Financial Flows and the Environmental Strategy in Indonesia in the 1990s

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FINANCIAL FLOWS AND

THE ENVIRONMENTAL STRATEGY IN INDONESIA IN THE 1990s

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In the end of March 1992, unilaterally the Indonesian government decided not to accept further financial assistance from Holland. The Indonesian government considered the Dutch government of having intervened too deeply in its domestic political affairs, in relation to the case of Dilli massacre in East Timor. The decision shocked the Dutch government which had been providing financial assistance to Indonesia since Suharto government came to power in 1967. In fact, Holland played a very important role in the formation of IGGI (Inter-Governmental Group on Indonesia), a multilateral organization dedicated solely to provide financial assistance for Indonesia, and was the Chair of the IGGI in 1992. Upon request from the Indonesian government, IGGI was disbanded, and the World Bank formed a new consortium called the CGI (Consultative Group on Indonesia) to take over IGGI's role. Holland was not invited to join the CGI, and it has not become a member until today.

The incident above showed that by early 1990s, the power of multilateral and bilateral financial assistance, and aid provided by the IMF and the World bank, had somewhat dissipated. By that time, Indonesia had been able to attract a lot of foreign private investments, in forms of foreign direct investment and increasingly in forms of portfolio investment, which had enabled it to refuse Holland's financial assistance and persuaded the World Bank to replace IGGI with CGI. However, ongoing liberalization of the economy has once again put Indonesia in a vulnerable position. Unable to overcome the current monetary crisis that started in August 1997, which has made the value of rupiah against US dollar decline more or less by 50%, the Indonesian government has once again turned to the IMF to provide financial assistance. The power of IMF and the World Bank over Indonesia has resurged in parallel with the integration of the country into the global economy that is going through a process of liberalization.

Environmental lobbying in Indonesia, especially in the whole decade of the 1980s, has traditionally been done by pressuring the Indonesian state on one hand and the donor countries and global funding agencies such as the World Bank and IMF on the other hand. And the established pattern of political pressure is hard to reframe. Before the environmental movements were able to adjust their strategy in response to the sharply increasing private foreign financial flows in the second half of 1980s and the first half of 1990s, now they experience the resurging power of the IMF and the World Bank. What will be the strategy that allows environmental movement to make use of the leverage of private (foreign) capital, amidst the resurging power of the IMF and the World Bank that has hit back with a vengeance, to help promote the agenda of sustainable development?

The rise and decline of public financial flows

In the early to mid-1980s, the drastic decline of oil prices made the Indonesian government lose so much revenues from oil. In order to compensate it, the government got more and more dependent on multilateral and bilateral foreign debts, loans from IMF and the World Bank, and loans from private foreign financial institutions arranged by the IMF and the World Bank. Table 1 shows that public debts in the 1980s did not only consist of the majority of Indonesia's debt, but their relative and absolute amount were also on the rise. Domestically, the government started to seriously treat taxes as the main source of income.

Realizing that it was impossible to keep borrowing since payment of debts and interests would put a heavy burden on the economy, and raising taxes took a lot of effort and time, the

Indonesian government decided to start pushing the private sector as the engine of growth. Starting in the early 1990s, the role of government expenditure in economic growth has declined significantly, and the source of economic growth is no longer the government expenditure sector (Basri, 1997, p. 31). When the private sector had become the engine of economic growth, the Indonesian government had some power to challenge its donor country (Holland), and pressure the World Bank and IMF to follow what it wanted. In the second half of the 1990s, shown in Table 1, the amount of private debts has exceeded that of public debts.

Table 1. The rise and decline of public debt in Indonesia

Fiscal Year	Public		Private		Total (US$ billion)
	US$ billion (growth)	Share	US$ billion (growth)	Share	
1981 *	15.9	81.53%	3.6	18.46%	19.5
1984 *	24.6	86.61%	3.8	13.38%	28.4
1990 * +	41.4	88.27%	5.5	11.72%	46.9
1995/96 **	58.6	55.08%	47.8	44.92%	106.4
1996/97 **	53.3 (-9.04%)	48.76%	56.0 (17.5%)	51.24%	109.3

Source: * Robison, 1987, p. 29.
** Bisnis Indonesia, June 18, 1996.
Note: + projected figure.

If we compare official foreign capital inflows with the inflows of foreign private investment, after looking just at the data on foreign debts, we can see that foreign private investment has indeed grown immensely since the 1980s. Table 2 shows two significant financial shifts that took place in the first half of the 1990s. First, in 1992 the flow of private investment started to exceed the flow of official loans taken by the government, reflecting the success of the

Indonesian government in attracting private foreign investment into the country. Second, foreign investment itself experienced a sudden and significant shift in 1993 when portfolio investment in stocks, Bank Indonesia Certificates and Money Market Notes (SBPU), commercial papers and bonds, and other promissory notes traded in the stock exchange and the national money market, experienced a sudden and meteoric rise. The rise continued in leaps and bounds that in the next year, the amount of (short term) foreign portfolio investments exceeded the amount of (long term) foreign direct investments by more than 100%.

Table 2. Net increase in the flow of foreign capital, 1990-1994 (US$ million)

	1990	1991	1992	1993	1994
Indonesia	**5,997**	**7,112**	**8,034**	**3,032**	**9,092**
Official Capital Flows	**2,669**	**3,590**	**3,320**	**2,558**	**1,684**
Official Grants	283	262	298	219	217
Official Loans	2,386	3,328	3,022	2,339	1,467
Private Capital Flows	**3,328**	**3,552**	**4,714**	**474**	**7,408**
Direct Foreign Investment	1,093	1,482	1,777	2,004	2,109
Portfolio Investment	338	381	275	1,844	4,167
Commercial Banks	2,453	2,035	2,822	-3,499	4,167
Other Private Flows	-556	-376	-160	125	722

Source: Darmaji, 1997, p. 60, data taken from World Debt Tables, 1996.

In the stock exchange market, foreign investors play a very important role. Data from the Jakarta Stock Exchange, arranged in Table 3, shows that although transaction by domestic investors had been increasing, the share of transaction by foreign investors in 1996 was still more than half of the total, a little bit over 60%. The dominant share of foreign investors in the transaction took place in spite of the fact that domestic investors as of August 13, 1997 actually owned 72.3% of all issued shares in the Jakarta Stock Exchange. It means that foreign investors have been more active in the trading of shares in the Jakarta Stock Exchange.

On September 3, 1997, when the Jakarta Stock Exchange (JSX) composite index started to fall drastically due to the monetary crisis, that is still going on until today, the government lifted up limitation on share ownership by foreigners. Before, foreigners were only permitted to own not more than 49% of the total share of a public company. The move to take down the ownership barrier, intended to protect domestic investors, are not supposed to be done until 2020, the liberalization dead line for less industrialized countries that have been agreed upon by APEC members. However, the measure has to be taken more than two decades earlier in order to halt the continuing decline of the JSX composite index. Although the move has not been able to make the JSX recover from its huge losses since foreign investors are still far from gaining back their business confidence in the Indonesian economy, it has opened the door for unlimited participation of foreign investors in the stock exchanges in Indonesia in the long term. It is expected that the inflows of foreign capital into Indonesia through the stock market will increase significantly in the coming years, after Indonesia recovers from the current monetary crisis.

Table 3. Transaction by foreign and domestic investors in the Jakarta Stock Exchange (%)

	1995	**1996**
Foreign investors	67.03	60.18
Domestic investors	32.97	39.82

Source: Kompas, January 3, 1997, p. 17.

IMF: Return of the old gun

The reason Indonesia has been relying more and more on foreign private capital inflows, and increasingly on short term portfolio capital, is because the country needs to fill in the increasing gap between savings and investment, and to finance the increasing current account deficit, both of them are the results of high economic growth that has been going on for more two decades. As we can see in Table 4, national saving-investment gap has been increasing rapidly since 1994. It means that the need of capital for investment has been increasingly larger than the amount of available capital generated from domestic savings. The gap has made it impossible for the government to bring down the interest rates that were averaging around 20% per year, before the monetary crisis hit in August 1997, compared to the interest rates in the international market that only came to around 8% to 10%. Increasing saving-investment gap hampers investment and slows down economic growth.

Table 4. National saving-investment gap (as % of GDP)

Year	**Saving-investment gap**
1994	- 1.9
1995	- 3.1
1996	- 3.8
1997 *	- 4.3

* Projected.
Source: Siregar, 1997, p. 15.

The inflows of private foreign capital is also badly needed to finance the increasing current account deficit, as shown in Table 5. Without a significant flow of foreign capital, Indonesia would have a big problem in providing hard currencies to pay for imports, to meet debts and interest payments, and to provide hard currencies for profit/capital repatriation. Since Indonesia has implemented a free foreign exchange regime, shortage of hard currencies, especially US dollars, will make investors lose business confidence in the country. When investors find it difficult to convert their rupiah into US dollar, they will read it as a sign of not putting in more money in the country, if not pulling out their money altogether. If that happens, Indonesia will experience a severe economic crisis.

Table 5. Current account deficit (US$ billion)

Fiscal Year	**Deficit**
1994/1995	3.5
1995/1996	6.9
1996/1997	8.8
1997/1998 *	10.7

* Projected.
Source: Siregar, 1997, p. 14.

Paradoxically, the large inflows of foreign private capital, increasingly in form of portfolio investments, that had given Indonesia some leverage against the IMF and World Bank in the early 1990s was also creating a condition that would eventually lead the country back into the very hands of the IMF. After orchestrating monetary and financial policies for more or less two months, including eliminating the intervention band of rupiah set by Bank Indonesia and limitation on share ownership by foreign investors, in order to stop rupiah from declining, the Indonesian government felt the need of an external intervention. On October 8, 1997, the Indonesian government, as the last resort, asked for financial assistance to the IMF in order to restore business confidence in the country. If business confidence, reflected in the value of rupiah and the Jakarta Stock Exchange index, is not restored soon, investors will be more and more reluctant to bring in hard currencies in form of foreign direct investments, portfolio investments, or investments in the money market.

On October 31, 1997, the Indonesian government announced the agreement with the IMF. IMF provides US$23 billion in stand-by loans that can be used in the period of three years. The total amount is larger than the amount given to Thailand last August (US$17.2 billion). However, since the aid package for Indonesia is in form of stand-by loan, the Indonesian government might not use all of the fund. The composition of fund can be seen in Table 6 below. The power of the IMF can be seen from the fact that countries that have promised to provide additional fund to Indonesia when needed, all of them will do it under the coordination of the IMF. It means that Indonesia has failed to mobilize bilateral financial aid in order to gain some leverage against the IMF.

Table 6. Composition of IMF's aid package to Indonesia, 1997

Donor	**Total (US$ billion)**
IMF's package	
IMF	10.0
World Bank	4.5
Asian Development Bank	3.5
Indonesian government	5.0
Total of IMF's aid	**23.0**
Standby bilateral fund *	
Singapore	10.0
Japan	4.0 to 5.0
U.S.	3.0
Malaysia	1.0
Australia	not known
China	not known
Hong Kong SAR	not known

* Bilateral fund will be provided, when necessary, under the coordination of the IMF

It is predicted that the IMF will wrest out four concessions from the Indonesian government (Bisnis Indonesia, October 31, 1997, p. 1). First, the liquidation of around 20 troubled banks, and a higher level of minimum capital and reserved funds for banks. Second, Bureau of Logistic Affairs should let go its monopolies in rice, sugar, flour, soybean, and garlic, all of them will able to be imported freely. Third, tariff and protection in the petrochemical industry should be eliminated gradually. Fourth, fuel subsidy should be reduced.

What should be the strategy of the environmental movement in Indonesia in facing the increasing role of private investment, especially in form of portfolio investment in the stock exchange and money market, and the increasing power of the IMF?

Agenda for environmental movement in Indonesia

Since the 1980s, environmental movements have been concentrating their effort in directly pressuring the IMF and the World Bank, and donor countries that provide aid to Indonesia. The environmental movements in Indonesia seemed to be slow in realizing the fact that the inflows of foreign private capital, especially in form portfolio investment, into Indonesia has been rising meteorically. The fact that the role of portfolio investment has been growing in importance suggests that environmental movement in Indonesia should also start targeting their lobbying pressure on portfolio investors. Due to the transparent character of public companies, it is easy to obtain information concerning share ownership of public companies. Pressuring a public company can be done by lobbying its institutional and individual shareholders, underwriters, and banks.

Trend of investment in the mining sector provides a good example of the opportunity to lobby portfolio investors. Table 6 below shows that in the period of 1992-1996, of all the projects in the primary sector, mining occupied the top position as the most favourite site of investment.

As we all know, mining activities are loaded with environmentally damaging potentials. Furthermore, the recent ranking of public companies into "SWA 100" (Sujatmaka, SWA, 14/XIII/July 31 - August 13, 1997, p. 44), SWA is a bi-weekly business magazine, provides data that mining sector, compared to other sectors, have been performing the best. All of mining companies that have gone public (five companies) are listed in the SWA 100 ranking. Data from the Jakarta Stock Exchange shows that foreign ownership in those five public mining companies is significant, as shown in Table 7. It means that the environmental movements can put pressure on the public mining companies by lobbying their domestic and foreign shareholders.

Table 6. Primary sector industries with the most investments, 1992-1996

Sectors	**Number of investments**
Mining	357
Plantation	244
Agriculture	147
Fisheries	76
Animal Husbandry	27
Forestry	20
Total	871

Source: Emmy Hafild, Indonesia Economic Almanac 1996-1997

Information regarding the treatment of *masyarakat adat* (indigenous people) who always get pushed aside by mining projects can also be used as a lobbying tool. The information could be organized systematically and sent regularly to business parties involved in stock and capital market, both in Indonesia and abroad. For example, information regarding the fact that the Indonesian government only recognizes land ownership supported by a legal land title issued by the government. According to Soetandyo Wignjosoebroto (1997), the Indonesian government's ideology of economic growth and its belief in the trickling down effect do not acknowledge the historical and cultural rights of *masyarakat adat* over their land. In the name of national interest, that has been defined in terms of economic growth, export growth, etc., if the land of a *masyarakat adat* is found to contain a deposit of valuable minerals, or if their forests have high commercial value, automatically their land falls under the control of the government in order to be utilized maximally for the welfare of the Indonesian people. The government then issues legal titles and licenses to private/state companies that will give them legal rights to start exploiting the natural resources. Having no legal title of their land, *masyarakat adat* are thrown out of their land when plantation, mining, or logging companies come to their area to do business. A network of information gatherer at the national level and a global distribution system need to be set up.

Table 6. Foreign ownership in the five public mining companies

Company name	**Business line**	**Foreign shares (%)**
Medco Energy Corp.	Oil and natural gas	16.62
Alter Abadi	Various	29.48
Citatah I Marmer	Stone mining	31.34
Tambang Timah	Metal and other minerals	32.83
International Nickel Co.	Metal and other minerals	49.00

Note: the maximum share allocated for foreign investors is 49%.
Source: Jakarta Stock Exchange, recompiled.

As of the resurging role of the IMF and the World Bank, the environmental movement do not have to always treat the global institutions as sworn enemies. Environmental movements should utilize the global financial institutions to help pressuring the Indonesian government to create a good governance, which is also the demand of the IMF and the World Bank. Good governance means that the government should run the management of the country in a professional way, not basing their measures on political and economic favouritism that creates widespread corruption and collusion between businesses and the government. Collusion and corruption make it impossible for the environmental movement to crack down on business activities, that are well connected politically, that damage the environment.

The recent case of forest fires in Indonesia provides a clear example on how collusion and corruption have made the business people who caused the fires untouchable by the law, let alone by lobbying of the environmental movements. It is suspected that, in addition to the El Nino that has been causing a severe and extended drought, several business people have cleared up their forests by burning them on purpose (Kompas, October 31, 1997, p. 2), causing smoke to fog up Malaysia, Singapore, and many parts of Indonesia for many weeks. Apparently, opening up forests by burning is much cheaper than paying people and renting heavy equipments to do the job. Collusion and corruption have been created a serious barrier to lobbying by the environmental movements in other industries as well, such as in manufacturing and plantation.

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