
SUMMARY OF FINANCIAL MARKETS IN INDONESIA: SECONDARY SOURCE SURVEY

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NOTE

This document was prepared by Arthur Young and summarizes existing literature describing the country. Secondary sources were obtained from the International Monetary Fund, the World Bank, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, the United Nations, and other relevant commercial sources.

INDONESIA

SUMMARY OF FINANCIAL MARKETS SURVEY

A. ENVIRONMENT

1. Stable political history:

- a) Indonesia has followed a constitutional parliamentary form of government since gaining independence from the Netherlands in 1949.
- b) The current government is stable, though the military plays a major role in maintaining this stability.
- c) The state is organized on the principle of Pancasila, or Five Principles. These principles are: belief in the one supreme God; belief in a just and civilized humanity; nationalism; democracy; and social justice. This philosophy shapes government policy on many issues, including labor issues.

2. Unstable economic history:

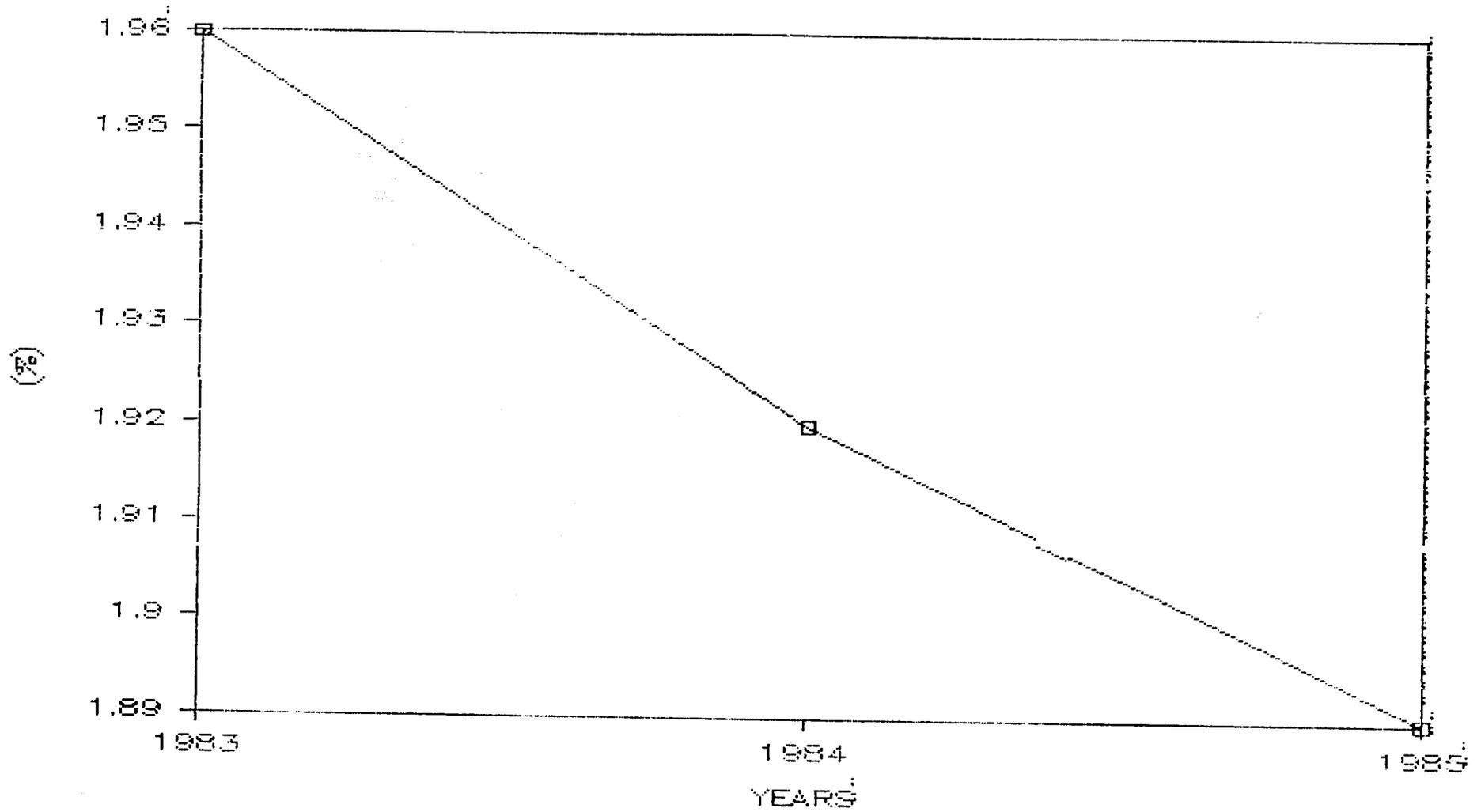
- a) Indonesia has had a turbulent economic history, with rampant inflation, a stagnant economy, and depleted foreign exchange reserves prior to 1966. The economy is moving towards stability. Inflation rates have been declining and foreign exchange reserves have been increasing.
- b) Indonesia's income, and economic stability, was given a boost during the 1970's by a rapidly growing oil income. Since then oil income has declined, and is projected to continue to decline through 1990. In order to maintain economic stability in the future, Indonesia must find alternate sources of income. To this end, GOI has taken steps to encourage foreign investment.

3. Social stability:

- a) Indonesia has a large, multi-ethnic population. Most Indonesians are of Malaysian origin with strains of Indian, Arab, and European mixtures.
- b) The largest archipelago in the world, Indonesia is comprised of five main islands (Java, Sumatra, Kalimantan, Sulawesi, and Irian Jaya), and over 13,000 other islands, of which approximately 6,000 are inhabited.

- c) The population distribution of Indonesia is extremely skewed; more than 63% of the population on Java alone.
 - d) About 365 languages and dialects are spoken in Indonesia, however the majority of Indonesians understand Bahasa Indonesia, the national language. English, Dutch, and Chinese are spoken in the business community.
 - e) The predominant religion in Indonesia is Islam.
4. International assistance:
- a) Intergovernmental Group on Indonesia (IGGI) - consortium of 14 active donor countries and international financial institutions including the World Bank, the Asian Development Bank, the Netherlands, the United States, and Japan.
 - b) Member of the Association of South East Asian Nations (ASEAN), which consists of five member states (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) with the common goal of economic cooperation.

POPULATION GROWTH RATE



B. ECONOMY

a) Recent economic trends

The last three years (1982 - 84) have been difficult for Indonesia. The economic growth rate has decreased from an average of 8% per year (1970 - 81) to just over 3% per year. In addition to the world recession of the early 1980s Indonesia has faced declining export prices (petroleum) and a severe drought during most of 1982.

In response to the current situation the government has instituted a number of measures aimed at countering the economic slowdown:

- adoption of an austere budget;
- reduction of subsidies on petro-products, food and fertilizers;
- devaluation of the rupiah by 28%;
- reduction of public investment projects;
- liberization of the financial sector;
- commitment towards deregulation of the private sector; and
- tax reforms.

b) The informal sector

The informal sector of the economy is the major source of employment in Indonesia. The core of the informal sector is composed of one-person and family enterprises (street stalls, pedicabs, newspaper sellers, cigarette butt collectors, self-employed artisans and skilled workers).

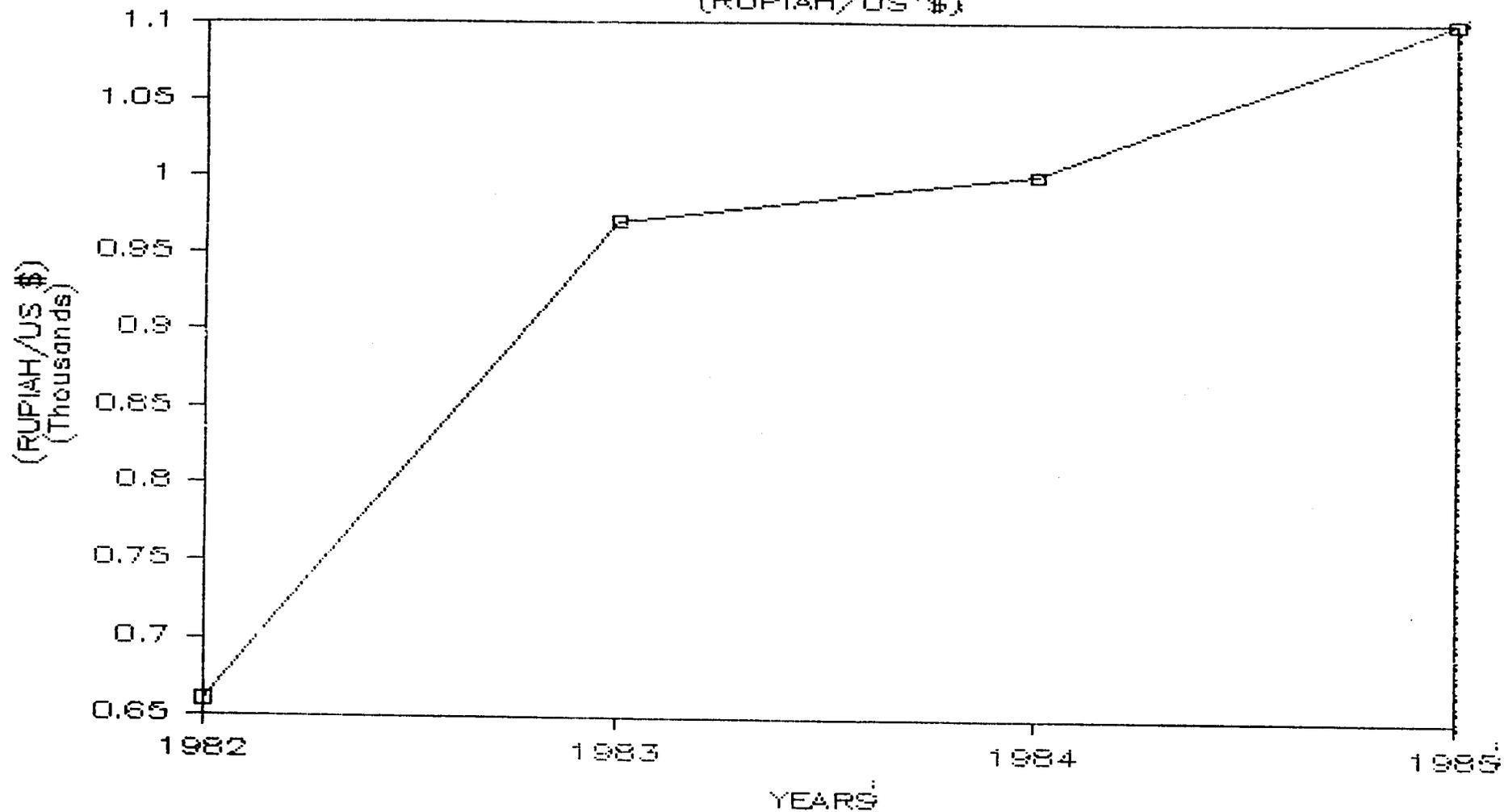
The estimated percents of the labor force employed in the various economic sectors are listed below:

<u>economic sector category</u>	<u>percentage share of informal sector in each category as compared to the total employment</u>
mining and quarrying	52.39
manufacturing	48.78
electricity	13.39
construction	32,15
trade and restaurants	90.18
transport, storage and communication	44.64
finance and related services	7.59
public services	31.72
others	31.61
unknown	73.38

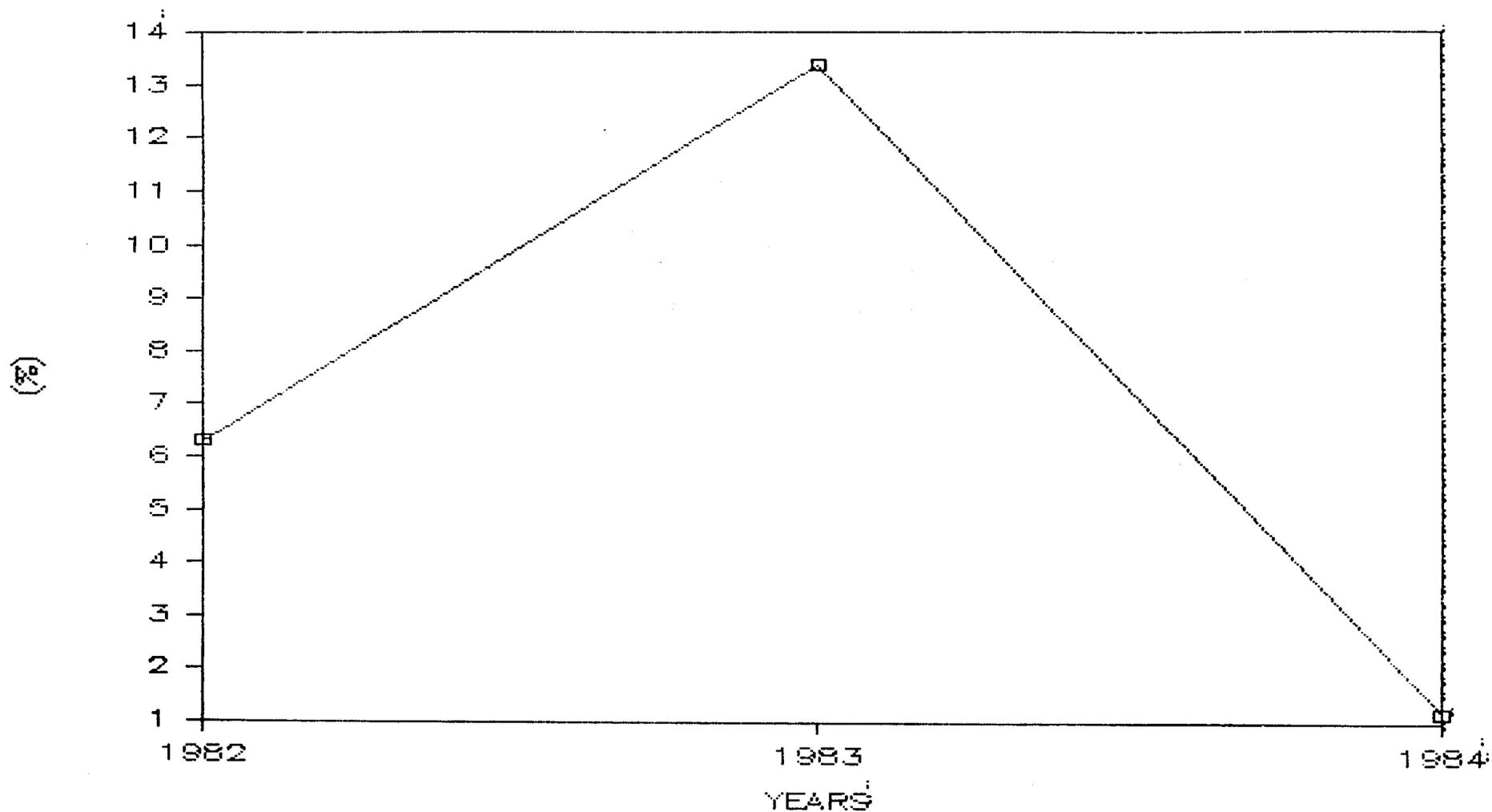
overall estimated total employed by the informal sector	53.84

MARKET EXCHANGE RATE

(RUPIAH/US \$)

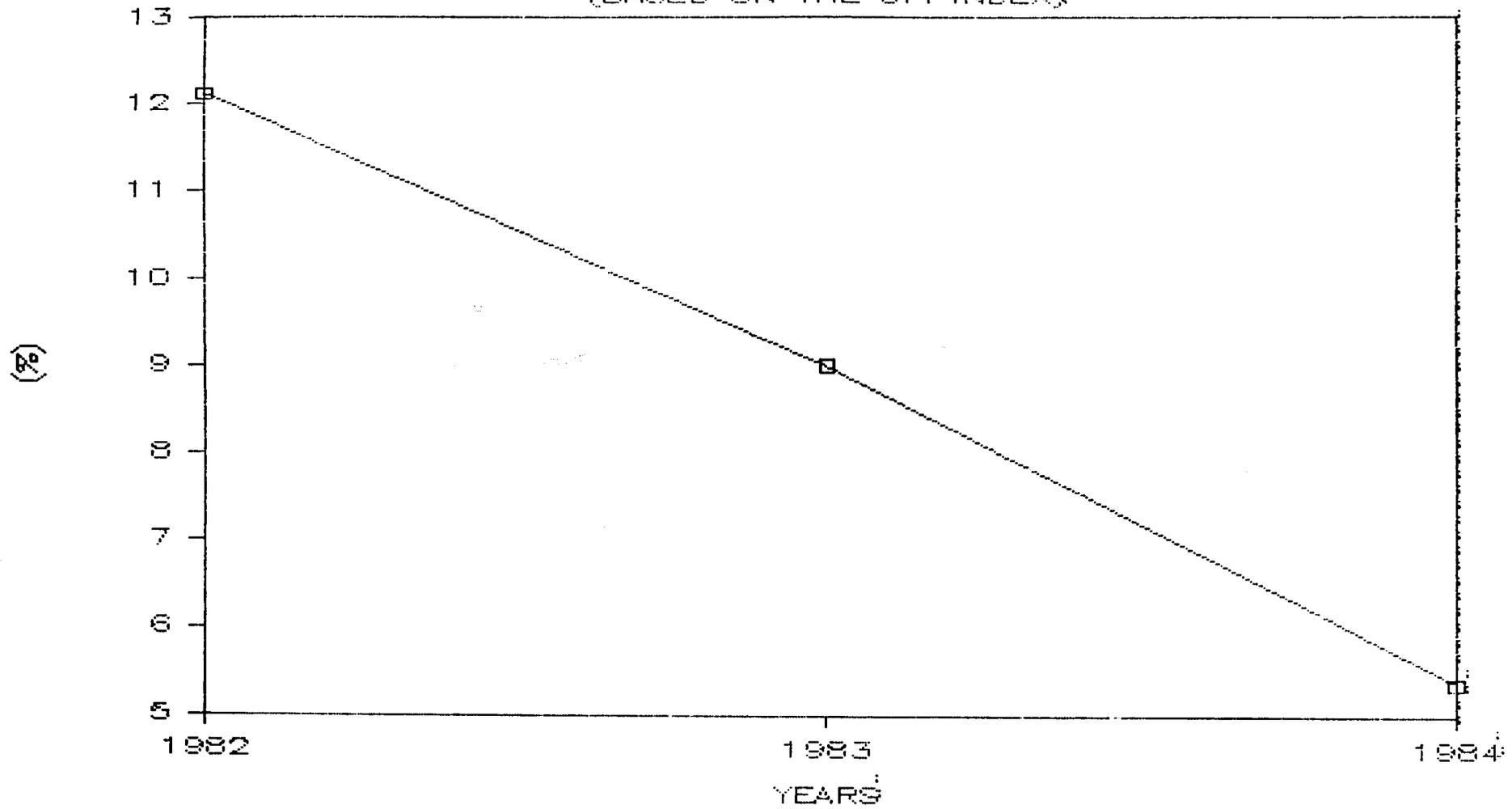


INDONESIA'S GROWTH OF MONEY SUPPLY



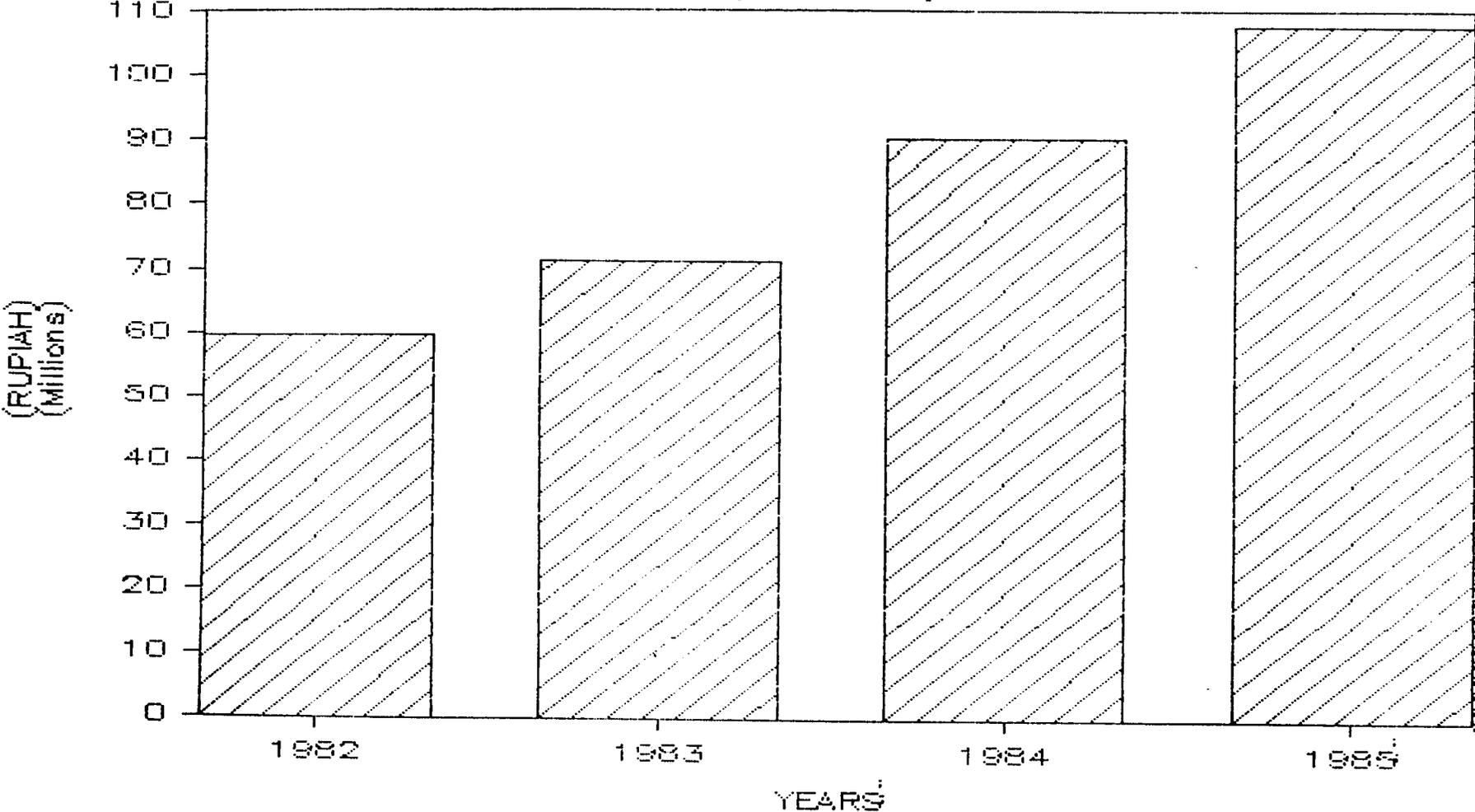
INDONESIA'S INFLATION RATE

(BASED ON THE CPI INDEX)

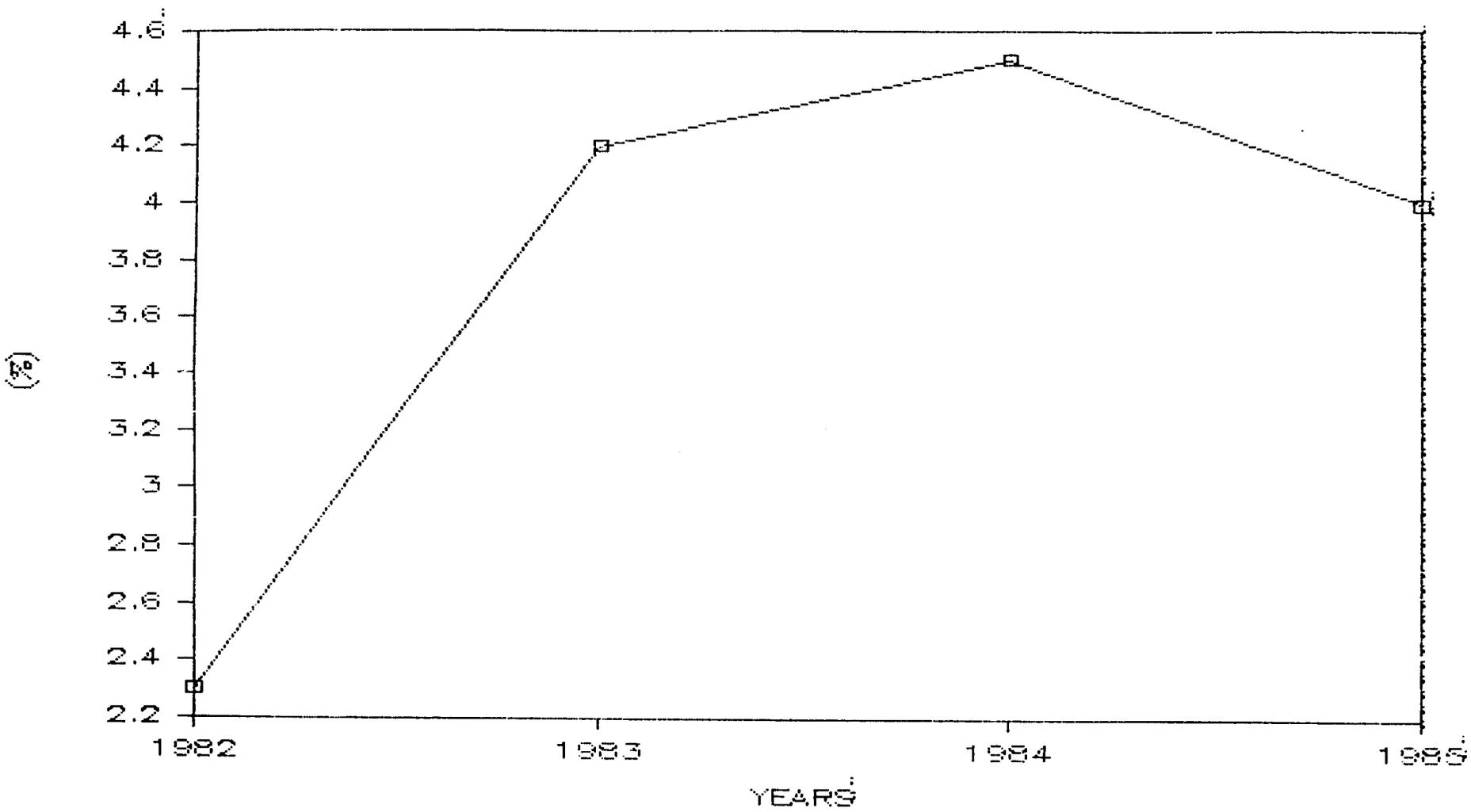


INDONESIA'S GROSS DOMESTIC PRODUCT

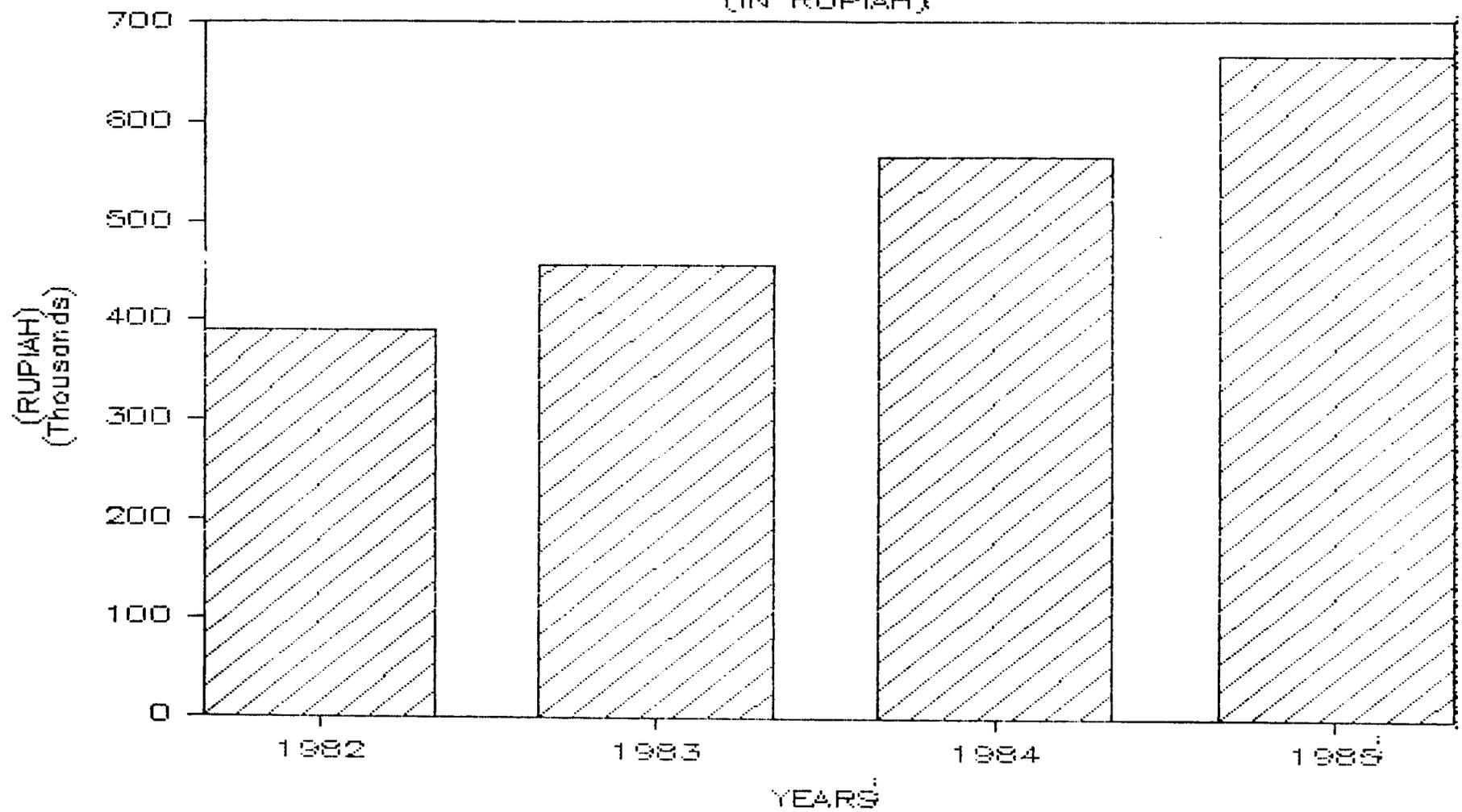
(IN RUPIAH)



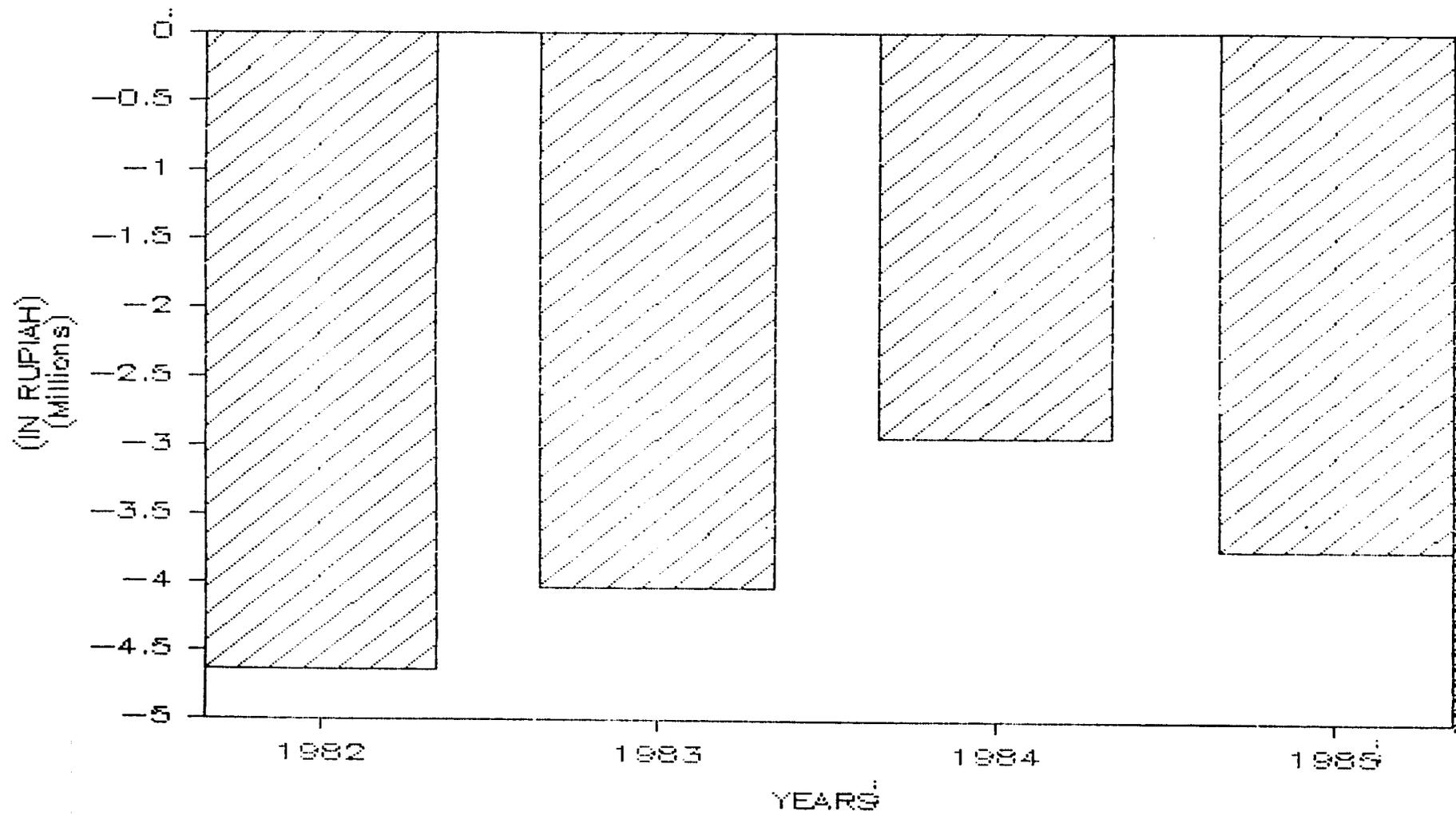
GROSS DOMESTIC PRODUCT GROWTH RATE



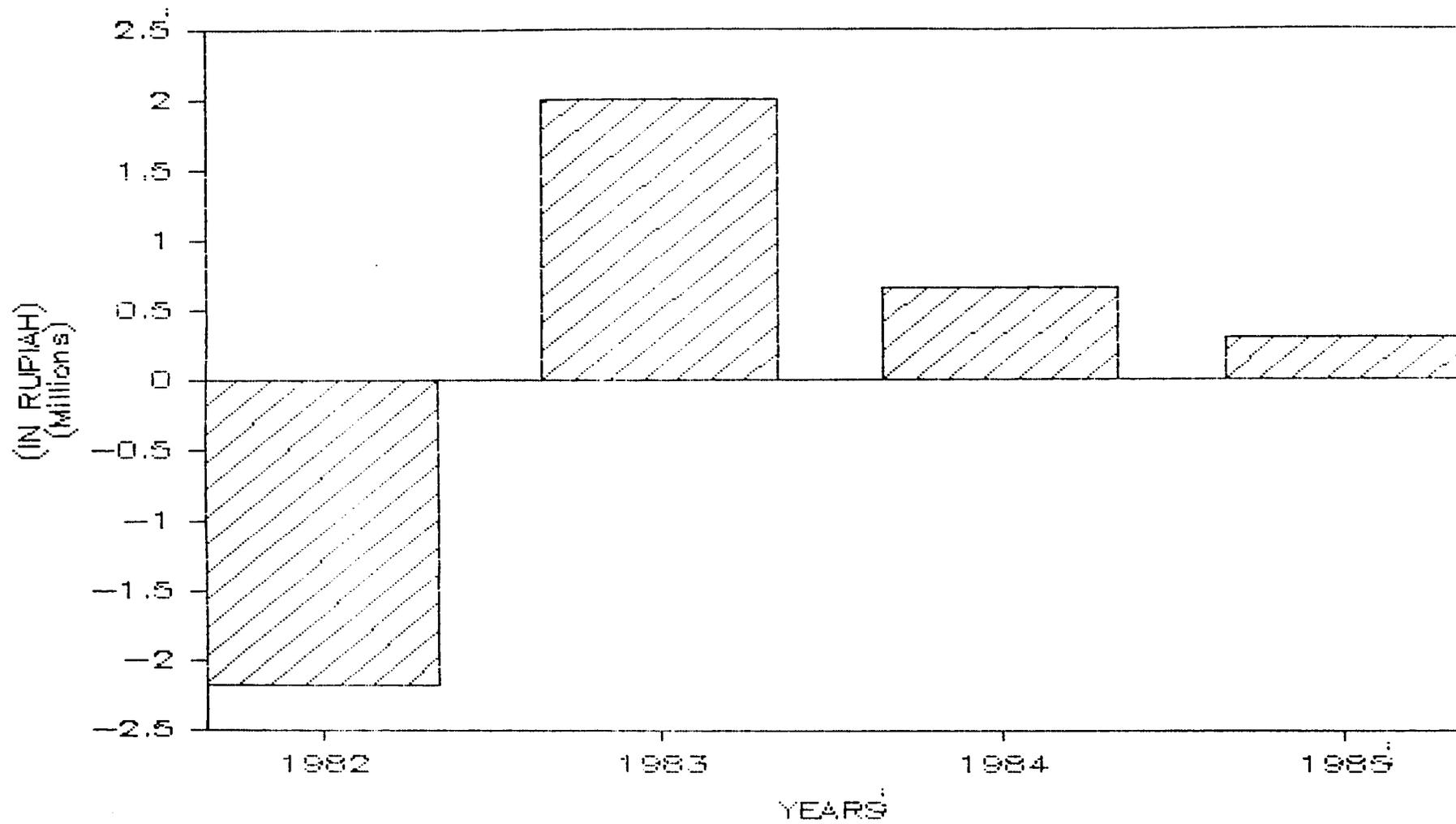
INDONESIA'S PER CAPITA GDP (IN RUPIAH)



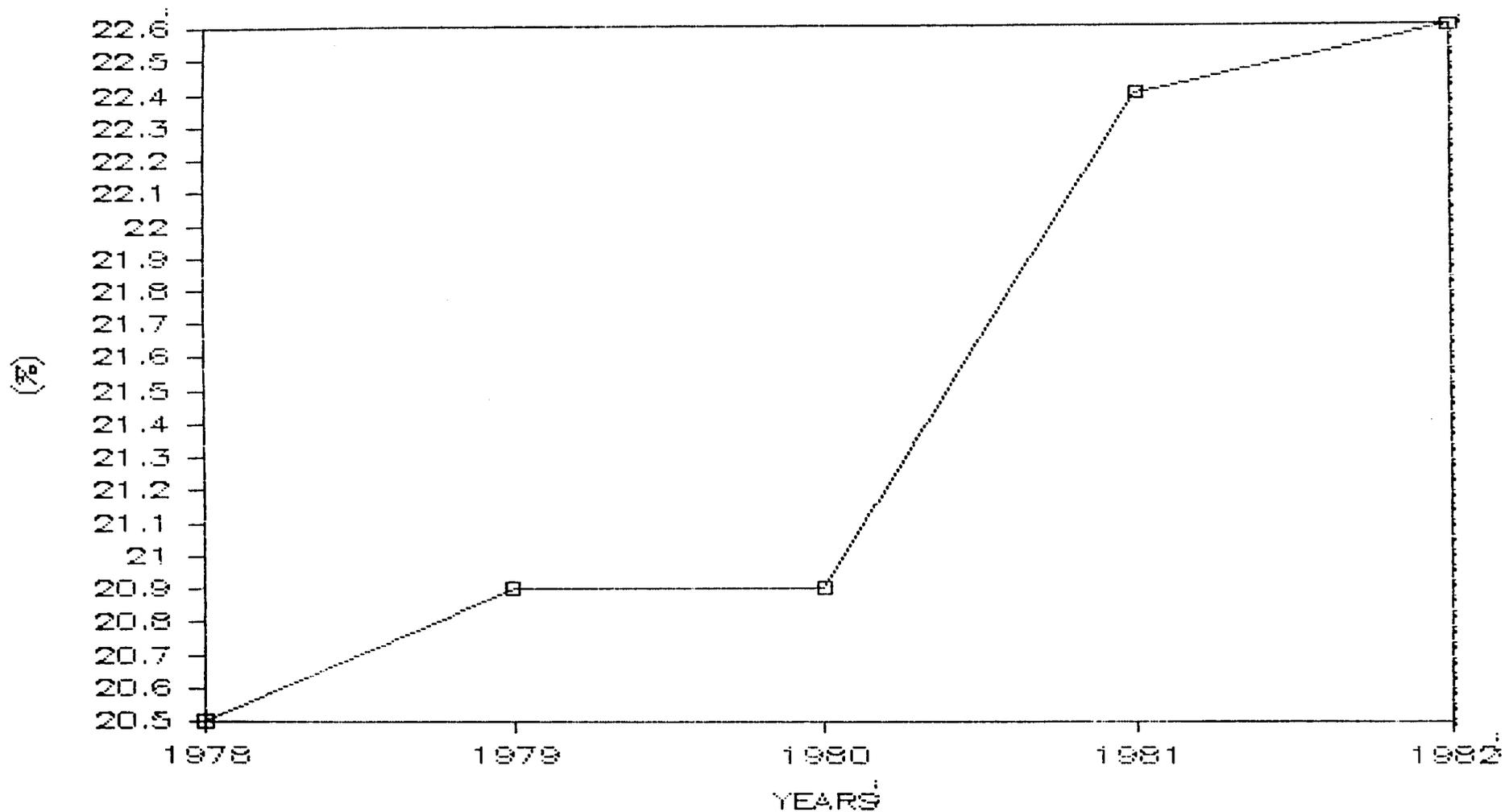
INDONESIA'S CURRENT ACCOUNT BALANCE



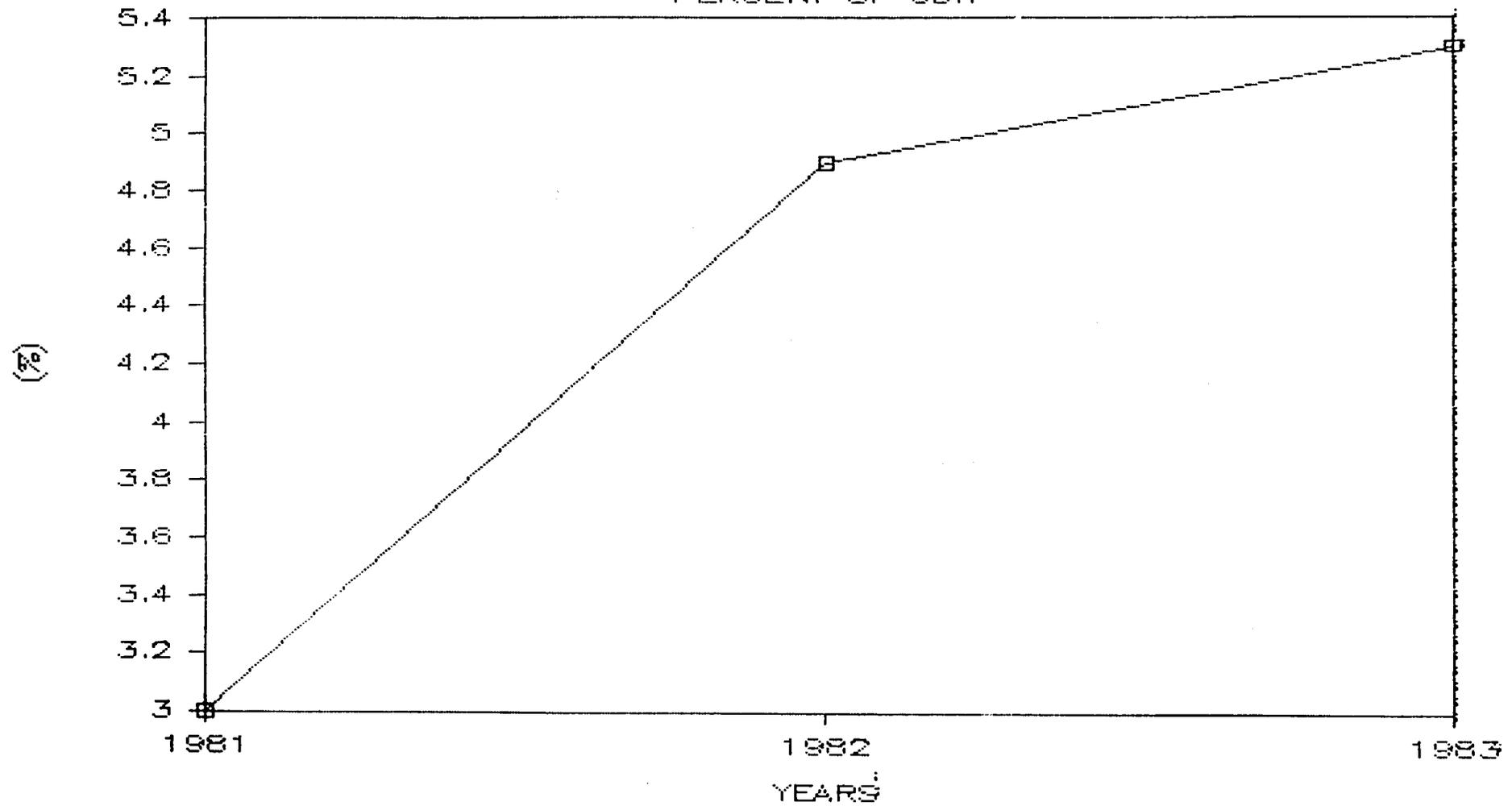
NATIONAL BALANCE OF PAYMENTS



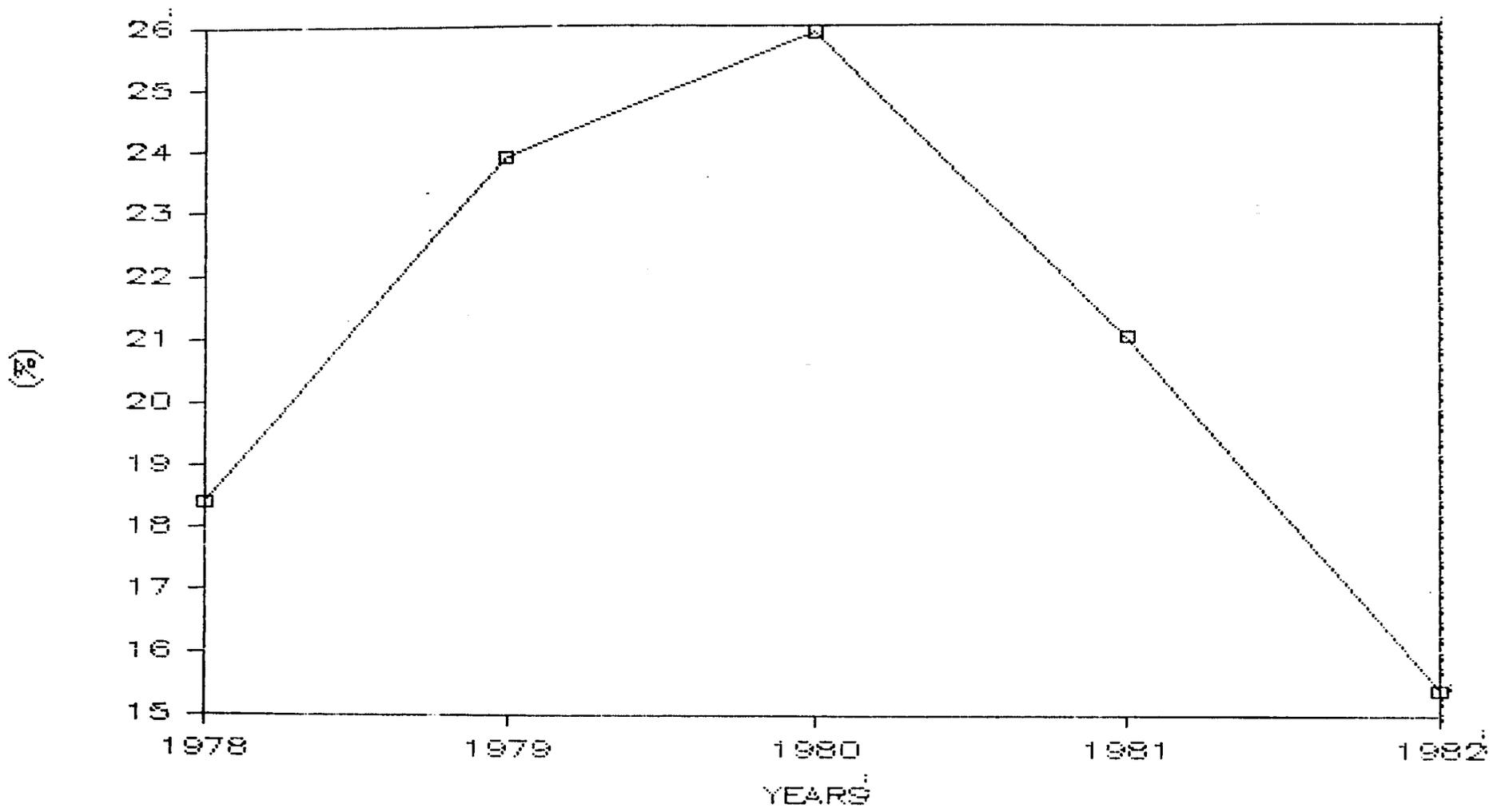
INDONESIA'S GDI AS A PERCENT OF GDP



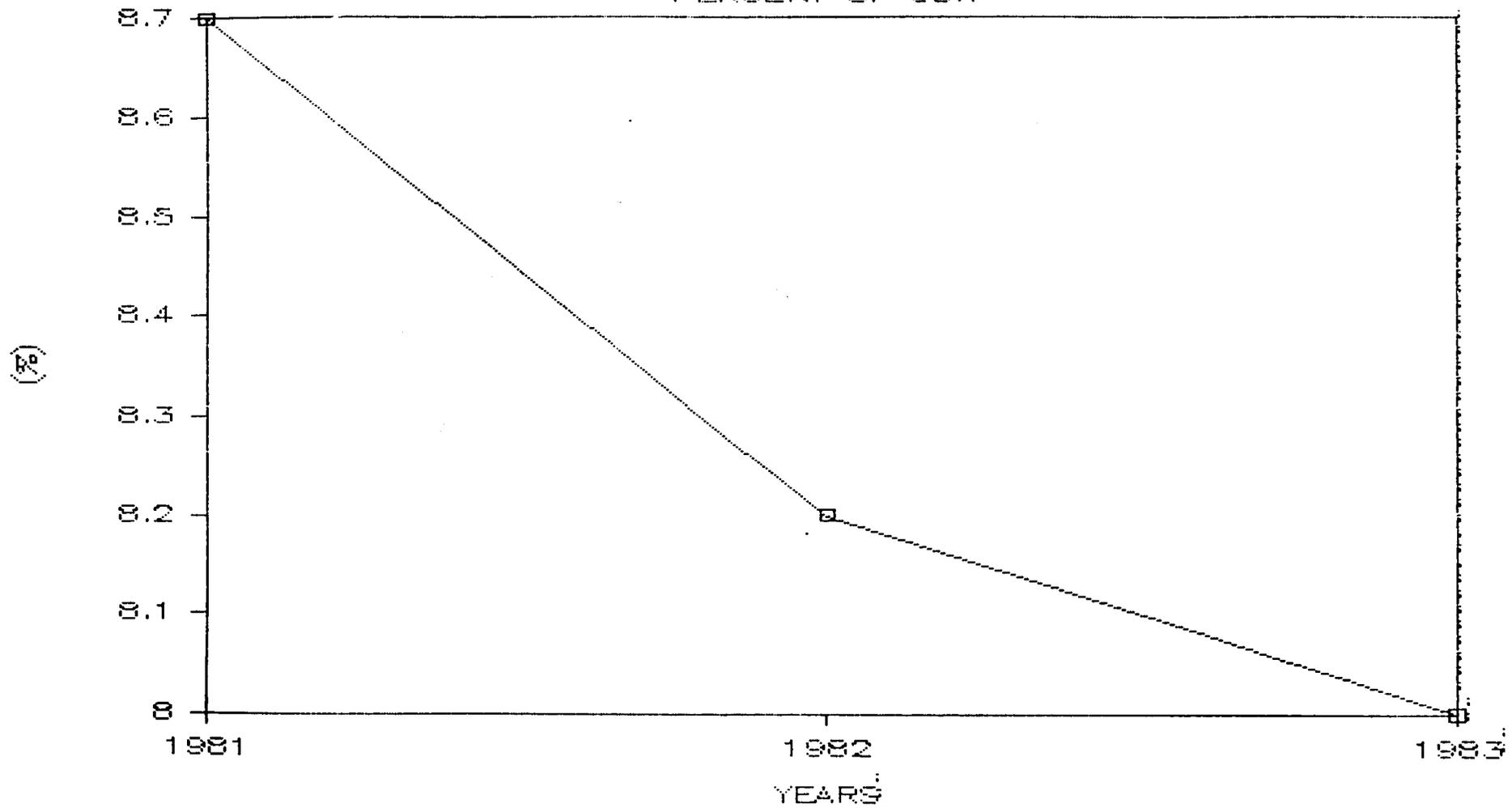
EXTERNAL BORROWING (NET) AS A PERCENT OF GDP



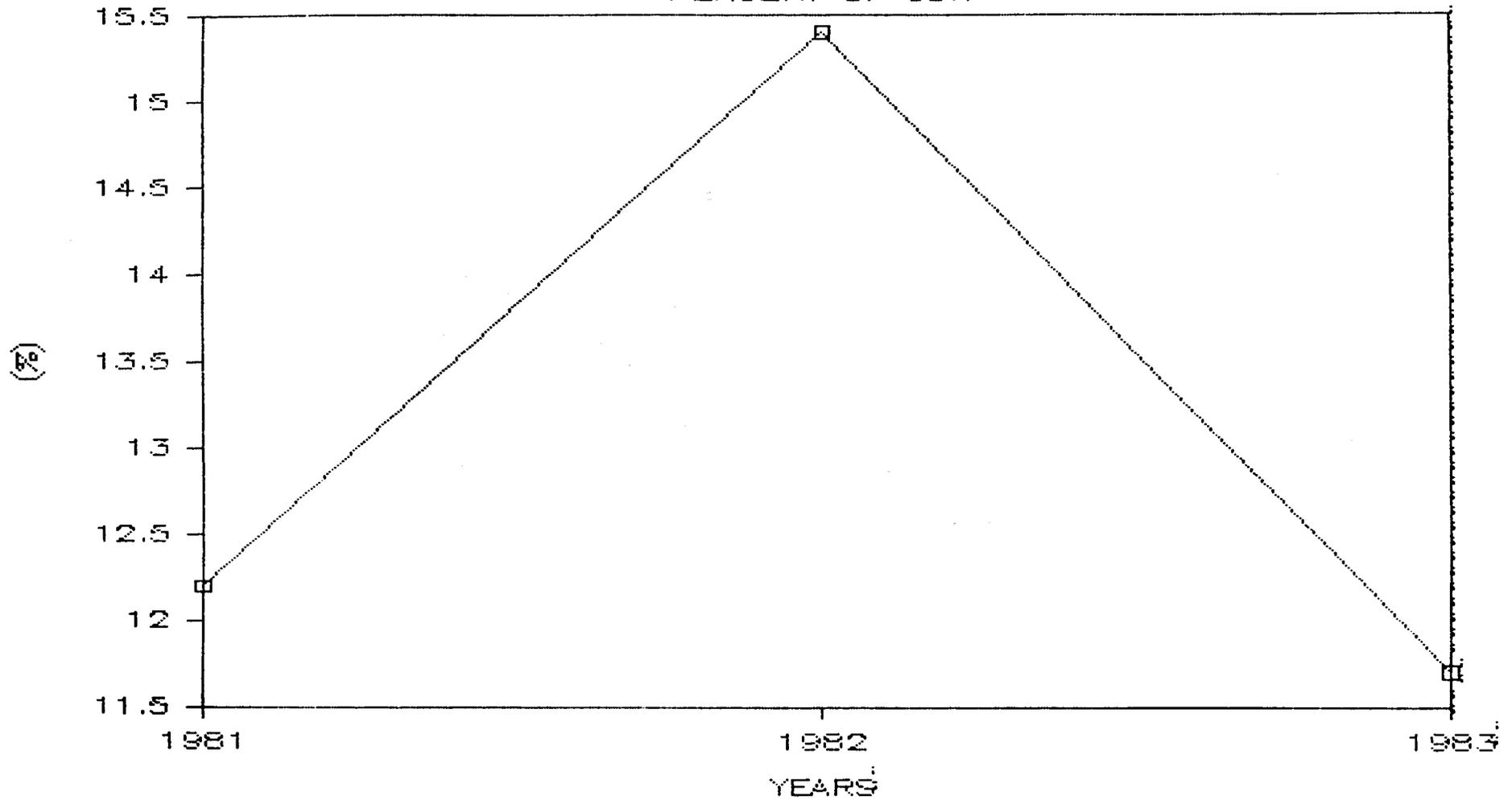
INDONESIA'S GNS AS A PERCENT OF GDP



PUBLIC SECTOR SAVINGS AS A PERCENT OF GDP



PUBLIC SECTOR INVESTMENT AS A PERCENT OF GDP



C. GOVERNMENT ATTITUDES

1. A large proportion of enterprises in Indonesia are government-owned. GOI is actively encouraging an increase in private ownership. Steps taken to date include requiring local equity participation in foreign investments and re-opening the Djakarta stock exchange.
2. In order to encourage the development of the motor vehicle assembly industry, GOI has prohibited the importation of most fully assembled vehicles.
3. In order to encourage foreign investment GOI has taken steps to simplify investment procedures. These include: simplified regulations (including work permits for foreigners); tax code revisions; improved customs procedures.
4. The recognizes the need to encourage the employment growth. Labor laws are also influenced by the philosophy of Pancasila, which requires government, labor, and employers to work harmoniously together to achieve the goals of national development, social justice, and an equitable share of economic development for all. Thus, after a 3-month trial period, employees may not be terminated without permission from the Department of Manpower. On the other hand, workers may not legally strike without government permission. This permission has been withheld in recent times.

D. REGULATORY CLIMATE

1. Foreign exchange control:
 - a) Bank Indonesia, the central bank, controls regulation and administration of the banking system and foreign exchange regulations. Any movement of funds into the country must be registered with Bank Indonesia.
 - b) New investment must be approved by the Badan Koordinasi Penanaman Modal (BKPM or the Investment Coordinating Board).
 - c) There are virtually no restrictions on the movement of funds into and out of Indonesia; all major currencies are fully convertible in Indonesia, and the IMF has declared the rupiah to be fully convertible currency.
2. The only industries entirely closed to foreign investment are refining, distributing, and marketing petroleum products.
3. The only goods under government price control are basic living commodities.
4. Import/Export:
 - a) Importers must be authorized by the Department of Trade; an import licence is required. Certain imports are restricted to approved importers; for example BULOG, a government agency has a monopoly over the importation of certain basic commodities.
 - b) Export licences are typically restricted to Indonesian nationals.
5. Land legislation in Indonesia is based on the Basic Agrarian Law of 1960, which grants nine different land rights. It is very difficult for foreign investors to purchase land in Indonesia; land rights are usually limited to right of building (20-30 years for industrial purposes; 10-20 years for residential purposes) or right of use (10 years).

E. FINANCIAL SYSTEM

The financial system of Indonesia is characterized by the Government's development policy and the massive influx of foreign exchange due to the oil-export revenues of the 1970s. In particular, the presence of the oil sector surplus removed any motivation from the financial sector to strengthen the domestic financial market.

The following list summarizes the prevailing condition of the financial system according to a recent ADB report:

- The government can no longer meet the long-term capital needs for infrastructural development and private sector investment.
- because of the low asset accumulation in the economy the supply of long-term funds is severely limited.
- As a consequence of the above, interest rates are very high which have resulted in a depressed capital market.
- because of Indonesia's liberal foreign exchange policy the country remains highly susceptible to the overseas financial conditions.

1. The banking system

a) Monetary system

- Central bank:
Bank Indonesia is the central bank of Indonesia. It performs the usual functions of a central bank such as controlling the liquidity of the banks by setting bank reserves requirements. Bank Indonesia implements monetary and fiscal policies through such measures as:
 - o development and support of the financial sector;
 - o promotion of consolidations of commercial banks; and
 - o support of various development financial institutions so as to advance social and economic development.

Bank Indonesia provides two types of credit:

- o liquidity credit to banks (these 3% loans were made to banks for use in long-term projects. However, Bank Indonesia is phasing these loans out.); and,
- o direct credit to parastatals.

Since 1983 the central bank has been instituting major changes from its previous policies. The new measures include:

- lifting of interest rate ceilings;
- lifting of ceilings on state bank credit;
- introduction of short-term notes (Central Bank Certificates, referred to as SBIs); and,
- introduction of a discount window for commercial banks as a means of monetary control.

- Foreign Exchange policy:

Foreign exchange transactions are totally free. Bank Indonesia provides commercial bank and non-bank financial institutions with the foreign exchange swap facility. By using this facility, financial institutions can protect themselves from the foreign exchange risk on overseas borrowing up to six months. The current cost of the swap facility is 4.75% per year for one month, 5.25% per year for three months and 5.75% per year for six months. The swap facility is available for US\$ only.

b) Banking institutions

The following list includes the different types of banks functioning in Indonesia:

Type of Bank	% of total banking assets	% of total loans
state commercial banks	77.0	78.4
private commercial banks	11.2	11.9
local development banks	3.2	3.5
foreign banks	8.6	6.5
savings banks	*	*

- state commercial banks:

There are five state commercial banks:

- o Bank Rakyat Indonesia;
- o Bank Bumi Daya ;
- o Bank Negara Indonesia;
- o Bank Ekspor-Impor Indonesia; and,
- o Bank Dagang Negara.

Their lending activities are mostly short-term although they do extend some long-term loans, backed up by the central

bank refinancing facilities. They are allowed to underwrite and deal in securities.

The state commercial banks dominate the banking sector because of their advantageous position. For instance:

- they have a well-developed national branch network.
- the government guarantees state bank deposits.
- they still have limited access to the central bank liquidity credit facility.
- insurance companies must keep 4.5% of their statutory reserve requirements in state banks.

- Private commercial banks:

There are 70 private commercial banks in Indonesia. 10 of these are designated as national private foreign exchange banks. All can underwrite and deal in securities. Most lending activities concentrate on short-term loans, from one month up to six months.

Besides the fact that these private banks are much smaller than their public counterparts, they face other barriers preventing them from expanding:

- they do not have ready access to credit from the central bank.
- the central bank rigidly controls the opening of new branches.

- Development banks:

There is one national development bank (Bapindo), 27 regional banks and one private bank. All are quite small except for Bapindo which is funded through the borrowings of the central bank, the government and other multi- and bilateral sources. Bapindo extends long-term investment loans and working capital loans to both large and small business operations.

- Savings banks:

There are three savings banks, one national (Bank Tabunga Negara) and two private. They act as collection centers for a government savings collection scheme (Tabanas/taska). Tabanas/taska funds are used to fund low-income housing. However, since these funds are limited the government provides most of the funds needed for low-income housing.

2. Non-banking financial institutions

a) Development type public institutions

These organizations provide mainly long-term loans to the private sector.

- PT Private Development Finance Company of Indonesia;

- PT Indonesia Development Finance Company;
- PT Bahana (a venture capital finance company).

b) Investment type public institutions

These nine institutions conduct merchant bank or investment bank type functions. Because of the lack of development in the security market these organizations' activities are mostly limited to the trading of promissory notes with their customers both for the source and use of their funds. No secondary market for promissory notes exists.

c) Public mortgage company

PT Papan Sejahtera provides mortgage financing for middle-income housing. It is funded through the government, IFC and several other insurance and finance companies.

d) Public investment trust fund

PT Danreksa was established by the government to assist in establishing equitable distribution of the ownership private enterprises. It invests in stocks listed on the stock exchange. It has maintained a policy of paying the investors a guaranteed 18% dividend. Currently, because of the depressed equity market the fund is facing major problems.

e) Leasing companies

There are 36 leasing companies in Indonesia, 23 joint-venture companies, one state owned company and 12 domestic private companies. They depend on borrowings from the banks and foreign sources to finance their activities.

f) Insurance companies

The insurance industry operates totally in the private sector with little regulatory control. As of 1982, there were 13 life insurance companies, 62 non-life insurance companies and 5 social insurance companies. Their investment funds totaled 675 billion rupiahs, having tripled in three years.

g) Pension funds

All pension funds are privately established. There are no data on their importance as a capital source.

3. Financial Markets

The financial markets are dominated by the indirect financing mechanism through credit extended by the parapublic financial institutions, whose sources are derived from the public sector surplus.

a) Money market

- the call money market:
The call money market consists of overnight call money, two-day notices and seven day deposits. The banks and the parapublic non-bank institutes are the only participants. All trading is carried out directly between participants. Interest rates are market determined.
- Interbank deposit market:
The interbank deposit market offers maturities of two weeks to 12 months. However, most deposits concentrate on maturities of up to three months. Transactions are mainly carried out through the buying and selling of promissory notes.

b) Capital market

- Jakarta Stock Exchange:
There are 23 companies currently listed on the Stock Exchange. 17 of the companies listed are foreign joint venture companies. The exchange is operated by the Capital Market Executive Agency which also acts as the regulatory body. The members of the exchange are:
 - PT Danareksa;
 - Bapindo;
 - the five state commercial banks;
 - the nine public investment companies; and
 - seven private brokers and dealers.

Requirements for listing share:

- companies must be registered in Indonesia as limited liability companies.
- they must have a paid in capital of 25 million rupahs .
- companies must have a record of profitability.
- companies must have publicly disclosed financial records.
- a minimum of 25 million rupahs representing more than 1,000 shares must be issued.

Three companies issued bonds in 1983. There is considerable uncertainty regarding future bond issues.

The secondary market is not very active, the average trading volume being 4,000 shares. This is a consequence of the high interest rates prevailing in the market along with the limited supply of shares.

There are no financial incentives for companies going public.

Tax treatment
Dividends and capital gains are taxable while
interest on time deposits are tax exempt.

F. TAX SYSTEM

1. In Indonesia taxes are imposed in three basic categories: State (national); regional; and customs and excise taxes.
2. Indonesia receives the largest share of tax revenue from direct taxes. In FY1980-81 direct tax revenues amounted to 82% of total tax revenue; however, over 85% of direct taxes were attributable to the oil corporate tax or oil revenue.
3. Income tax:
 - a) Corporation tax:
 - The general tax rate for all companies/corporations is 20% on taxable profit less than Rp. 25 million, 30% on taxable profit between Rp. 25 and 50 million, and 45% on taxable profit greater than Rp. 50 million.
 - All income, with the exception of certain time deposits, is aggregated for taxation in Indonesia. Capital gains are taxed as ordinary income, as is interest income; profits are taxed, whether or not they are distributed to shareholders.
 - Indonesia-domiciled enterprises are taxed on their worldwide income; there is no credit for foreign taxes paid, but a tax credit is issued equal to the tax paid had the income been earned in Indonesia.
 - Foreign enterprises operating through a permanent establishment in Indonesia are taxed on their Indonesian income only.
 - b) Individual income tax:
 - Individuals domiciled in Indonesia must pay income taxes on their worldwide income. Domicile does not depend on nationality or citizenship, but on residence in Indonesia. Nonresidents are taxed on income earned from Indonesian sources only.
 - Individual tax rates are graduated, ranging from 5 to 50%.
4. Tax incentives:
 - a) Inward investment - Tax incentives are granted to foreign investors investing in priority sectors and meeting government requirements. Incentives include exemption from corporation and dividend withholding taxes, allowances on certain investment expenditure, and exemption from duty on initial imports of equipment, machinery, and supplies.

G. ACCOUNTING

1. All business entities in Indonesia are required to keep records, however, the manner in which these records are maintained is not specified. Books, records, and a copy of annual balance sheets must be kept for 30 years, copies of correspondence for ten years.
2. A statutory audit is required of all:
 - * companies listed on the capital market,
 - * foreign banks,
 - * companies desiring certain tax reliefs/incentives,
 - * underwriters and stockbrokers.
3. Accounting standards - The accounting profession is regulated by the Indonesian Association of Accountants. Accounting principles are based on U.S. auditing standards.

- b) Capital investment - Accelerated depreciation may be claimed at the rate of 10% for permanent construction, and 25% for infrastructure and equipment. Also, an investment allowance of 20% is granted to existing enterprises which invest new capital in Indonesia.
 - c) Tax holidays of 2 to 6 years are granted to approved new ventures meeting government requirements.
5. Indonesia holds tax treaties with Belgium, Canada, France, Germany (West), The Netherlands, and the United Kingdom, In 1981 treaties with Japan, New Zealand, Singapore and the United States were in negotiation.

** NOTE: The data sources on taxation are current as of August, 1981. We have no information on subsequent changes to Indonesian tax law.

RECOMMENDATIONS OF A RECENT ADB REPORT

1. Banking system
 - banks should strengthen their resource mobilization capacity, including expanding their role as underwriters.
2. Long-term lending institutions
 - these institutions must offer services to their depositors so as to attract more long-term deposits, including increased liquidity for long-term instruments. The government should give full support to these institutions.
3. capital market
 - more companies should be listed on the exchange.
 - the investing public should be educated on the capital market activities.
 - the government should consider some deregulation of the investment licencing system.
 - the government should consider offering securities for some of the parastatals.
 - foreigners should be allowed to buy shares on the stock exchange.