

Indonesia's privatisation plans run into troubled waters

Tuesday 26 December 2006, by [BULLARD Nicola](#) (Date first published: 1998).

Rioting, demonstrations, escalating unemployment and the resignation of President Soeharto notwithstanding, the Indonesian government was able to keep to the IMF's schedule for selecting which state owned enterprises would be privatised and which institutions had been given the nod as their financial advisers.

The list, published on 5 June, includes the lucrative PT Indosat and PT Telekom, the country's largest steel company PT

Krakatau, cement producers, various mining activities, toll roads, seaports and airports and plantations.

No one knows how the companies were selected, although Dr Faisal Basri, director of Indonesia's Institute of Development of Economics and Finance (INDEF) suggests that "maybe they were easiest to privatise, or there was already a potential buyer." His colleague, Dr Didik Rachbini added that the "only good companies are being privatised."

The government also announced the eight financial institutions charged with advising and overseeing the privatisation and sale. According to news reports at the time private placement is the preferred option, to maximise 'synergy' between the company and investor. Others might argue that private placement has the potential added benefit of 'minimising' transparency.

The Minister of Empowerment of State Enterprises, Tanri Abeng, himself a former chief executive officer of one of Indonesia's largest indigenous conglomerates, said that the process of selection of financial advisers was done with 'professionalism and transparency' considering their previous experience in privatisation and expertise in particular sectors.

The institutions are all foreign owned, and include some of the biggest names in international commercial banking: Merrill Lynch and Lehman Brothers, Goldman Sachs, Jardine Fleming, Morgan Stanley, Credit Suisse First Boston, Salomon Smith Barney, and UBS/SBC Warburg Dillon Read.

Privatisation is a central plank in the IMF's programme for Indonesia. The 15 January Letter of Intent, famously signed by then President Soeharto under IMF Director Camdessus' stern gaze, notes that the 'second major thrust of the structural reform strategy will be to deregulate and privatise the economy, in order to promote domestic competition and expand the scope of the private sector.'

Further, it says, 'A clear framework will be established for the management and privatisation of government assets by April 1998, including (i) criteria for determining whether enterprises should be closed, restructured or fully privatised and (ii) a transparent sales process that maximises the return to government and treats all bidders fairly.'

The first phase of privatisation is due for completion by March 1999, and initial estimates put expected revenue from sales at 2.5 billion.

Even at first glance, the timeline set by the IMF for this huge task seems optimistic and hardly conducive to a transparent process. It is all the more extraordinary considering the circumstances.

First, Indonesia has no less than 160 state owned enterprises, worth \$60 billion (at an exchange rate of 10,000 rupiahs). In January this year, responsibility for the state owned enterprises was moved from individual line ministries to the Ministry of Finance. Specific responsibility lies with the Minister for State Owned Enterprises, Tanri Abeng, who survived the cabinet re-shuffle following Soeharto's resignation.

Second, between January and April (and even now) Indonesia was in a state of confusion, tossed on a roiling sea of economic and political turmoil: hardly the climate to undertake a thoroughgoing and impartial review of how public enterprises should be restructured.

Third, the Indonesian economy is in an exaggerated state of deflation, again hardly the time to assess the true market value of assets and enterprises.

Fourth, allegations of corruption and cronyism linked to the Soeharto regime were pouring from every quarter. Surely this would have caused the assessors to pause and consider the impartiality of government ministers and their business associates, let alone unravel the true financial health of the state owned enterprises.

In these circumstances, the IMF's imposition of the April deadline made an absurdity of the commitment to establishing a clear framework and a transparent process. But it is consistent with the IMF's pattern of wrong-footed bungling in Indonesia over the past year. They badly mishandled the announcement to close banks, causing a panic run on the banks, they admit to not really knowing how the government spent the first two IMF installments, and they persisted with demands to lift fuel subsidies despite growing social unrest and clear indications of the hardship it would cause.

But the IMF appears to have a striking inability to learn from experience, and pushed ahead with its privatisation agenda, against all good sense.

And they have reaped as they sowed.

In the past three months, the privatisation process has become a comedy of confusion, derailed by a combination of community protests, the government's indecisive and quixotic behaviour, the obvious efforts of both local and foreign vested interests to either slow down or speed up sales, and the beginnings of a wider public debate about the benefits and costs of privatisation.

The case of PT Semen Gresik is telling.

Gresik is a cement company, already partly privatised but with a majority government shareholding of 65 per cent. It was one of the twelve companies included in the June list. Jardine Fleming is the nominated financial adviser.

Mexico's Cemex SA, the world's third largest cement maker, offered to buy 51 per cent of shares, 35 from the government and the remainder from minority shareholders, for \$418.2 million. However the sale was opposed by workers at two of Gresik's plants, fearing that jobs would be lost under foreign ownership.

On 11 August, the State Enterprises Ministry confirmed that Cemex's bid was 'satisfactory' but just one week later extended the deadline to ensure that a new formula could be worked out to 'safeguard Indonesian control and interests.' The financial institutions were not pleased, with one

analyst commenting that “the decision to delay the final step... would make investors wary of returning to Indonesia when private foreign capital is most urgently needed.”

Krakatau Steel, Indonesia’s largest steel company, is also slated for privatisation.

On 4 June, one day before the list was published, the Financial Times reported that the Soeharto administration had already agreed to sell a 51 per cent stake in Krakatau Steel to the Indian-controlled company Ispat International as early as 7 May. Ispat already has steel interests in East Java, and ownership of Krakatau would have given them control over 80 per cent of Indonesia’s steel manufacturing, hardly in line with the IMF’s expressed desire to ‘promote competition.’

The sale price of \$400 million also provoked charges that Krakatau was being ‘sold on the cheap’ and that the price had been agreed without seeking additional bids. According to reports from Krakatau executives, they were summoned to witness the signing of a contract they had not seen, and which was promptly pocketed by the Minister of State Enterprises Tanri Abeng. According to Indonesian economist Rizal Ramli, “The teams (of Minister Tanri Abeng) simply wanted to cut deals from the moment they came in.”

Two large European utilities companies also found themselves caught in the mire created by political confusion and vested interests. Thames Water (UK) and Suez Lyonnaise des Eaux (France) had won 25 year concessions to supply water to east and west Jakarta in the heady days of Soeharto, despite opposition from city officials and a wave of complaints about the 60 per cent tariff hike to finance ‘proposed improvements.’

Following Soeharto’s resignation, the deal was denounced when the companies’ close connections with Soeharto’s son Sigit Harjojudanto, and his close associate Sudano Halim were revealed. The foreign companies were forced to withdraw from the contracts, but ‘won’ them back again after ten days of ‘intensive diplomatic lobbying’ and agreeing to buy out the Soeharto clan’s stakes.

Privatisation is a murky, dirty business in Indonesia.

The ambitious target of raising \$2.5 billion has been cut to \$1 billion, the list of companies cut to ten, and the government is now unlikely to sell controlling stakes to foreign companies. Minister Tanri Abeng’s stakes are low in spite of his department’s offer to set up a desk to ‘register complaints.’

Opposition is coming from managers of state owned enterprises, who see their jobs - and in many cases probably their kick-backs - disappearing. Some of the anger against privatisation have been engineered by managers and local interests and it is reported that demonstrators were paid by ‘prominent locals’ to go to the Minister’s office to protest the sale of Krakatau Steel.

The Indonesia Chamber of Commerce recently called on the government to sell shares in state-owned banks to Indonesians rather than foreigners, a sentiment which could easily spread beyond the financial sector.

Workers fear losing their jobs and locals resent the prospect of foreigners taking over their land. It’s one thing to lose your land ‘in the national interest,’ quite another to lose it to foreigners, no doubt stirring memories of colonialism.

According to INDEF’s Dr Faisal Basri, there are serious problems with the process, or more accurately, the lack of process. “What we need,” he said, “are clear objectives, a comprehensive strategy and a transparent process.”

“The government needs to decide on the criteria for privatisation, based on how it would contribute to the people,” he said.

“The government has changed the rules to cool things down. But the real problem is that they don’t have a national strategy to attack the crisis, so there is no way of knowing whether the privatisation will be useful.”

But his colleague, Dr Didik Rachbini, believes the government is powerless. “Everything is decided by the IMF. The power of the people has been removed and replaced by the IMF.”

“The IMF wants to introduce the market system, but before you have the market you need to build political and civil society,” he said.

Rachbini fears that Indonesia will be pushed from state controlled capitalism to the free market without any debate and without any transparency.

The money expected to be raised by the sale of state enterprises — just \$1 billion on current estimates — will be poured straight back in to fill up the government deficit of \$8.3 billion, rather than strengthening or restructuring other potentially efficient state owned enterprises. It’s like pouring water into a leaky bucket.

The IMF has also imposed extensive privatisation programs on South Korea and Thailand as a loan condition.

In Thailand, half the revenue raised through privatisation of industries, including energy, water, telecommunications and transport, will be used to “offset losses incurred by the Financial Institutions Development Fund” the agency which channelled private foreign capital to Thailand’s private finance institutions and lost huge amounts of money in the financial meltdown. Regardless of the arguable benefits of privatisation, the public sector is again being asked to pay the price of private sector folly.

The IMF’s doctrinaire position on privatisation has forestalled the possibility of wide-ranging public debate about the costs, benefits and purpose of privatisation, and how it fits into an overall plan to revive the regions economies, rather than simply cover short term shortfalls.

But the investors are getting impatient. Following the Indonesian government’s volte face on the Cemex deal, one analyst commented that it “called into question the willingness of the government to push through painful change in the face of populist pressure and powerful local vested interests.”

Surely populist pressure and even powerful local vested interests are the stuff of democracy? But then again, why should such niceties get in the way of cutting a deal.

P.S.

* Nicola Bullard is a senior associate with Focus on the Global South.