REFORMS OF STATE-OWNED ENTERPRISES IN INDONESIA: RESTRUCTURING AND PRIVATIZATION

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Pada dasarnya dalam reformasi BUMN, kebijakan restrukturisasi mencakup reorganisasi BUMN, penjualan aset pemerintah, dan mentransfer konsep manajemen swasta ke dalam manajemen publik. Sementara privatisasi mencakup tiga cara dasar yaitu mentranfer kepemilikan pemerintah baik sebagian dan seluruhnya kepada sektor swasta, deregulasi ekonomi terutama terhadap kondisi monopoli serta privatisasi dengan menyingkirkan hambatan dalam perekonomian yang bertujuan mempermudah pihak swasta masuk dalam bisnis BUMN serta pemakaian manajemen swasta ke dalam manajemen publik. Perbedaan restrukturisasi dan privatisasi menjadi tidak jelas.

1. INTRODUCTION

1.1. The Rational of State-Owned Enterprises

Te rationale of state-owned enterprises (SOEs) in Indonesia is based on Article 33 of the Republic's constitution which mandates that 'branches of production important for the State and of dominating interest to the livelihood of the masses of the people have to be controlled by the State.'' This is usually interpreted as stating that economic activities which concern the daily life of the people should be controlled by the government through state enterprises. A long-standing major debate has been concerned with whether control in this context means "belonging to" or "supervised by " the government. There is likely to be a tendency to shift from the interpretation to the latter. The shift will affect government policy on SOEs.

The number of SOEs grew during the Sukarno government through the nationalization of foreign companies (mostly Dutch). SOEs's organization was a Perusahaan Negara or the PNs (Perusahaan Negara). Their performance poorly because of a combination of deteoriting economic condition, mismanagement and political instability.

1.2. The Objectives of State-Owned Enterprises

The objectives of SOEs are to act as an agent of development, contribute to state revenues, provision of basic goods and services for general public, pioneer activities which promote or complement private sector development, and generate income and profits.[1] There is additional distribution objectives for SOEs related to political and other reasons. Additional objectives is contributing part of their profits to the

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1. *As stated in Government Regulation no. 3, 1983.*

development of the weak economic sector and cooperative. The existing SOEs are required to contribute 1-5% of their profits to finance the development of these sectors in terms of improving managerial skills, technical assistance, provision of working capital including raw material, marketing assistance and providing bank guarantees to cover loan. Many have interpreted this policy as an added burden to SOEs.

1.3. Meaning of Restructuring and Privatization

There is no clear cut official definition of restructuring. The Indonesian government undertook a restructuring policy in 1960 when the previous forms of SOEs were reorganized into one form, known as PN (Perusahaan Negara). In 1969, in turn, the PN was divided into three forms of SOEs. In this sense, restructuring took the form of re-arranging or re-organizing the form of SOEs. During the last decade the government has been seeking to restructure the economy by opening up business activities to market control rather than government intervention. Dhakidae, Bertens and Parera (1992, 393) argue that restructuring covers two fundamental items; (1) object, that is the existing structure;and (2) activities, that is a process of adjustment. Restructuring, accordingly, is an effort to rearrange or to adjust the existing structure, organization or formation.

In the recent Indonesian SOEs reforms, restructuring policy consisted of a set strategies. It covered reorganizations of the SOEs, divesture or selling of government assets, and the transfer of private sector management concept into public enterprise management. It means that the distinction between restructuring and privatization become blurred. [2]

The word "privatization" itself has been used with many different meanings. One view of privatization is that a transfer of ownership from the public to the private sectors. Others claim that privatizations does not necessitate the sale of government assets, but rather accommodates private management into the public sectors. While the first interpretation may be somewhat narrow, and the second, broader meaning, reflects the need for structural adjustment not only internally within companies but also the government, for example, through deregulation and debureaucratization measures, which can to a great extent influence the nature of SOEs.

Privatization of SOEs may take place in three basic ways: (1) by transferring government ownership (fully or partially) to the private sectors; (2) by deregulation of economies. This is concerned with the relaxation of regulation and statutory monopoly power; (3) by privatization in terms of liberalization, which refers to relaxing the restraints of newcomers in the economy by allowing private entry into business of SOEs and allowing private sectors yardsticks to be utilized in the management of public sectors.

The objectives of this paper is to look overall profile of SOEs, reforms of SOEs since New Order, and finally to identify the problems related to the SOEs's performance.

2. *from I Ketut T. Mardjana, CSIS, 1993*

2. ROFILE OF STATE-OWNED ENTERPRISES

Presently, out of the 212 SOEs owned by the central government.[3] The central government-owned enterprises 2 *perjans*, 33 *perums*, and 150 *perseros*. The *perseros* include 116 of which the government had sole ownership and 34 joint ventures. The state sector also includes the five state commercial banks, the national development and the savings bank.

2.1. *Growth, Budgetary Impact and Performance*

Several growth indicators of SOEs show that the assets, sales and profits of SOEs increased substantially in the oil boom years (table1)

Table1 *Indicators of growth of state-owned Enterprises*

INDICATORS	1978/79 (Rp billion)	1983/84 (Rp billion)	1988/89 (Rp billion)	1989/90 (Rp billion)	Growth* 1978/79 1989/90
Total Assets (cumulative)	14,774	72,661	125,239	138,016	23%
Sales	2,077	20,873	35,710	40,913	31%
Profits before tax	200	2,271	3,297	4,742	33%
Assets/GDP @ (%)	61%	94%	88%	83%	
Sales/GDP @ (%)	9%	27%	25%	25%	

* Compound growth p.a.
@ GDP for calendar year
Source: Attachment to President's National Day Speech, 16 August 1990 and Central Bureau of Statistics (unpublished) for GDP numbers

Sales as a percentage of GDP reached 27 per cent and declined sligthly after that. Due to government revenue constraints, after 1983/1984, the growth has slowed down. Sales grew faster than assets, indicating some measure of a better utilization of assets.

Government subsidies to SOEs through capital participation and loans have declined with the fall in oil revenues. Only strategic industries continue to receive capital participation from government (table2).

3. *There are SOEs owned by the regional government*

Table 2 *Government Capital Participation in State-Owned Enterprises 1987/1989 - 1989/1990 (Rp billion)*

Sectors	1978/79	1983/84	1988/89	1989/90	Growth 1978/9-1983/4	Growth 1983/4-1989/90
Agriculture	18.7	10.2	-	-	-11.4%	-
Industry	18.5	249.0	83.6	107.3	68.2%	-13.1%
Public Service	18.5	59.0	27.8	7.1	26.1%	-29.7%
Financial (non bank)	6.9	40.3	2.5	20.0	42.3%	-11.0%
Mining	0.2	121.9	-	-	260.6%	-
Trade	6.0	-	-	-	-	-
Banking	10.7	65.2	-	-	43.5%	-
Others*	49.0	46.1	11.1	6.4	-1.2%	-28.0%
TOTAL (Rupiah)	128.5	591.7	125.0	140.8	35.7%	-21.3%
TOTAL (US$million)	311.0	595.0	71.5	78.4	13.9%	-28.7%

* Government contribution to International Organization

Source: Attachment to the President's Speech, 16 August, 1990.

The figure shows the growth rate of 36% of capital participation by the government in the latter half of the oil boom years can be contrasted with the decline of 21% in the latter period. Some sectors have also stopped receiving subsidy. SOEs in the industrial sector continue to receive the highest amout of capital participation but at a lower rate than before.

Contribution of SOEs to the budget in terms of taxes, dividends and other transfers, declined in the oil boom years. On the revenue side of the budget, SOEs contributions appear under domestic revenue as part of the income tax of limited liability companies and transfer of dividend/profits of SOEs which are classified as part of non-tax revenues. Improvement on tax collection (since 1983/1984) had caused increased contribution of limited liability SOEs taxation, rather than by improvement of performance of SOEs.

The net budgetary impact has become less negative (as percentage of GDP) due to the fall in capital participation of the goverment in SOEs. Since 1982, profitability has risen to about 5.2% per cent in 1989 compared with only 2.3 per cent in 1983.

The overall performance of the SOEs has not been encouraging. Contribution of 165 SOEs to government in 1995 is only Rp. 1.1 quintillion from total assets Rp. 320.1 quintillion (0.3 %). The return on investment of SOEs has remained low and is to be around 3.22 per cent in 1995. It means that their profit is low, compare to their huge assets (*Gatra*, 29 March 1997, p.80). Many assets are in idle capacity. The bulk of profits is concentrated in a few sectors, mainly banking and some of the SOEs in the industrial sectors. The current level of profits is still low compared with investment needs.

2.2. State-Owned Enterprises by Sectors

In terms of number of SOEs by sector, in 1986 the major sectors are industry with 54 enterprises, agriculture with 41 and finance with 32. Most of the joint ventures are in the industrial sectors. Unfortunately for value added, capital formation and profits, the lattest information is 1982 . From these figures it can be observed that in terms of value added, the industrial and finance sectors dominate. Whereas in terms of capital formation, the highest shares are for the electricity, gas and water, industry and agriculture sectors. Whereas the largest contributors to profits are the financial and industrial sectors.

2.3. Changing Share of Ownership of SOEs in the Industrial Sector

The share of government ownership in total manufacturing sector has fallen slightly from 28 percent in 1975 to 24.4 percent in 1985 . In terms of sectoral, there has been a shift from government to private ownership of basic needs such as food and textile. For the food, beverages and cement, despite the increase role of private sectors, the share of SOEs is still around one third. Furthermore, there has been an increase and dominance in government ownership of more capital intensive for strategic industries such as basic chemicals, basic metals, and non-electrical machinery.

3. REFORMS OF STATE-OWNED ENTERPRISES

3.1. New Order Until 1982 (Second Oil Price Shock)

The shift from the "Old Order" (President Sukarno) to the "New Order" (President Suharto) government brought about changes in policy direction. The economic policy was there was to be no bureaucratic interference in the economy and that a democratic economic system would begin. The review of government intervention, protection and regulation has led to an attempt to find a larger role for market mechanism.

Reform in the SOEs under Act No. 9/1969 dated 1st August, was characterized by restructuring of PN into three categories, *perjan, perum*, and *persero*. The *perjan* are the public service enterprises, such as the railways, attached to the government department and financed out of the national budget. The *perum* are the vital enterprises to general well-being, such as the state bus transportation company, state housing company and electricity and gas companies, which are expected to generate sufficient income to cover operating cost. The majority of the SOEs are *perseros*, a limited liability form in which the shares are owned wholly or partly by the Finance Ministry on behalf of the government. The government expected these SOEs to be profitable and to operate under same provision of private sectors. In practice, SOes faced the difficulties because the legitimacy of multiply objectives related to their role as "agent of development". It seems that this new division of activities shows a clear dividing line between SOEs which have social functions, commercial functions or are mixed between the two.

However, the policy of restructuring SOEs , experienced ebb and flow in its implementation. The increase in government revenue due to high oil prices from 1973-1982 had the effect of restoring the government's role in controlling the economy. It appears unlikely that there was any difference in government attitude to the three groups of SOEs. The Persero, which is terms of legal status should be profit-making and therefore enjoy discretion in policy decision-making, found that in practice, socio-political consideration could intervene. Conflict between legal principles and the socio-political practises resulted in latter prevailing.

During this time, budget allocations were continually increased because of the rise of national income from oil. Total investment in SOEs increases from US$42 billion in 1979 to US$75 billion in 1982.

3.2. From 1983 (after second oil price shocks) - 1996

As oil price began to fall, the increasing resource gap between government investment and saving is met by external borrowing since the government does not want to borrow domestically. The resource gap of SOEs indicates a significant deficit, 4.8% of GDP in the period of 1980-1983 and 2.8% in the 1986. The government has reduced the subsidy provided to SOEs in the form of capital participation through the budget and has recommended that SOEs turn to the commercial market for investment financing through borrowing and issuance of bonds. Part of government's external debt has been used by SOEs.

Only when oil prices dropped in 1986, the government's resolution resolve to increase the role of the private sector become a priority. By 1988, several government policy announcements have marked the beginning of privatization efforts.

3.2.1. Why Privatize

In 1989, the Indonesian Minister of Finance explained the critical problems faced by Indonesian SOEs were; (10 the weaknesses of financial structures; (2) lack of managerial capability; and (3) absence of efficient and productive methods, and lack managerial flexibility in the decision making process (*Kompas*, 7 October 1989).

Consequently, because of the inefficient of many SOEs combined with of government funding, present core government policies are designed to enhance the efficiency and productivity of SOEs management. The Approach used in this policy reform consists; (1) company restructuring; and (2) simplification of the decision making process.

Pressure for privatization is not only from internal but also from external pressure. External pressure come from primarily from multinational institution or bilateral agencies, such as IMF, the World Bank, and ISAID, in order to carry out development more rapidly. This pressure is carried through aid and loans to Indonesia. [4]

Privatization of SOEs has been occuring in Indonesia for some years. For example, the government has approved production/ profit sharing between Pertamina (the state oil company) and foreign companies, user pay charges on toll roads that are conducted by PT Jasa Marga (the state road enterprise)

4. *From I Ketut T. Marjana. CSIS. 1993*

and a private company has been allowed to build toll roads as well as to operate them jointly with PT Jasa Marga. There are joint operations involving PT Perikanan Samudra Besar (the state fisfery company) and PT Bali Raya (a private Company).[5]

3.2.2. Deregulation: Restructuring and Increased Role of Private Sector

SOEs restructuring, which is covered in the Minister of Finance Decree No. 740/KMK.00/1989, was planned to be conducted through seven options, as follows:

- Changing the legal status of SOEs into a status that is likely to be conducive to efficient and productive operations
- Contracting out the SOEs to a third party (public or private enterprises) with the purpose of increasing market shares, technological/operational capability and managerial efficiency
- Consolidating or merging the enterprises to increase working capital, in order to increase market shares and competitiveness
- Splitting-up the SOEs into two or more productive enterprises, in order to strengthen internal control and to increase business services
- Going public through the capital market, if company is able to comply with the requirements of the capital market, or otherwise the direct placement of shares. Going public or direct placement of shares is intended to improve the capital structure of the SOEs and simultaneously extend the people's participation through ownership of shares
- Joint ventures with private sector businesses to extend market shares, operational capability and improve capital returns
- Liquidation

Government asked all SOEs to make a long-term corporate plan for five years and a yearly work plan in order to control SOEs better.

The decree also mentioned the result of evaluation of 189 SOEs. The criteria for determining the health of SOEs are; (1) rentability, which measures the profitability of the SOEs; (2) liquidity, which measured the SOEs's ability to cover short-term liabilities; (3) solvency, which measures the ability to cover long-term liabilities. By using the criteria, the SOEs could be classified into; very healthy, healthy, less than healthy, and not healthy. The technical departments have complained that this unfair because many of the SOEs are burdened with social objectives that can make their performance poor. The result of the evaluation of the 189 SOEs indicate that half, nine-two, are not healthy, thirty-seven less than healthy, and thirty-five very healthy.

In November 1989, the Minister of Finance announced an implementation plan, in which 52 SOEs would go public, 15 would change their legal status, 5 would sign management contracts, one would become a joint operation, 17 would merge with other SOEs, 16 were to become joint ventures, and six would be sold (*Kompas*, 13 November 1989). There are three SOEs would be liquidated and the remaining SOEs are to undergo improvement in their management.

5. *From I Ketut T. Marjana. CSIS. 1993*

Although the government planned to apply the above policy implementation in 1990 and 1991, delays have in fact occurred. Up to 1991, only one (from 52) SOEs has gone public (PT Semen Gresik -- cement company)[6], 14 (from 15) SOEs have changed their legal status, 1 (from 16) -- PT Intirub (tire manufacturing) has conducted a joint venture with private companies (PT Bimantara Citra and PT Astra Group) by direct placement of its shares, 2 (from 6) SOEs have been sold (PT Lepin to its employee, and *Perum Pengeringan Tembakau Bjonegoro* to a cooperative), and 3 (from 17) SOEs have merged with other SOEs.

Moreover, a new salary structure of the Boards of Directors and Board of Supervision has been introduced. The new salary structure links with the financial performance achieved by the relevant SOEs. This must be provide an incentive to stimulate the Boards to achieve levels of return, increase competing power, and increase levels of efficiency.

There have also been efforts to improve the management of SOEs by deregulating policies that tend to restrict the operations of an SOEs as a commercial entity. Such changes have involved allowing salary scales to be different from the civil service, for evaluation and incentive schemes, and in the case of the banking sector massive retrenchment.

Based on deregulation of financial sector in October 1988, SOEs are no longer required to keep their deposits at State Banks. Around 40% of deposits at State Banks come from SOEs.

Other important action in order to improve levels of efficiency was rationalization of personnel. PT Tambang Timah (State Tin Company) had rationalized its employee from 24,000 to 13,500. Also there are two SOEs which moved to a place close to production, that are PT Tambang Timah to Bangka (South Sumatera), and PT Pupuk Sriwijaya (State Fertilizer Company) to Palembang (South Sumatera).

In a development unrelated to the reforms engineered by the Ministry of Finance, a board headed by the Minister of research and Technology, J.B. Habibie, was set up to manage strategic SOEs. On 28 August 1989, Presidential Decision No. 44/1989, was issued which put 10 SOEs under the supervision of a Board for the Management of Strategic Industries (*Badan Pengelola Industri Strategis*, BPIS). Ten SOEs are placed under this agency: PT Krakatau Steel, Pt Boma Bisma Indra (machine working), Pt Barata Indonesia (machine working), PT INKA (railway), PT IPTN (aircraft), PT PAL (shipbuilding), PT Pindad (ammunition), PT Dahana (explosive), PT Inti (telecommunication) and *Unit Produksi Lembaga Elektronik Nasional* (Electronics). All planning and supervision, including marketing of products, would be under Habibie. The rationale given for the consolidation was to enable them to face competition from international competitions and to raise efficiency and productivity.

The reaction to the consolidation was not altogether support to the policy. Some expressed hope that he could bring about the efficiency looked for, while others expressed

6. *Until 1996, additional SOEs which gone public is five SOEs; PT Telkom, PT Indosat, PT Tambang Timah, and Bank BNI (Gatra, 29 March 1997)*

concern about the transparency in the financial aspects of the consolidation, making it more difficult to avoid subsidizing SOEs. The establishment of the BPIS has nationalistic oriented policies of the oil boom period than to less cost orientation.

4. NALYSIS PROBLEM OF STATE-OWNED ENTERPRISES

Financial performance indicators of course fail to capture the true performance of SOEs. The performance of SOE is affected by factors which are external to the enterprise and can act favourably or unfavourably on its performance. Government policy can often constraint the operation of SOEs. However, policies such as the exclusive right of operation, preferential access to funds and immunity against bankruptcy puts SOEs in favourable position compared with private sector compared.

However, overall performance of SOEs is still poor. Reasons for that are covered poor management, no coordination and consolidation. SOEs could not improve their performance, before they solving their basic problems:

First problem is the lack of transparency. SOEs's accountability to the owners declines since there was lack of transparency. The owners do not aware about changing in SOES, such as growth or loss. It is immaterial whether those enterprises are performing well, moderate or terrible. The point here is, that the establishment of an enterprise and its substantial expansion are too important to be left wholly to the management, including the board of directors of an enterprise.

Those condition has created the principal-agent problem. The principal-agent problem occurs where the principals (government) cannot provide effective incentives or adequate monitoring to guarantee that their agents (manager) pursue the principal", as opposed to their own interest (Hemming & Miranda, *Privatization*)

The autonomy of management in SOEs is difficult to achieve. In one hand, outside agencies tighten the management which reduces the autonomy of the management. The other hand, total autonomy which is given to the management creates the accountability problem.

Second, the accountability problem also can come from lack of specification of a clear goal. There is conflicts goal in Indonesian SOEs, between SOEs as an "agent of development" and the efficiency. During the oil boom years, SOEs's role dominant as an "agent of development". For example, the state Banks should provide a cheap funds to be allocated to some priority sectors at a given interest rate. The result is that the state Banks worked inefficient and Indonesian government issued deregulation for this.

After oil boom year, other task as an "agent of development" is the policy of allocating part of SOEs's profits to help the weak economic sectors and cooperatives. This is burden to SOEs, because for redistribution, government could use channels such as the taxation and transfer mechanism (Pangestu, 1990).

Third, government always rescue the SOE that was having the difficulties. This has effected to the competition environment. If government always helps SOEs, they can not face the competition inside or outside (as a result from globalization). So, for achieving efficiency goals, SOEs should independently from government intervention.

Fourth, there is no clear agreement on which sectors should remain with the state and which to be privatized. Also, there is no clear definition of "strategic industries".

Fifth, the issue of ideological and political. Divesture of ownership has met a lot of resistance in the past to those who are ideologically against a more market oriented system and the fear that it would be shifted to non indigenous hands.

Sixth, management problems. There is no coordination and consolidation among SOEs. There is tendency that management runs per sector. Some of manager of SOEs is not professional one but they are chosen based on political consideration.

Seventh, selling shares in stock market is not successful because only a few of the healthy SOEs would pass and even then with the requirement of adjustment to their present operations, including changes in mana-gement. Another problem in implementation selling shares is the ability of stock market to absorb new issues. Since stock markets have been sluggish, and the public's ability to buy shares is still weak, the divesture of SOEs is low.

Eighth, lack of legal environment. This refers, first, to basic laws and regulation relating to the operations of SOEs, governing and facilitating their establishment, working and exit. For example, until now, it has been difficult to close down an SOEs because there is no clear exit mechanism and in fact there is a presumption that the government will always come to the rescue. Other lack of legal environment , it is refers to laws specifically dealing with privatization. The laws could overall laws on privatization, laws on sectoral or specific-enterprise privatization, and laws on specific techniques of privatization.

Ninth, information facilities. Related to success of privatization, information facilities are the vital aspect. The availability of information to the potential investors and to the general public concerning privatization policies and programmes. The more important aspect is the quality of financial information regarding the SOEs.

Tenth, interference of politics and multiply objectives have caused productive inefficiencies which arising from public ownership and management. Political interference creates problem on quality managerial decision making. Multiply objectives reduces the ability of managers to minimize costs (Hemming & Miranda: *Privatization*).

5. CONCLUSION AND RECOMMENDATIONS

5.1. Conclusion

Reforms of SOEs in Indonesia has been occurring since New Order regime where SOEs divide into *perjan, perum and persero*. During oil boom years, SOEs's dominant role was as an "agent of development". Multiply objectives and political interference has brought into inefficiency.

There is tendency to shift from context "belonging to" to " supervised by" the government on SOEs policies.

Restructuring, including privatization was taken place in the reforms of SOEs after oil boom years. Pressure for privatization is not only come from internal but also from external. Pressure from internal come from productive efficiency while from external, pressure come from multinational institutions or bilateral agencies.

Overall performance of SOEs is still poor. The delay in the implementation plan indicates that the process of privatization is not easy. The difficulties in implementation are both political and technical. The success of SOEs reform will to a great extent depend on political will and consistency of policies within the government. The fundamental issue is which sectors should be privatized and for what reasons.

5.2. Recommendations

- Improving efficiency should be the primary goal of SOEs.
  Eventhough designing programs to maximize efficiency politically is more difficult, but it will bring to the economy more sustained gains, which can then be distributed to potential losers. [7]
- Privatization does the most good when it is used to increase competition and prevent monopolistic behavour.[8]
- Short-run distributional goals, although they cannot be ignored, should not be pursued at the cost of management competence.[9]
- Restructuring and implementation of privatization require conducive country condition, such as market are competitive, resource are allocated on the basis of marginal returns, and the regulatory and supervisory institution are effective.
- SOEs in Indonesia should make vertical integration in order to create one network to increase their efficiency.
- Among SOEs could merger in order to increase the synergy of SOES
- To increase productive efficiency, political interference and multiply objectives should be reduced.
- The maximum efficiency gain will result from privatization accompanied by liberalization. So, implementation of privatization need liberalization environment.

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