focus regional interests on central banking issues. These conferences were organized in Indonesia to provide access for BI personnel to a wide range of experiences and procedures existing at other central banks in the region. One important example is the so called "Bali Conference" held last December 14-16. On that occasion, 22 central bankers made presentations on technical topics, mainly monetary management, to representatives from 12 of the region's central banks.

  - Arranged visits for BI personnel at other central banks around the world, to expose them to a variety of instruments and procedures.[7] To assure maximum use of the visits, The MMC advisor assembled detailed briefing books explaining what was to be observed on each visit. After visits, formal discussion was held and written summaries made. Upon return to Jakarta, those traveling made presentations to their colleagues on what they had observed. Central banks visited were in the region (Malaysia, Thailand, Taiwan, Korea), Latin America (Chile, Argentina, Brazil, Mexico) the U.S. and Japan.

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[6] The SOR system was not invented by the MMC. Problems with the cut-off rate system were well known and discussed for may years by many advisors as were the benefits of shifting to a stop-out rate system. The MMC's contribution can probably best be characterized as assisting with a move that BI would have made anyway. It is nevertheless a valuable contribution.

[7] Unlike many other fields, central banking is really only learned on the job. There is limited academic curricula and text books, and other than workshops on specialized topics, no comprehensive training facilities exist outside central banks.

BI can successfully sell below-market SBIs partly because several firms elected to become primary dealers when the primary dealer system was introduced in 1993, because of the consensus nature of Indonesian transactions and the strong role of the central bank. These firms committed themselves (though not under law) to taking specified allotments.[8] But since the SBI carries a below-market interest rate, firms have to take a loss to sell them into the open market, which constricts such selling and hence SBI trading. Secondary market trading is also constrained because dealers need to hold SBIs to maintain the liquidity needed for buying their committed amount of SBIs in the next weekly auction. In sum, BI has taken two key steps--introduction of the stop-out rate and introduction of the primary dealer system--towards a true market but has not taken the final step of letting the interest rates be fully market determined. Thus, in some respects we have the appearance of a market without having market outcomes.

4. Summary and Observations

The MMC has been relatively successful. The long-term advisor to BI has responded to BI's needs. Several important elements of institutional development have occurred. The long-term advisor also gained considerable leverage from the AID monies that were available. Several of the items in the log-frame that were not achieved were either not necessary (a paper-based check clearing system) or not open to change by a foreign advisory project, given the Indonesian setting (creating more instruments). Several difficulties worked to reduce the long-term advisor's effectiveness. They included:

- Unrealistic budgeting by AID. This caused adjustments in the scope of the MMC and uncertainty as to whether resources would be available for seeking project goals.

- Long-term planning of project activities was made difficult by the uncertainty about funding for short-term TA, training support, etc. during the project's life.

- BI's need to finance SBI interest payments from its own budget, which constrains BI's willingness to let interest rates be fully market determined (as they may rise significantly and become very costly to the central bank).

5. Recommendations

Section 7 of the document notes some recommendations for future work in the money markets.

[8] BI also tries to dampen any fluctuation in interest rates by adjusting the amounts of SBIs sold. Primary dealers "know" the range of discount rates that they are expected to bid within.

D. *The Privatization Component*

1. *Introduction*

The main objectives of the Privatization Component were to assist with developing privatization policies, strategies, and models for evaluating IPOs and provide support for privatization transactions and restructuring of SOEs to prepare them to be privatized. The project got off to a slow start, partly because of limited government interest relative to the other components of the FMP and partly because of funding and contracting problems. Since then, the PC has made many contributions to Indonesian privatization; though it is important to note that Indonesian privatization in general has been now somewhat limited. It involves a partial, not full, sale to the general public, it is driven by government budgetary, rather than corporate efficiency, needs,[9] and to date, only two privatization have occurred: the first in 1991 for PT Semen Gresik, before the PC began, and the second in October 1994, for PT Indosat. Repelita VI recently reiterated the point that the GOI would not provide new money to SOEs and that SOEs would have to generate funds through their own capabilities and credibility.

2. *Implementation*

The Privatization Component began in January 1992. A project paper supplement in August 1991 revived the PC, authorizing that $5 million be added to the FMP for this purpose. The component was financed through a "buy-in" to AID's Privatization and Development Project and occurred through a direct contract with Price Waterhouse. The PC concluded on February 28, 1995. Total expenditures were about $2.46 million for technical assistance and $239,000 for training.

The PC got off to a slow start and began to gain momentum in 1993. The slow start reflected limited GOI interest in getting privatization moving in the face of other FMP activities. At the time the FMP began in 1990, privatization was under the Ministry of Finance's Directorate General of Monetary Affairs which also governed activities of the FMP. The Director General decided that the Capital Markets and Money Markets components were most important and should be done first. The PC was dropped from the original project implementation.

Over time, however, the issue of privatization gained more importance. In 1993, it obtained its own directorate when the Directorate General of Monetary Affairs was divided into two new directorates--the Directorate General of State-Owned Enterprises and the Directorate General of Financial Institutions. The new SOE Director adopted a focused

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9 These characteristics were spelled out in Presidential Instruction No. 5 of 1988 and the follow-up Decree of the Minister of Finance No. 740 (28 June, 1989). These documents ordered financial and technical assessments of all SOEs and were followed by creation of a legal framework for SOE's to "go public". Privatization was viewed as the sale of minority ownership by those SOEs that were capable of attracting outside investors. This concept of privatization exists today.

program to give more attention to privatizing SOEs. Once the new Director was installed, activities accelerated. Three areas of need were identified and worked on:

- *Policies and Strategies*: Assist the SOE Directorate in such areas as developing privatization strategies and policies; selection criteria for IPOs, underwriters, and accountants; restructuring criteria for SOEs; and policies for use of IPO proceeds. Towards this end, the team drafted policies and strategies for various aspects of the privatization process, provided presentations to the Director General of SOEs and his staff on the conditions necessary for the success of privatization programs, and addressed issues in designing privatization strategies and the roles of various institutions in the privatization process. Without the PW (Price Waterhouse) team there would have been no in-house source of this information at the MOF.

- *Institution Building:* Improve the skills of Directorate staff and restructure and strengthen SOEs. The team helped with institution building through two key means: (1) Working closely with a Privatization Task Force, walking them through evaluations of IPOs, selection of underwriters, and all other activities that needed to be done so they could learn while doing; (2) Providing training to Directorate staff. Courses were provided in BOO/BOT,[10] and for using and understanding the IPO candidate selection model and other aspects of IPO activities. Training provided for IPOs centered on a course for MOF personnel at the New York Institute of Finance. The MOF sent 14 people. Ten other persons were sent by the five SOEs which were under going diagnostics at the time. In addition, MOF teams were formed to work with the PW teams on each of the SOEs being considered for privatization.

- *Transaction Facilitation and Support*: Assist with privatization transactions. Approximately 60% of the PW team's effort was focused on transaction support. The main impact of the privatization component during late 1993 and 1994 was in the area of transaction facilitation. IPO diagnostics, and IPO-related analyses, were done for a number of SOEs (i.e. 11 SOEs). The MOF does not have internal skills available to deal with these tasks. Without the PW team, either the work would have been done poorly, or not at all, or would have had to be contracted to outside parties. The transactions support work was actually pre-transaction support. It consisted of such things as diagnosing particular SOEs to determine if they were eligible for going public and identifying other work, such as restructurings, which would be necessary to prepare for privatization.

A separate set of tasks involved evaluating SOE pension funds and the possibility for private participation in the provision of public services. The team worked closely with the Director General and, as long term advisors, generally focused on issues of importance to the Directorate.

[10] Build, own, operate / Build, operate, transfer. These models are particularly important for considering private participation in public services. The Paiton energy project is an example of BOT.

3. *Impact*

The team appears to have provided useful assistance to the Directorate in formulating broad-based policies and in beginning to build the Directorate's capabilities to implement those strategies. The team met the terms of their scope of work and was helpful to the government. They completed work that needed to be done and that the government could not have done on its own. The IPO diagnostics were a necessary step before an SOE could consider doing an IPO. Over the past two years or so, the general expectation in Indonesia is that SOEs are capable of going public and thereby raising the capital needed for infrastructure expansion. Surely the work of the PW team is partially responsible for the recognition that some of Indonesia's SOEs are capable of "going public". The fact that the MOF is currently trying to find a way to continue the work begun by the PW team indicates that the work has been to the satisfaction of the MOF.

In some respects, the impact of the privatization work is constrained because of the nature of privatization in Indonesia. In others, it is too early to judge the impact:

- Privatization is partial. The government is not turning over controlling interest to the private sector. In the two cases where partial privatization has occurred, the proportion of equity sold to the public ranged from 27% for Semen Gresik to 35% for INDOSAT.

- Oversight of the privatization process is split between the MOF and the technical ministries associated with each SOE. Not all technical ministries are as enthusiastic about privatization as the MOF.

- It is motivated mainly by the need to relieve public budgets from having to raise capital for SOE expansion. Improved efficiency from deregulation and increased competition is only a remote secondary motivation.

In other cases, the impact has not yet been felt.

- Privatization was to help support development of the local capital markets by increasing the number of shares listed and traded. It may just be starting to do that. Moreover, recent offshore listings of newly privatized SOEs are advertising for the local capitals markets; they highlight the fact that Indonesian firms can meet tough overseas listing requirements.

- Privatization should strengthen SOE operations. Although Indonesian's main objective for privatization is not efficiency but budgeting, companies that list offshore, or onshore, will have to maintain profit strength and will have to continue disclosing their activities which will help improve their economic management.

4. *Summary and Observations*

The Price Waterhouse team seems to have done a reasonable job of meeting the objectives that the project paper set for them. The project raises interesting policy questions about the extent to which AID should finance privatization support in a country like Indonesia, given that privatization transactions can result in large sums of money to the government which could be used to pay for advisors.

In our view, USAID's role should focus on the first two areas of PW's activity: policy and procedure and institution building. The MOF had limited skills for developing an overall privatization strategy, and for understanding and creating the policy changes necessary to promote privatization. MOF personnel also need to develop the ability to work closely with the private sector, purely commercial entities such as underwriters in doing transactions.

Thus, looking at the work done by PW, we would say that:

- Supporting the policy and strategy work is useful and should be done.
- Providing models for selecting IPOs, underwriters, accountants, etc. are useful tools for institution building in the government providing guidance.
- Company-specific work should be supported when it concerns analyses done well before the privatization transaction, i.e. when trying to identify companies that might be good IPO prospects.
- Some work might be supported for particular company transactions as pilots--to train government employees, and walk them through the process.

In many respects these have been the activities of the PW team, and as such they have contributed to the privatization thrust. However, PW mainly focused on the IPO diagnostics and similar firm-specific preparatory work. MOF personnel were involved in the IPO diagnostics, and to that extent some training occurred. However, the main objective of the IPO diagnostics did not appear to be training. There is a second reason for withdrawing AID from doing the preparatory work for IPOs. The work is very expensive. The skills required are specialized ones, combining production specialists with financial expertise. From AID's perspective, there may be more cost-effective ways to spend scarce resources.

5. *Recommendations*

See Section 7.

SECTION 6: Lessons To Be Learned

A. Lessons for Projects and Project Design in Indonesia:

Several lessons can be drawn from the FMP's experience in Indonesia:

1. *The FMP gave its advisors the flexibility they needed to build close and effective working relationships with advised parties.*

   To be most effective, long term advisors need to build confidence and relationships with those they are advising. That means they often must be "reactive" rather than "proactive". The development process can be unwieldy; the person being advised often needs to respond to unplanned market, economic, and political developments. A long term advisor that tries to follow an externally determined schedule, that tries to push the advised person into addressing issues that are not viewed as critical, will jeopardize his/her access to the advised person and the project's overall effectiveness. The long-term advisor structure was at the heart of the FMP. The FMP allowed advisors to operate with flexibility and that contributed to the project's success, by having many open-ended tasks. This allowed the advisors to adjust their activities to match the economic environment in which they operated.

2. *The need to build consensus among several involved parties in Indonesia often means that development can take longer than in other countries.*

   This must be recognized and accepted. Related to this is that social pressure and moral suasion are work in economic relationships. Rather than being confrontational, Indonesian policy makers and business people "understand" what is expected of them, and usually behave accordingly. This environment creates limits to what can be expected of an AID project, but also creates opportunities if the conditions are recognized.

3. *More is not always better.*

   Project papers frequently set out quantitative measures of success, such as the number of money market brokers, the number of companies privatized, the number of regulations written. But higher numbers do not always mean "more" development. Indeed, in some cases, pushing to achieve higher quantity of output can harm the quality of development, and reduce its sustainablity. For example, an advisor, feeling pressed to produce a large number of regulations, drafts regulations alone instead of guiding and training local counterparts; more regulations are drafted and adopted than the local regulatory agency can understand or implement intelligently; more firms are privatized than the local capital markets can absorb obstructing market activities; or more brokers are incorporated than can be supported by local financial market transactions.

B. Lessons for Project Design

In general, the FMP identified important aspects of financial sector development as objects of technical assistance. Observations for future project design include:

1. *Realistic budgets should be assessed before a project is begun or during project implementation.*

   During implementation of the FMP, activities had to be scaled back, and in some cases dropped entirely, because the original budget estimates were unrealistic. The adjustments led to considerable uncertainty among the contractors as to what was to be done, and what resources would be available to them.

2. *Project designers should focus on a few major issues, and the general activities that would address them, rather than concerning themselves with many of the details of how things were to get done.*

   For example, in the money market component the contractors were to "review bank reserve requirements and revised liquidity ratios to permit a wider range of reserve investments by banks". Why specify so precisely how one would go about creating a wider range of reserve instruments? Specifying things this narrowly can force the contractor to either step outside the scope of work or fail to perform as specified.

C. Lessons for Project Implementation

1. *The utility of a Host Country Contract (HCC) should be questioned.*

   Usually an HCC is supposed to promote the institutionalization of a contracting ability in the host institution. In Indonesia this is somewhat naive. Host institutions are likely to already have this capability. Also, in practice an HCC simply overlays the bureaucratic processes of AID onto the host institution. Thus, the host does not develop contracting ability *per se*. The host at best develops an ability to satisfy AID requirements. At worst, the host simply turns contract management and the satisfaction of AID requirements over to the long-term advisors. The host develops no new contracting ability and the technical advisor has to deal with two, often incompatible, bureaucracies.

2. *AID's management of the project was not as strong as it perhaps should have been.*

   Usually, project managers claim that they do not want to "micro manage", and that the HCC requires that the host institution manage. There is a danger that the only one managing is the long-term contractor. There are occasions when AID should take a stronger position on management issues. For example, when advisors are not working out, when major shifts in project emphasis are occurring, when priorities are being set, and on other occasions, it is not "micro management" to intervene. It is simply management. For most of the FMP, AID intervened little. The records kept at AID show minimal involvement on a regular basis with the FMP until later in 1994. The project was assessed in 1992 and again in mid 1993.

3. *When it becomes clear that major components of a project must be dropped, there should be more formal ways of reviewing the reasons for change and the consequences for the rest of the project.*

   In the FMP, when components were dropped, there was little evidence that the changes were examined in this way. For example, at the outset the privatization component was dropped as was a focus on commodities markets and on DANAREKSA. While in the FMP case these seem reasonable, no analysis or review was done. Furthermore, in retrospect, without a record of the consequences expected of changes, one cannot reconstruct how well projects have done. Along the same lines, there is no good record at AID of periodic assessments (other than from outside reviewers) of how the project progressed, how expectations changed, etc.

4. *When major expenditure shifts occur within a project, careful documentation should be prepared and filed.*

   In the case of the FMP, expenditure totals, by category, do not match the levels specified in the project papers. For example, the project paper supplement of August 1991 justifies $5 million to be spent on privatization. In the end, $2.7 million was spent on privatization. Total expenditures are as planned ($14.6 million) but apparently about $2.3 million more was spent on the capital markets component than planned. Redeployment of resources of this magnitude require some explanation.

SECTION 7: Recommendations and Conclusions

Although the FMP is not being extended, it is still useful to make recommendations on future work that could be undertaken for further developing the Indonesian financial markets and moving forward on the privatization front.

A. Capital Markets

In the area of regulations and regulatory capacity, some suggestions are:

1. Continue strengthening BAPEPAM's rulemaking and enforcement capacity, and building depth of staff:

   - Use new World Bank funds to obtain assistance in drafting rules and in learning new enforcement techniques. BAPEPAM staff must continue to learn and draft regulations under the new project.
   - Use ELIPS funds to assist with training and developing rules and rulemaking capacity.

2. Continue training BAPEPAM staff but concentrate on targeted, on-the-job, and operational training so staff understand exactly what needs to be done in their jobs. Simulated exercises and "case" studies are especially helpful. Degree training is of less interest but is still important and will be supported by funds from the World Bank and ELIPS. Degree training, especially overseas, builds important technical and analytical skills and confidence that has spill-over effects onto other strengths of the employees. Given the large amount of donor-funds for degree training, efforts might be made to negotiate a redistribution of the funds to localized job training.

3. Prepare ways to retain key staff. BAPEPAM will have to be work hard to retain good people, given the agency's salary structure compared to the securities industry with which BAPEPAM staff will have frequent interaction and job opportunities. While a revolving door from the government to the private sector can be healthy, it cannot happen so frequently that BAPEPAM is constantly losing its most talented staff. As is true in any regulatory agency, the key to retaining talented people will be offering them interesting and challenging assignments, and rapid advancement to higher positions. BAPEPAM will need to have a human resource policy on this. This strategy has worked successfully in other parts of the Indonesian government. But again, BAPEPAM's task will be complicated by its proximity to the rapid growth and high salaries of the securities industry.

In the market itself, efforts must be made to continue developing market liquidity or foreign firms will leave to go to other emerging markets that offer more liquidity. Competition for foreign funds is growing as new emerging markets develop. Several steps are already underway and will have to be managed properly, such as automation. Others will need to be encouraged, such as drawing in domestic investors as noted below.

In the area of developing a domestic investor base, domestic financial institutions will have to take it upon themselves to develop the domestic investor base because foreign firms are not interested in doing that. Their business relies on foreign funds and they seem content to remain with that limited clientele, at least in the near future. Several steps will have to be taken to expand the institutional and retail investor base. It is not clear who should be responsible for taking these steps:

1. Educate investment fund managers: Developing the domestic investor base will depend to a large extent on developing a cadre of trained, talented, and active investment fund managers who can manage pension funds, insurance monies, and retail funds. There is no such group in Indonesia today and one will have to be developed. Fund managers at pension funds will have to become more "trading minded"--today they simply buy and hold securities--and new fund managers will have to be developed to draw retail investors into the market.

2. Educate domestic securities firms on research and marketing. These firms could help cultivate a local investor base, but they will need far stronger research and marketing capabilities.

3. Local securities firms will need to improve their transaction-related operations as well to avoid losing domestic clients to foreign firms. Although foreign firms are not apt to actively cultivate large portions of the domestic investor base, they are also not apt to turn away funds, especially of sizable clients.

As noted, the capital markets as they exist today are not geared to providing funds to small firms directly. Firms may profit from having greater access to bank financing that is not "crowded out" by larger firms because the larger firms can use the financial markets for funds. To assist small firms more directly, the following might be done:

1. Develop a strategy for the combined Surabaya Stock Exchange (BES) and the Bursa Parallel (over-the-counter market) so they can develop rapidly and be a useful source of funding for smaller firms. If the BES and Bursa Parallel do not focus their efforts and prepare a strategy for their growth, they will be unable to provide any additional benefits to the current capital markets.

2. Provide training for PT Bahana staff so they can perform their role as a local venture capital fund focused specifically on small and medium-sized enterprises.

B. Money Markets

A few recommendations can be made regarding development of the money markets:

1. Continue working to implement the electronic funds transfer system. That will speed payments throughout the banking system.

2. Provide management assistance to Pefindo. Although Pefindo is a private sector company, it appears to be having difficulty getting started and setting up its strategy. As a new entity with no similar institutions in Indonesia, Pefindo may need the kind of start-up support that was given by the government to other "central" firms such as the BEJ and PT KDEI. Or other capital market institutions might provide support. In any event, it is extremely important that Pefindo get off to a good start.

C. *Privatization Activities*

In the area of privatization, the recommendations are generally to continue along the path which the FMP has been following. That is:

1. Continue identifying new firms as privatization candidates and working with those firms to restructure their operations as necessary to assure they present attractive investments to the local and foreign investors.

2. Continue training Director staff on how to analyze companies, underwriters, accountants, etc. so they can appropriately select and work closely with private sector parties, such as underwriters, in the privatization process.

APPENDICES

APPENDIX A

Delivery Order # 18
PCE-0025-Q-00-3071-00

ARTICLE I - TITLE

Financial Markets Project Final Evaluation, Project No. 497-0360

ARTICLE II - OBJECTIVE

1. Activity to be Evaluated. The Financial Markets project (FMP) which was authorized on August 30, 1988. The current project assistance completion date (PACD) is March 1, 1995, but is in the process of being extended until June 1, 1995. Life-of-project grant funding from USAID is $14.6 million; the total host country contribution, from both public and private sources, is $4.9 million; therefore total funding is estimated at $19.5 million.

2. Purpose of the Evaluation. The purpose of this evaluation is to provide the Government of Indonesia (GOI) and USAID/Indonesia with an assessment of the impact of the Financial Markets project. The emphasis of the evaluation will be to analyze the relationship between the availability of debt and security instruments to the success of Indonesia's poverty alleviation policies. The analysis should be broad enough to consider the effect of improvement in financial markets on the lower income populace through facilitating economic reform and continued rapid economic growth. This evaluation will review what has taken place in the Indonesian financial sector since this project intervention was initiated, systematically collect information about the extent to which this intervention made a difference to the economic development of Indonesia, suggest what problems remain, and speculate about alternative designs for similar programs or projects in the future. The intention is contribute to more informed future decisions, rather than to try to arrive at definitive conclusions that FMP led to specific results which would not have occurred in its absence.

3. Background. The FMP was designed as a response to the GOI's desire to develop well-regulated, efficient, and active financial markets, particularly capital and money markets. Improvements in the depth and efficiency of capital and money markets were assumed to lead to increases in the availability of domestic and foreign investment capital. It was recognized that a strong capital market could be important for the privatization of state-owned enterprises through the public sale of securities in financial markets. Privatization was also seen as a means to broaden and deepen Indonesian capital markets by increasing the supply of marketable securities.

   The goal of the FMP is to increase the availability of long-term investment capital by supporting open financial markets. The project purposes are to increase the number of debt and equity securities and commodity contracts available to investors, to increase the transparent trading volume of these instruments, and to improve the efficiency of the public sector through restructuring and/or privatization of the ownership and management of state-owned enterprises.

Increased investment in capital assets was seen as crucial for Indonesia's continued economic development and, in turn, contributing to this country's poverty alleviation policies. If investment does not expand significantly, Indonesia will not realize the sustained economic growth necessary to employ its large and growing population, many of whom are still living in poverty. In order to mobilize the necessary investment, Indonesia has been relying on foreign borrowing and investment, but also has to continue to stimulate domestic savings. Public sector savings can be increased through raising taxes, reducing or eliminating price subsidies, and increasing the operating efficiency of governmental agencies. Increasing private sector savings requires continued deregulation of business activities. An important step to be taken is to increase both sectors' savings and investment in order to further develop Indonesia's financial markets.

FMP contains a Capital Market component implemented through a host-country contract with Price Waterhouse; a Money Market component implemented through a host country contract with Deloitte Touche Tohmatsu International; and a Privatization component funded through a "buy-in" to the Price Waterhouse contract managed under the centrally authorized Privatization and Development project. All three components will be considered in this evaluation.

ARTICLE III - SCOPE OF WORK

This evaluation will address the following questions:

a. Has the FMP achieved its goal, purposes, and outputs?

b. What people-level impact has FMP had on contributing to the GOI's extensive poverty alleviation policies, as well as poverty alleviation itself? What are the interrelationships, if any, between financial markets development and poverty alleviation?

c. Have project inputs, including host country contributions, been used effectively?

d. What are the lessons learned from the FMP? Are its activities sustainable? How relevant is the project in the context of USAID's overall strategies for sustainable development?

e. What is the impact of the achievements of the FMP on Indonesia's financial markets, the GOI's restructuring and privatization program, and overall economic development?

f. Have increases in investment and savings occurred by increasing the types of securities available? If so, has the development of financial markets increased the level of equity finance relative to debt finance and has this stimulated the development of small and new businesses?

g. Are there indications that the flow of funds from investors to users of funds has become more efficient?

h. Has financial market development lead to increased economic stability?

i. Has privatization contributed to the deregulation of the public sector?

j. Have FMP activities had any impact on the more equitable distribution of financial sector resources?

k. Are there positive or negative effects resulting from the project that were completely unanticipated?

5. Specific Evaluation Tasks.

a. Before departure for Indonesia, expatriate teams members should familiarize themselves with the literature of Indonesian financial market development. USAID/Indonesia will supply the following documents: FMP Project Paper, Project Paper Supplement, and Approval of Authorized Amendment No. 2; "Assessment of the Financial Markets Project," September 1992; Midterm Evaluation, October 1993; and the most recent Annual Workplans and Quarterly Reports for each of the three components.

b. The evaluation team leader will draft a workplan and submit it to the FMP project officer within three days of the beginning of the evaluation in Indonesia.

c. The evaluation team will conduct evaluation activities, including regular weekly briefings to USAID staff and GOI counterparts and preparation of the final report, over a three-week period in Indonesia. The draft final report will be submitted to the FMP project officer before the evaluation team leaves Indonesia.

d. USAID/Indonesia will then have 15 days to comment on the draft final report before the evaluation team leader submits the final report within 30 days after leaving Indonesia.

6. Methods and Procedures. Interviews should be conducted with a number of people involved in the current project and/or Indonesia's financial markets. These should include USAID personnel; representatives of project contractors and consultants; GOI counterparts, including the Ministry of Finance, BAPEPAM, BAPPENAS, and Bank Indonesia; private sector experts, participants, and beneficiaries; academic experts; and other donors.

Research should include USAID documentation, contractors' reports, and any other books, reports, and articles deemed relevant.

7. Evaluation Team Composition. The team should consist of an evaluation specialist, a financial specialist, and a financial research specialist.

Evaluation Specialist/Team Leader: A social scientist with a Ph.D., field research experience, and an economic or financial background is needed for the evaluation specialist position. This person should have considerable experience in evaluating economic development projects. The evaluation specialist will be responsible for managing the evaluation team and producing all evaluation documentation, including the final report.

Financial Specialist: The financial specialist should have extensive experience in the financial sector, have prior experience with financial sector development in developing countries, and possess wide exposure to numerous facets of financial sector issues. A minimum of fifteen years experience in the financial sector obtained through high-level assignments is required.

Financial Research Specialist: This person will be a local-hire who will be responsible for gathering data regarding Indonesia's financial markets, privatization activities, and general issues of financial sector development and economic development. He or she must be fluent in Indonesian and English. A strong background in financial market development is required. This person will obtain data and research materials relevant to the evaluation.

IV. REPORTS

Reporting Requirements. The team will prepare, in the field, a draft final report which addresses the questions in item 4 above, and which corresponds to USAID's required format for evaluation reports. The following sections must be included in the final evaluation report:

a. Executive Summary
   - Purpose of activity evaluated
   - Purpose of the evaluation and methodology used
   - Findings and conclusions
   - Clear and succinctly stated lessons learned, both regarding project design implications and broad action implications

b. Project Identification Data Sheet

c. Table of Contents

d. Body of the Report, including sections on:
   - purpose and study questions
   - the economic, political and social context of the project
   - description of the project
   - team composition and study methods
   - findings and analyses of the study concerning the evaluation questions
   - succinctly stated conclusions drawn from the findings (including lessons learned and policy implications)
   - recommendations based on the study findings and conclusions.

e. Appendices, including:
   - a copy of the evaluation scope of work
   - the project log frame
   - a list of documents consulted, and of individuals and agencies contacted
   - more detailed discussions of methodological or technical issues, as appropriate.

USAID/Indonesia strongly favors concise writing and the avoidance of jargon. This draft final report will be submitted to the FMP project officer prior to the team's departure from Indonesia. The team will also be responsible for drafting Sections H and J of the standard USAID Evaluation Summary. USAID/Indonesia will provide the team with written comments on the draft final report within 15 days of the team's departure. The team will provide a final report within 30 days after leaving Indonesia. Both the draft and final report will be provided on a diskette written in Word Perfect 5.1, plus fifteen printed and bound copies, with copies to CDIE in accordance with normal USAID/W requirements.

The team is responsible for providing its own computer facilities. USAID Mission security regulations preclude the use of the team's computers on the U.S. Embassy compound. The Mission cannot guarantee office space, but will provide it on an as-available basis. The contractor must provide office supplies and equipment for the team. Secretarial services are to be arranged by the contractor. A six-day working week is authorized.

ARTICLE V - TECHNICAL DIRECTIONS

Technical Directions during the performance of this delivery Order will be provided by the Director of Private Enterprise & Development office, USAID/Indonesia, or designee, pursuant to Section F.8. of the contract.

ARTICLE VI - TERMS OF PERFORMANCE

A. The effective and the estimated completion date of this delivery order is set forth on the cover page, block 7 and 8 of this contract.

B. Subject to the ceiling price established in this delivery order and with prior written approval of the Project Manager (see Block No. 5 on the cover page), the contractor is authorized to extend the estimated completion date, provided that such extension does not cause the elapsed time for completion of the work, including the furnishing of all deliverables, to extend beyond 30 calendar days from the original estimated completion date. The contractor shall attach a copy of the Project Manager's approval for any extension of the term of this delivery order to the final voucher submitted for payment.

C. It is the contractor's responsibility to ensure that the Project Manager-approved adjustments to the original estimated completion date do not result in costs incurred which exceed the ceiling price of this delivery order. Under no circumstances shall such adjustments authorize the contractor to be paid any sum in excess of the delivery order.

D. Adjustments which will cause the elapsed time for completion of the work to exceed the original estimated completion date by more than 30 calendar days must be approved <u>in advance</u> by the Contracting Officer.

LOGICAL FRAMEWORK

COMPONENT: CAPITAL MARKET			
Purpose: To increase the number of debt and equity securities and commodity contract available to investors, and to increase the transparent trading volume of these instruments.	Permanent and long-range regulatory environment for stocks, bonds, and commodities, established with operational responsibilities separated from regulatory authority.	Regulatory environment established for securities through Capital Market Decree 1548/90 and development of BAPEPAM. Fifty percent of rulebook work (20 percent of rules) complete. Further institutional strengthening is required for BAPEPAM to be autonomous and self-sustaining.	Seventy percent of the rulebook work is complete. The final draft of the Capital Market Law was submitted to Parliament in February 1995 and is expected to pass anytime within the next year. The Law will give BAPEPAM the ability to investigate and require compliance with regulations by capital market institutions. The Public Information Support Office (PISO) was established in August 1993. This institution is part of BAPEPAM and provide information to the public on listed and public companies among other institutions
	At least 50 private broker/dealers operating profitably from broker/business alone.	There are currently 205 securities houses and stockbrokers. Profit data not available, but PW reports that agency brokering is unprofitable because of high costs.	There are currently 197 securities houses and stockbrokers. Profit data are not available but about 25 to 30 companies are said to have good profits. Current data indicated that the active stockbrokers are about 164. Transaction fees are 1%; 0.6% goes to the exchange and 0.4% to the PT KDEI.
	At least one new stock and two new bond issues marketed each month, and average daily stock trading volume reaching 4 million/day. Total stock and bond market capitalization increasing to at least Rp. 25 trillion.	There were 81 stock issues and 5 bond issues in 1992; and 22 bond issues in the first half of 1993. Stock trading volume averaged Rp. 32 billion. Stock capitalization was Rp. 24.8 trillion at the end of 1992 and bond capitalization was Rp. 741 billion.	There were 51 stock issues since Dec. 1993 and 7 bonds issues in 1994. For 1995 (up to February), there were 2 new bonds issues. Stock market capitalization was Rp. 103 trillion at December 1994 while bond capitalization was Rp. 1.905 trillion.
	Commodity futures and at least two new commodities traded on the ICE.	Commodity exchange activities were dropped from project implementation. See section A.1., above.	Coffee and Crude palm oil are currently traded on the ICE

COMPONENT: CAPITAL MARKET (continued)			
	Growth in pension and insurance companies by 50 percent and increased total stock and bond holdings to 30 percent of portfolios representing Rp. 3 trillion.	Data not available. Total pension fund assets estimated at Rp. 8 - 10 trillion. Number of funds rose from 106 in 1988 to 194 in the spring of 1992. Civil service pension fund TASPEN had 30 percent in bonds and 3 percent in stocks in 1990 and is increasing stock holdings. Insurance companies do not generally write long-term investment policies.	Number of funds in 1994 is more than 200. However, only 120 are operated based on the Pension Law 1992. There is a 10% diversification rule for pension funds to invest in the capital market and that limit has not been satisfied yet.
	Reduction of Danareksa's percentage of portfolio that is unpledged. Restructured and increased level of individually owned certificates.	Danareksa had reformed, but issue of new certificates was frozen under the Capital Market Decree.	
Output 1.1. market deregulation	Separation of BAPEPAM's regulatory and operational functions. Clearer division of regulatory roles.	Separation provided for by Capital Market Decree and effected in march-July 1992.	Proposed Capital Market law was submitted to the Parliament in February 1995.
	Strengthened technical capital market skills of MOF, BAPEPAM, and privatized stock exchange(s).	Market skills of MOF and BAPEPAM strengthened for licensing and registration, but more needs to be done, especially on market regulation. No direct strengthening of market skills of stock exchanges via FMP.	Market skills of BAPEPAM strengthened in regulation area. More work is needed. No direct strengthening of market skills of stock exchanges via FMP.
	Promotion of Danareksa's role as mutual fund for individual investors, and reduction of its favored status in market as mutual fund and underwriter.	Danareksa is active as an underwriter and broker dealer, and in fund management and finance.	Danareksa is still the only company that issues local mutual funds in Indonesia. However, with deregulation in the capital market, it is expected that the number of local investment funds will increase soon.
	Separation of the operational and regulatory functions of the commodities exchange.	Commodity exchange activities were dropped from project implementation. See section A1., above.	Not yet separated
Output 1.2. Increased supply of long-term investment capital	Developed standards that encourage pension funds and insurance companies to diversify portfolios.	Pension fund work has had much success. SEE TEXT.	The portion of this activity dealing with insurance companies was largely dropped from FMP implementation. See section A.1., above.

[illegible]	[illegible]	[illegible]	[illegible]
COMPONENT: CAPITAL MARKET (continued)			
Output 1.3. Improved securities trading capability and structure	Increased investor interest in securities through promotional campaigns.	No direct impact on investors, but assistance given in public relations via the media.	Electronic transaction started late May'95.
	Greater individual and foreign access to markets, e.g., new mutual funds, linkages among markets, and restructured Danareksa certificates.	Greater access to the market derived from deregulation and growth, but not from the project. Mutual funds prohibited by the Capital Market Decree, but a new law will probably allow them. Danareksa certificates frozen by the Decree.	Mutual funds are regulated in the capital market decree (Article 19-28). Some companies have applied to be mutual fund promoters, but none has started to operate yet. The draft allows for open-end and closed-end investment funds. The company can be in the form of limited liability or collective investment entrance.
	Developed private sector brokerage through training and technical assistance.	Formal training discussed in section D., above. Substantial work has been undertaken in presentations and seminars to assist the business development of domestic brokers/dealers.	Training has been provided to brokers through seminars and presentations.
	Future contract traded at the ICE.	Commodities exchange activities were dropped from FMP implementation. see section A1., above.	Coffee and crude palm oil are now being traded at the ICE. Feasibility study by Sparks company (re. commodity trading and cost/benefit analysis) was well received by the Minister of Trade. The action plan for implementation of commodity exchange is underway.
	BAPINDO, BPDs, & PT. Bahana Selling of equities through the stock market.		
COMPONENT: PRIVATIZATION			
Purpose. To improve the efficiency of the public sector through restructuring and/or privatization of the ownership and management of SOEs.	Tested legal, financial, and administrative procedures.		IPO for Indosat has been completed. 10 more IPOs are currently being developed.
	Increased understanding of benefits.		Pilot privatization and action to build awareness of the program continued.

[illegible]	[illegible]	[illegible]	[illegible]
COMPONENT: PRIVATIZATION (continued)			

	Restructuring and/or privatization of 10 selected SOEs.		There are at least 10 SOEs on the privatization list right now. Besides Semen Gresik, which was partially privatized in 1991, Indosat, is the only company that has gone public. PLN and Telkom are targeted to go public this year.
	Database of potential investors and sources of funding and technical assistance.		
	Valuation procedures.		
	Core group of privatization specialists.		Beginning to be developed.
	Dissemination of information.		
	Overall policy framework that provides the fundamental direction of the SOE program.	Policy framework design ongoing. SOEs classified into categories requiring assistance.	
	Coherent and integrated set of policies and procedures that clearly define the process of carrying out the SOE program.	Privatization strategy clarified for MOF, but to date no clear policy direction for SOE restructuring and privatization.	
	Fully developed institutional capacity to design, implement, monitor, and revise the SOE program on a systematic, ongoing basis.	Begun in January 1992, and ongoing. Heavy emphasis on this activity has taken away from privatization implementation and transaction activity.	Helped strengthen MOF capabilities. Continued development is necessary.
Output 2.1. Improved overall policy framework	Developed information base, including: profiles of candidate companies; data bank of SOEs, potential investors, and sources of funding and technical assistance; and methodology for economic impact analyses.	The accomplishments below apply to a wide range of specific privatization and restructuring activities with a SOEs in a number of sectors that fall under the general indicators listed in the previous column.	

[illegible]	Objective Verifiable Indicators: Project Paper [illegible]	Objective Verifiable Indicators: [illegible] Evaluation [illegible]	Objective Verifiable [illegible]
COMPONENT: PRIVATIZATION (continued)			
	Established scope of the program, including revised performance measures and restructuring criteria (with supporting analyses and recommendations), and revised lists of restructuring and privatization candidates. Design and implementation of strategies for reducing labor displacement effects through early retirement, increased pension benefits, generous severance packages, and new business start-ups. Design and implementation of strategies to privatize and use proceeds, including proposals for small business expansion schemes; delivery mechanisms to direct subsidies to affected labor; labor compensation packages for redundancies and early retirements; funding of retraining programs for displaced skilled labor; and infrastructure development programs. Design and implementation of a strategy to maximize private investment in public services, including analyses of the benefits and consequences of private investment.	Telecommunications sector. Internal discussions were held regarding the role of FMP. Electric power sector. Helped carry out negotiations between GOI and Paiton project, investors, and promoters. FMP advisor is assisting the financial modeling of options and facilitating negotiations. PTP Estates Marketing System. Produced report on performance of KBP and on the financial, economic, and commercial implications of reforming marketing arrangements of PTP Estate production. Recommended action program to improve efficiency of system. SOE pension funds. Produced draft approach for DG/SPE to create policies and guidelines to supervise and design operations of SOE pension funds that are developing professional fund management capabilities. Wrote report on SOE pension fund conversion from defined benefits to defined contributions.	Developed strategies for selecting IPOs, underwriters, and accountants; restructuring criteria.
	Development of a consensus building program including a proposed strategy, media items (print, audio, video), workshops/seminars, and promotional campaigns. Monitoring and adjustment of the SOE program, including developed success and a computerized monitoring system.	Air transportation sector. Wrote report on aircraft leasing activities that P.T. PANN Multifinance and IPTN could carry out to rationalize air fleets of Garuda and Merpati. Continuing to help develop leasing modality to strengthen IPTN and PANN Multifinance.	

[illegible]	[illegible]	[illegible]	[illegible]
COMPONENT: PRIVATIZATION (CONTINUED)			
Output 2.2. Improved policy implementation and procedural framework.	Identification of legal. regulatory. and other procedural constraints to the SOE program. including methodology for identification and lists of constraints. changes. and new policies/procedures.		
	Definition and institutionalization of procedures to restructure and privatize SOEs. including: offering memoranda: restructuring and privatization methods and procedures: developed SOE privatization action plans: decisions to privatize selected SOEs: public announcements of tender offers: and recommendations for procedures for specialized techniques (e.g. . ESOPs).	This activity is behind schedule. DG/SOE reorganization, cabinet changes. and election have caused delays. Privatization strategy clarified for MOF. but no clear policy direction to date for SOE restructuring and privatization	Designed selection criteria for IPOs, underwriters, and accountants and restructuring criteria for SOEs.
	Definition and institutionalization of guidelines and procedures for arranging and managing private investment in the provision of public services. including negotiating criteria and guidelines for reviewing proposals and monitoring contract compliance.		
Output 2.3. Enhanced institutional capacity	Completed organizational and management assessment of BUMN. including proposed action programs to strengthen BUMN.	Terms of reference submitted to DG/SOE but implementation delayed by DG restructuring.	
	Design and implementation of a BUMN training program.	Training needs assessment completed. Financial model developed and training sessions for DG/SOE personnel given. Design of broader training program/curriculum ongoing.	

[illegible]	[illegible]	[illegible]	[illegible]
COMPONENT: MONEY MARKET			
Purpose. To increase the number of debt and equity securities and commodity contracts available to investors, increase the transparent trading volume of these instruments, and strengthen BI monetary management.	Increase supply of long-term investment capital.	Work on the commercial paper market instruments has the potential to help diversify the portfolio of institutional investors.	Issuance of CP has increased. Over 100 years firms have used the market. Regulations were drafted about one year ago, but have not been approved.
	Removal of fiscal, monetary, and regulatory disincentives for long-term capital investment.	The government is developing a commercial paper market, and efforts are underway to create medium- and longer term debt instruments with market-driven interest rates.	As of January 1, 1994, the provision on capital gain transactions was revoked to be replaced by a transactions tax which is regulated through a government regulation. This Government regulation is similar to the imposition of taxation on bank deposits.
	Revised reserve and liquidity requirement of Bank Indonesia.		
	Wider BI issuance of notes and bills.	SBIs will go from seven days to one year in maturity, and all maturities are available. BI is planning a study of medium and longer-term debt issues and the possibility of the MOF issuing treasury securities to establish reference rates and a yield curve, and also for monetary control purposes.	
	Creation of BI national credit file.	BI has established a national credit file that all banks contribute to and receive information from. This information is on companies and people who have bad loans outstanding at commercial banks.	
	Developed BI nationwide automated check clearing system.	First stage is complete. A pilot project in November-December 1992 linked 20 banks to BI. 120 banks are now linked and the system should go up soon.	BI is currently working to build an Electronic Funds Transfer System.
	Improved trading capability and structure of money markets.	Promotional campaigns are being carried out to increase investor interest in securities. Work is proceeding on the establishment of mutual funds.	BI designated primary dealers for the SBI markets.

[illegible]	[illegible]	[illegible]	[illegible]
COMPONENT: MONEY MARKET (continued)			
	Enhanced institutional capacity.	A long-term advisor is to train BI staff in deposit insurance systems, and credit rating & information services.	Several conferences were held for BI on: • Credit Rating Activities • Monetary management • Central Bank issues
Purpose. To increase the number of debt and equity securities and commodity contracts available to investors, increase the transparent trading volume of these instruments, and strengthen BI monetary management.	General progress to achieve the component purpose.	Established structure for the instrument, market, and regulation of the market by BI for the Commercial Paper project.	
		BI has recruited 22 primary dealers who will establish a secondary market for SBIs when BI eliminates its daily auctions (moving from COR to SOR). BI is running both systems in parallel for now, to reduce interest rate volatility.	BI has moved from the COR to SOR for the weekly SBI auction.
		BI, in concert with the MOF, BAPEPAM, and BAPPENAS is establishing a credit rating and information service firm. Service should be established within six months. A major conference on credit rating was held in Bali in July 1993.	Pefindo, a credit rating agency, was established in December 1993.

APPENDIX C: DOCUMENTS USED

USAID, (1988) Project Paper, Indonesia Financial Markets (497-0360)
---------, (1995) Country Program Strategy, 1995-2000
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--------------, (1994b) Indonesia Stability, Growth And Equity In Repelita VI (May 31)

LIST OF PEOPLE INTERVIEWED:

APPENDIX D

FMP Consultants:

Mark Camstra:	Resident A.I.D. Advisor (Price Waterhouse) - Privatization
Ted Burns:	Resident A.I.D. Advisor (Price Waterhouse) - Privatization
David Whitehead:	Resident A.I.D. Advisor (Deloite & Tousche) - Money Markets
John Evans:	Resident A.I.D. Advisor - Capital Markets

U.S.A.I.D:

Jerry Barth:	Office of Private Enterprise Development
Lanna Lubis:	Office of Private Enterprise Development
Robert Aten:	Economic Policy Support Office

BAPEPAM:

Barcelius Ruru:	Chairman
I Nyoman Tjager:	Head, Legal Bureau
IPG Ary Suta:	Head, Corporate Finance Bureau
Herwidayatmo S. P.:	Head, Stock Exchange Development Division

Ministry Of Finance:

Bambang Subianto:	Director General of Financial Institutions
Martiono Hadianto:	Director General of State-owned Enterprises
Adhi Paryono:	Directorate General of Financial Institutions, Directorate Banking & Finance Company

Jakarta Stock Exchange (BEJ):

Hasan Zein Mahmud:	President Director
Achmad Daniri:	Director
Kris Yarismal:	Research Division

Private Sector Firms:

Eugene Galbraith:	President Director, HG Asia Indonesia
Arvind Parakh:	Senior Manager Finance, Indo-Rama Synthetics
Jahja Setiatmadja:	General Manager Finance & Teasury, Bank Central Asia
Wito Chandra:	Manager Treasury Operations, Bank Central Asia
L.G. Rompas:	President Director, P.T. Inter Pacific Securities

Economists:

Alex Korns:	Advisor, Economics Statistics, Central Bureau of Statistics
Bill Wallace:	Development Studies Project
Mari Pangestu:	Central for Strategic and International Studies
James Hanson:	Economist, The World Bank

KDEI:

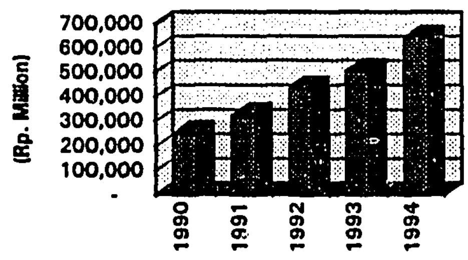
Cyril Noerhadi:	President Director

Bank Indonesia:

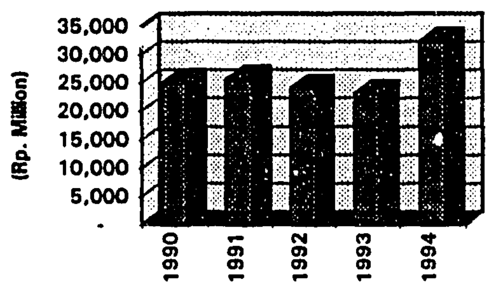
C. Harinowo:	Director, Money Market and Clearing Department

**PERFORMANCE OF THE COMPANIES LISTED SINCE 1990
(EXCL. BANKING SECTOR)**

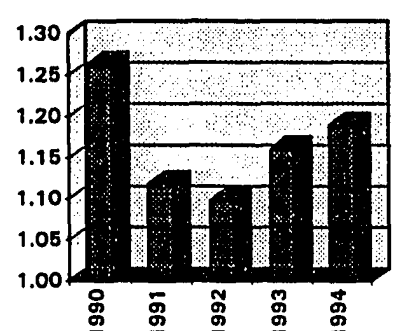
Average Total Assets



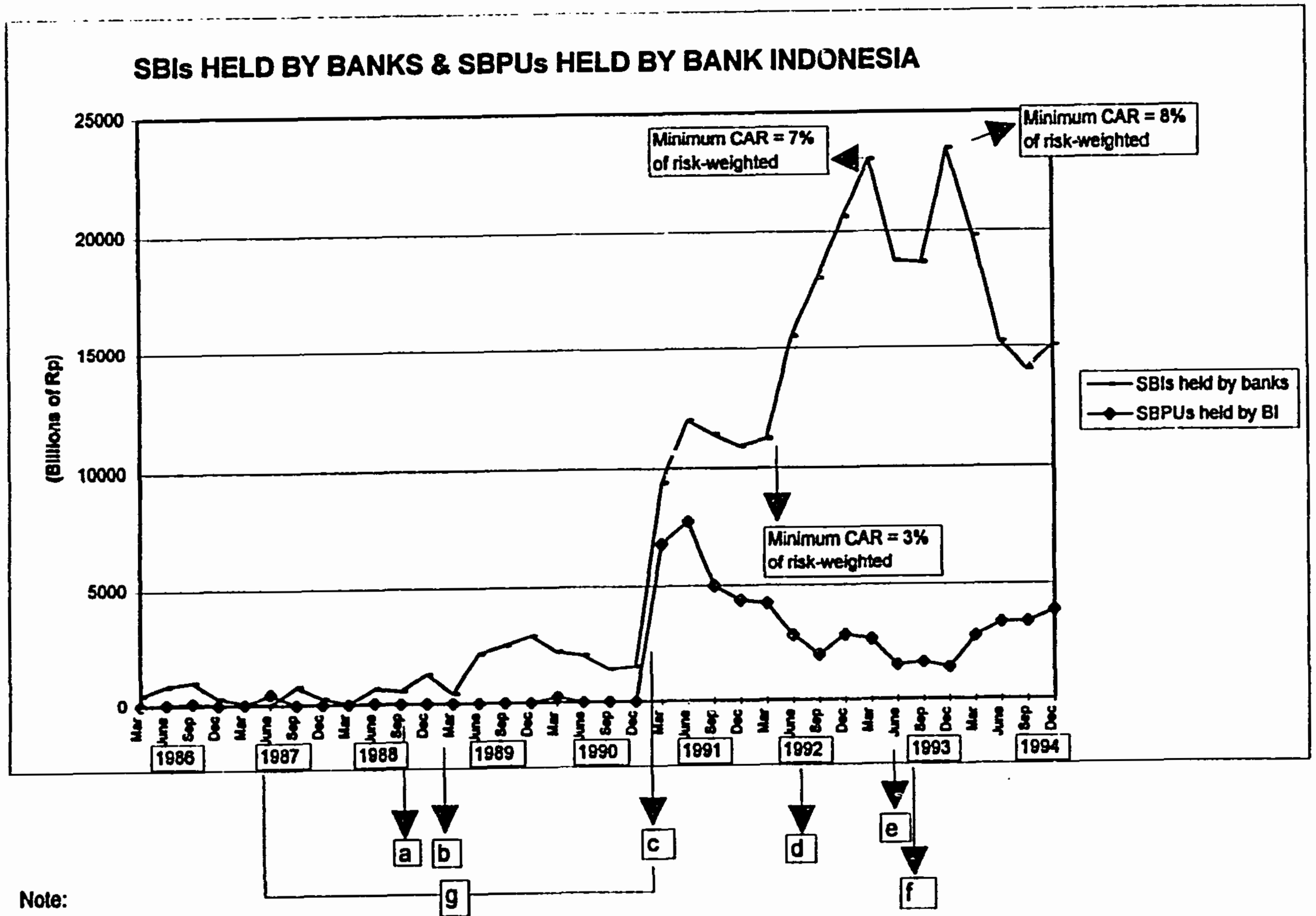
Average Net Income



Average D/E Ratio



Source: Jakarta Stock Exchange



Note:

a October Package 1988 (Pakto)

b March Package 1989 (Pakmar)

c February 1991 Package (Pakfeb)

d Promulgation of new banking law

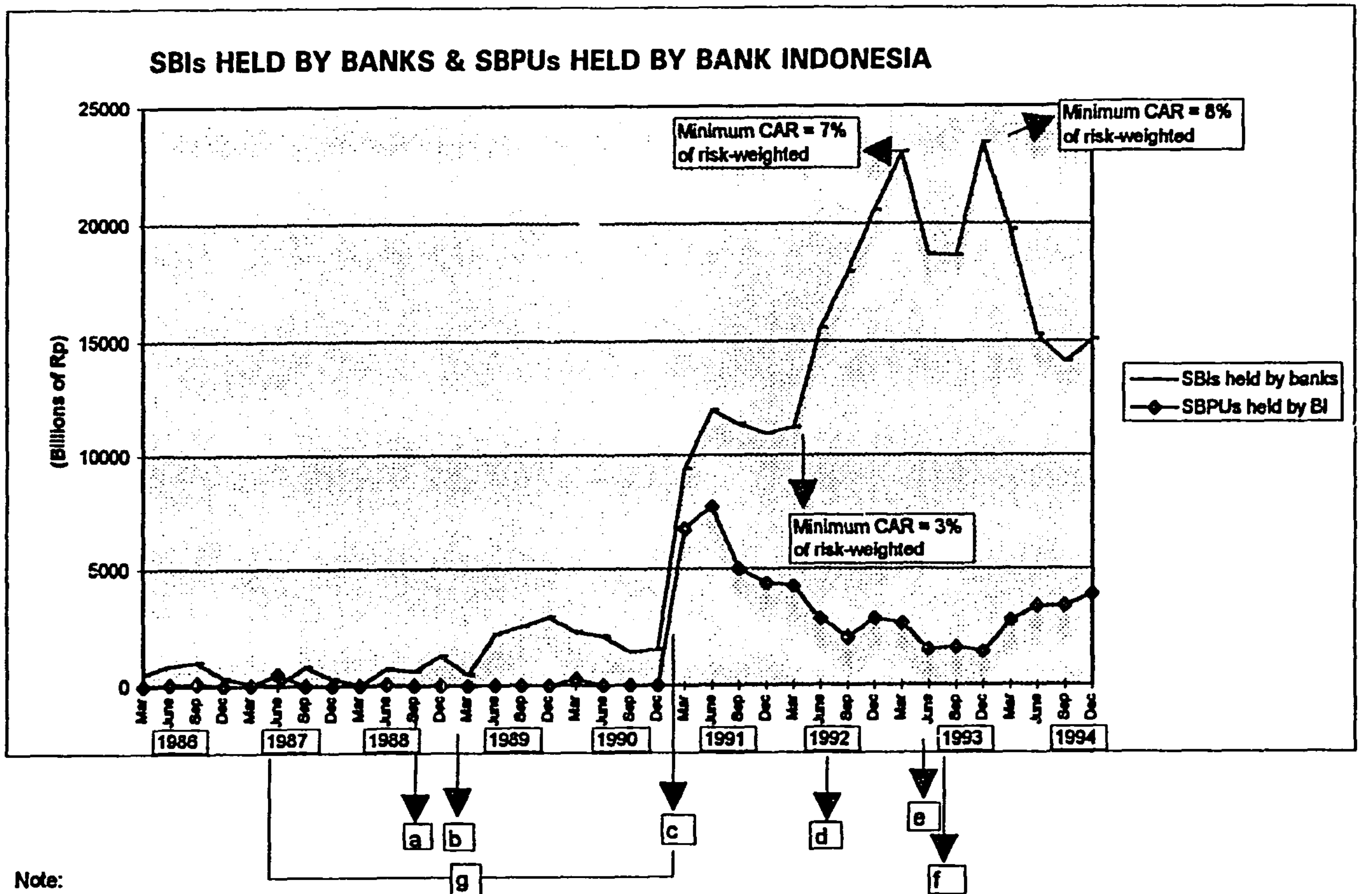
e May 1993: legal lending limits were nominally strengthened

f SBI auctioned system was changed from COR to SOR

g Sumarlin Shocks (June'87 and Feb'91)

MARKET ACTIVITY, 1977 - May 12 , 1995

Year Month	End of Period US $ Rate	Total Trading Volume	Total Trading Value (Rp)	Total Trading Freq.	Average Daily Trading Volume	Average Daily Trading Value (Rp)	Average Daily Trading Freq.	Trading Days	Composite Index	Market Capitalization (Rp)	# Listed Companies	# Listed Shares
1977	421	14,577	153,100,000	n/a	149	1,562,245	n/a	98	98.000	2,730,000,000	1	260,260
1978	634	19,541	218,500,000	n/a	78	874,000	n/a	250	114.990	4,050,000,000	1	330,260
1979	632	119,310	1,333,500,000	n/a	479	5,355,422	n/a	249	110.030	23,930,000,000	4	7,058,116
1980	634	1,656,290	5,733,800,000	n/a	6,573	22,753,175	n/a	252	103.540	41,040,000,000	6	14,588,116
1981	643	2,889,547	7,650,200,000	n/a	11,376	30,118,898	n/a	254	100.260	48,600,000,000	8	19,788,128
1982	692	5,014,806	12,624,800,000	n/a	20,140	50,702,008	n/a	249	95.000	99,260,000,000	13	39,948,208
1983	994	3,507,748	10,104,400,000	n/a	14,031	40,417,600	n/a	250	85.620	102,660,000,000	23	48,005,208
1984	1,076	1,218,833	2,139,300,000	n/a	4,955	8,696,341	n/a	246	67.680	91,060,000,000	24	57,498,184
1985	1,125	1,886,601	3,206,500,000	n/a	7,732	13,141,393	n/a	244	66.530	89,330,000,000	24	57,827,872
1986	1,641	1,431,921	1,815,900,000	n/a	5,774	7,322,177	n/a	248	69.690	94,230,000,000	24	58,349,872
1987	1,650	2,523,374	5,184,000,000	n/a	10,258	21,073,171	n/a	246	82.580	100,095,203,732	24	58,569,311
1988	1,729	6,944,592	30,591,960,720	n/a	27,668	121,880,322	n/a	251	305.120	449,237,227,025	24	72,844,043
1989	1,800	95,791,539	964,272,000,000	n/a	387,820	3,903,935,223	n/a	247	399.690	4,309,444,178,950	56	432,839,874
1990	1,901	702,587,441	7,311,288,727,968	n/a	2,891,306	30,087,607,934	n/a	243	417.790	14,186,633,982,250	122	1,779,936,594
1991	1,994	1,007,920,460	5,778,248,697,009	n/a	4,113,961	23,584,688,559	n/a	245	247.390	16,435,891,904,650	139	3,729,481,279
1992	2,062	1,706,269,484	7,953,299,560,350	n/a	6,907,974	32,199,593,362	n/a	247	274.335	24,839,446,042,275	153	6,253,916,082
1993		3,844,031,699	19,086,237,219,525	251,742	15,626,145	77,586,330,161	1,023	246	588.765	69,299,599,701,000	172	9,787,393,323
Jan	2,066	219,021,212	1,441,003,909,325	8,561	11,527,432	75,842,311,017	451	19	280.148	26,064,381,970,975	156	6,406,240,834
Feb	2,067	272,098,247	1,179,910,073,550	16,404	13,604,912	58,995,503,678	820	20	300.378	28,346,352,798,100	156	6,628,732,783
Mar	2,071	222,285,236	1,097,060,828,925	13,428	12,349,180	60,947,823,829	746	18	310.758	29,713,492,590,475	157	6,703,607,187
Apr	2,074	136,755,456	541,504,718,325	11,329	6,512,165	25,785,938,968	539	21	314.099	30,498,355,061,500	157	6,885,410,120
May	2,079	228,361,219	911,545,007,325	15,680	12,019,012	47,976,053,017	825	19	341.850	33,883,812,585,000	157	7,191,657,229
Jun	2,088	324,089,795	1,448,389,196,850	19,176	16,204,490	72,419,459,843	959	20	360.346	35,757,218,607,775	157	7,271,216,844
Jul	2,096	318,739,890	1,240,316,212,450	10,384	14,488,177	56,378,009,657	472	22	358.721	36,055,112,995,100	158	7,488,099,588
Aug	2,102	344,506,286	1,612,207,820,500	23,929	17,225,314	80,610,391,025	1,196	20	417.301	42,963,566,840,775	162	7,718,581,007
Sep	2,108	382,441,395	1,879,641,143,700	25,193	17,383,700	85,438,233,805	1,145	22	419.961	43,536,040,957,225	164	7,895,464,594
Oct	2,105	409,726,602	2,559,424,646,275	23,790	19,510,791	121,877,384,108	1,133	21	466.147	54,510,355,860,150	168	8,798,590,653
Nov	2,106	501,855,062	2,603,349,466,075	44,007	22,811,594	118,334,063,640	2,000	22	518.779	60,696,217,023,250	171	9,067,164,811
Dec	2,110	484,151,299	2,571,884,196,225	3?,861	22,006,877	116,903,827,101	1,812	22	588.765	69,299,599,701,000	172	9,787,393,323
Change '92-'93		125.29%	139.98%		126.20%	140.95%			114.62%	178.99%	12.42%	56.50%
1994		5,292,580,825	25,482,803,341,345	373,867	21,602,371	104,011,442,210	1,526	245	469.640	103,835,241,141,600	217	23,854,339,821
Jan	2,122	510,993,891	3,227,240,720,400	39,447	25,549,695	161,362,036,020	1,972	20	592.015	75,401,576,795,625	173	10,949,727,107
Feb	2,136	380,962,074	2,133,296,040,750	27,494	19,048,104	106,664,802,038	1,375	20	546.228	69,903,340,301,225	176	11,423,864,615
Mar	2,144	427,654,598	2,497,331,282,225	24,367	23,758,589	138,740,626,790	1,354	18	492.373	67,679,715,061,550	182	12,585,479,091
Apr	2,149	340,176,881	1,603,159,393,025	29,436	17,904,046	84,376,810,159	1,549	19	462.400	65,589,040,413,350	180	12,971,209,908
May	2,155	422,889,701	1,958,287,359,175	38,059	21,144,485	97,914,367,959	1,903	20	501.790	74,601,661,558,150	181	13,725,308,664
Jun	2,160	253,606,021	1,224,326,332,225	18,927	11,527,546	55,651,196,919	860	22	457.295	70,028,905,195,225	186	14,547,020,726
Jul	2,169	287,046,912	1,314,678,758,250	21,423	13,668,901	62,603,750,393	1,020	21	451.084	79,525,780,423,900	193	17,025,145,432
Aug	2,175	573,838,244	2,451,898,063,350	48,320	26,083,557	111,449,911,970	2,196	22	510.259	86,405,313,782,475	198	17,512,777,163
Sep	2,181	540,782,339	2,320,753,038,500	37,750	24,581,015	105,488,774,477	1,716	22	497.970	95,604,250,768,825	199	20,113,720,229
Oct	2,186	541,514,369	2,675,912,836,400	31,712	25,786,399	127,424,420,781	1,510	21	523.494	111,575,295,836,300	206	22,463,972,674
Nov	2,193	409,797,822	1,815,618,282,275	27,856	20,489,891	90,780,914,114	1,393	20	482.632	105,196,790,916,775	210	23,292,875,107
Dec	2,200	603,317,973	2,260,301,234,770	29,076	30,165,899	113,015,061,739	1,454	20	469.640	103,835,241,141,600	217	23,854,339,821
Change '93-'94		37.68%	33.51%	48.51%	38.25%	34.06%	49.12%		-20.23%	49.84%	26.16%	143.73%
1995		2,954,429,812	9,333,931,350,975	156,727	33,195,841	104,875,633,157	1,761	89	461.526	107,420,308,514,625	223	27,310,757,655
Jan	2,207	560,213,102	2,191,508,446,650	34,847	25,464,232	99,614,020,302	1,584	22	433.831	98,551,651,599,875	221	25,241,406,062
Feb	2,212	1,155,615,824	2,854,839,177,475	42,509	57,780,791	142,741,958,874	2,125	20	453.576	105,153,880,928,025	222	25,869,199,192
Mar	2,218	425,551,319	1,564,302,406,525	29,242	22,397,438	82,331,705,607	1,539	19	428.641	98,838,176,954,300	222	25,967,299,192
Apr	2,226	463,077,203	1,554,939,726,050	25,821	24,372,484	81,838,932,950	1,359	19	416.449	98,640,967,532,825	222	27,196,634,655
May 12	2,232	349,972,364	1,168,341,594,275	24,308	38,885,618	129,815,732,697	2,701	9	461.526	107,420,308,514,625	223	27,310,757,655



Note:

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