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**Reform and Modernization of State Enterprises:**  
**The Case of Indonesia**

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## Abbreviations

<b>BAKORSTANAS</b>	Badan Koordinasi Stabilitas Nasional; Coordinating Agency for National Stability
<b>BAPPENAS</b>	Badan Perencanaan Pembangunan Nasional; National Development Planning Agency
<b>BBD</b>	Bank Bumi Daya; State Estate Bank
<b>BDN</b>	Bank Dagang Negara; State Trading Bank
<b>BEXIM</b>	Bank Ekspor Impor; State Export-Import Bank
<b>BLP</b>	Bagian Laba Pemerintah; Profit for the government
<b>BNI</b>	Bank Negara Indonesia; Indonesian State Bank
<b>BOO</b>	Build-Operate-Own
<b>BOT</b>	Build-Operate-Transfer
<b>BPIS</b>	Badan Pengelola Industri Strategis; Strategic Industry Board
<b>BPK</b>	Badan Pengawas Keuangan; Supreme Audit Board
<b>BPKP</b>	Badan Pengawasan Keuangan dan Pembangunan; Supervisory Agency for Finance and Development
<b>BPU</b>	Biro Pimpinan Umum; General Management Board
<b>BRI</b>	Bank Rakyat Indonesia; Indonesian Popular Bank
<b>BTN</b>	Bank Tabungan Negara; State Savings Bank
<b>BTU BUMN</b>	Biro Tata Usaha Badan Usaha Milik Negara, State Enterprises Administrative Bureau
<b>CAR</b>	Capital Adequacy Ratio
<b>DIRJEN</b>	Direktorat Jendral; Directorate General
<b>DPR</b>	Dewan Perwakilan Rakyat; House of the People's Representatives
<b>DSP</b>	Dana Pembangunan Semesta; Universal Development Fund
<b>DSR</b>	Debt Service Ratio
<b>EKUIN</b>	Ekonomi, Keuangan, dan Industri; Economy, Finance, and Industry
<b>GOLKAR</b>	Golongan Karya; Functional Grouping
<b>IBW</b>	Indische Bedrijvenwet
<b>ICW</b>	Indische Comptabiliteitswet
<b>INPRES</b>	Instruksi President; Presidential Instruction
<b>IPTN</b>	Industry Pesawat Terbang Nusantara; State Aircraft Company
<b>KIK</b>	Kredit Industri Kecil; Small Investment Credit
<b>KMK</b>	Keputusan Menteri Keuangan; Finance Ministry Decree
<b>KOPKAMTIB</b>	Komando Operasi Pemulihan Keamanan dan Ketertiban; Operational Command For the Restoration of Security and Order
<b>KSO</b>	Kerja Sama Operasi; Joint Operation
<b>LEMHANAS</b>	Lembaga Pertahanan dan Keamanan Nasional; National Defense and Security Agency

<b>MENKEU</b>	<b>Mentri Keuangan; Finance Minister</b>
<b>MPR</b>	<b>Majelis Permusyawaratan Rakyat; People's Consultative Assembly/Parliament</b>
<b>PAL</b>	<b>Pabrik Angkatan Laut; State Shipyard Company</b>
<b>PARPOSTEL</b>	<b>Pariwisata, Pos, dan Telekomunikasi; Tourism, Post, and Telecommunications</b>
<b>PDI</b>	<b>Partai Demokrasi Indonesia; Indonesian Democratic Party</b>
<b>PELITA</b>	<b>Pembangunan Lima Tahun; Five-Year Development</b>
<b>PERJAN</b>	<b>Perusahaan Jawatan; Government Agency</b>
<b>PERTAMINA</b>	<b>Perusahaan Tambang Minyak Negara, State Oil Company</b>
<b>PERUM</b>	<b>Perusahaan Umum; Public Corporation</b>
<b>PINDAD</b>	<b>Perindustrian Angkatan Darat; Arms Industry</b>
<b>PLN</b>	<b>Perusahaan Listrik Negara; State Electric Company</b>
<b>PN</b>	<b>Perusahaan Negara, State Corporation</b>
<b>PP</b>	<b>Peraturan Pemerintah; Government Regulation</b>
<b>PT</b>	<b>Perseroan Terbatas; Joint Stock Company/limited company</b>
<b>PTP</b>	<b>Perseroan Terbatas Perkebunan; State Estate Plantation Company</b>
<b>ROI</b>	<b>Return on Investment</b>
<b>RUPS/SHGM</b>	<b>Rapat Umum Pemegang Saham; General Share Holder Meeting</b>
<b>TELKOM</b>	<b>Telekomunikasi; Telecommunications</b>
<b>UU</b>	<b>Undang-Undang; Acts</b>

## Chapter One: Introduction

State enterprises in Indonesia constitute one economic actor besides private enterprises and cooperatives. Their importance within the Indonesian economy is revealed in terms of their relative size and strategic position. Up till 1980 their capital made up 58.75 percent of domestic investment and 9.24 percent of foreign investment<sup>1</sup>. They occupied not only many important and strategic sectors of the economy but also a few less important ones such as hotels and department stores. In the banking sector, state enterprises held 85.84 percent of total bank credit in 1977-1981<sup>2</sup>. A similar dominant position was also true for the state enterprises in the cement industry where they held 74 percent of total domestic production in the early 1980s<sup>3</sup> and in the more basic industries of steel, aluminium and petrochemicals where they held 80 to 100 percent. Also in the provision of infrastructure and transportation state enterprises played a dominant role. Even in telecommunications, electricity, and many public utilities, prior to 1980, state enterprises held a monopoly.

At the beginning of the 1980s, the winds of change at the international and national levels affected the course of development of the Indonesian state enterprises. At the international level, the role of the state in the economy was reconsidered. The state was no longer viewed as the necessary engine of growth. The failure of many governments to maintain full employment and high economic growth contributed to the ever increasing view of the state as the predator in the economy. This change in views raised the question regarding the effectiveness of state enterprises as a policy instrument of government. At the national level, the state embarked on economic reforms, following the global trend towards a market economy. As a result, the allocation of resources to productive sectors began to increasingly rely on market mechanisms rather than on state intervention. In an economy where a big number of state enterprises was present in important sectors, the impact of the economic reforms was bound to be limited, unless state enterprises also moved in the same direction. Consequently, since 1986 Indonesian state enterprises have been entering the phase of reform and modernization with substantial consequences for their future.

The purpose of this research is to analyze the processes of reform and modernization of state enterprises in Indonesia. Specifically, it focuses on the analysis of restructuring and privatization of state enterprises as part of the policies of deregulation and debureaucratization. It studies in particular the

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<sup>1</sup> C. Wibisono, "Saham Pri dan Non-Pri", *Tempo*, 14 March 1981, pp.70-72.

<sup>2</sup> Indonesian Commercial Newsletter (ICN), *The Development of the Banking Industry*, No.20, 9 August 1982, p.8.

<sup>3</sup> S. Hambali, "Semen: Profil Industri Yang Menguntungkan", *Eksekutif*, May 1981, p.51.

adjustment of four state enterprises to their new industrial structure as cases illustrative of the process of restructuring and modernizing of state enterprises. The analysis is undertaken with reference to the policy environment between 1983-1995, during which time the government undertook major policy changes.

### ***A. Research Problems***

The existence and growth of state enterprises in Indonesia, which dates back to the early period of the republic and, for some of them, even to the pre-independence period, did not arise out of a vacuum. It constituted part of a wider development of the dynamics of economic and political forces in the country. Thus, when the government has embarked on reforms and the modernization of state enterprises since 1986, then it was a propitious time to raise five questions:

- a) What has been the historical context that contributed to shape the present development of state enterprises, and particularly the present reforms towards their modernization?
- b) Which circumstances and influences caused the present reforms and the modernization of state enterprises ?
- c) How were reform policies formulated and implemented ?
- d) What reform policies have been implemented which changed the institutional set-up of state enterprises?
- e) What were the various adjustment measures taken by state enterprises in response to the reforms and to the deregulation and liberalization of their respective sectors ?

Explicit answers to these questions necessitate a review of the past and present developments affecting state enterprises which cover a time period from 1945 to 1995. The first question deals with the past development between 1945 and 1983. The remaining ones are concerned with the present development, which is defined in this research as occurring from 1983 to 1995.

The answer to the first question is presented in chapter one where an overview of sociopolitical and economic factors that gave rise to and affected the growth of Indonesian state enterprises is presented. This overview begins with a discussion of the origin and rationale of Indonesian state enterprises. It continues with a review of their development during the 'Guided Economy' era (1957-1965) and of their position in the early 'New Order' government (1967-1983). The overview ends with a discussion of the role of state enterprises in the import-substitution industrialization program. The purpose of this overview is to highlight the important sociopolitical forces that shaped the past development of state enterprises. The assumption is that these sociopolitical factors remain

powerful and continue to affect the present development of state enterprises. The results of the overview are given in chapter two.

The remaining four questions pertain to the reforms and modernization of state enterprises which have taken place since 1983. It is assumed in this study that the period between 1983-1995 constitutes the turning point in the development of state enterprises in Indonesia. Major changes in policy on state enterprises occurred in this period, and as a result, all Indonesian state enterprises were forced to take some measures to meet the demands of a new policy environment. The second question to be addressed is, which circumstances and influences engendered the reforms and modernization of state enterprises ? To answer this question a review is conducted of the economic situation of Indonesia in 1983 and of the government response to this situation. The review will show that the reforms of state enterprises were a necessary part of a broader economic adjustment to the decline of government revenues from oil. Particular attention is also given to various government measures ranging from austerity programs to deregulation packages which directly and indirectly affected state enterprise operations and which finally led to the necessity of state enterprise reforms and its modernization. Included here is the analysis of the conflict of interests among ministers on issues of economic reform. The review is presented in chapter three.

The third question deals with the politics of policy formation and implementation: how were the reform policies formulated and implemented ? To answer this question the public debate on the issue of privatization of state enterprises during 1986-1989 is described in detail. Various interest in this debate are also identified, and their influence upon the formation and implementation of reform policy is described. A specific review is done about the bureaucratic conflicts at the cabinet level and to the crucial role that the President played in resolving the conflicting interests of the ministers. The purpose of this review is to show how different interests in the cabinet lead to a broad option of reform policies chosen by the President and how this broad option in turn paves the way for the emergence of different paths for state enterprise reform. The discussion is given in chapter four.

The fourth question is what reform policies have been implemented so far? To answer this question a review of the existing structure of control prior to the reform policy is needed. This is followed by a review of various presidential instructions, ministerial decrees, and acts during the period 1986-1993. The review is done in order to identify the effects of reform measures on the existing institutional set-up of state enterprises. One objective of this review is to assess whether or not changes in the institutional set-up improved the autonomy of state enterprises and affected their role in national development. Another objective is to show that a partnership structure between state enterprises and private enterprises, and to a certain degree with cooperatives, is as important as a competitive structure and that the former provided a better solution, particularly



for those state enterprises that raised political obstacles to their complete sale to the private sector. The review also shows that besides its positive effects, the emerging partnership structure created the potential adverse effect on public interests. The conclusions from this part of the study are presented in chapter five.

The last question is concerned with the micro level consequences of reforms, that is, with regard to programs carried out by state enterprises to change their organization and management in response to various threats and opportunities. To answer this last question reform programs in four state enterprises are reviewed and described in detail in chapter six. The main focus of the review is the actions of management to build competitiveness in the market environment and to prepare the enterprise for partial privatization through stock offering in capital markets. The objective is to show how programs went with different scopes and at differing pace and timing and how a similar trend in the orientation towards the business environment emerged. A review is also given over the performance of the enterprises after the implementation of reforms. This is done in order to gauge, though roughly, whether or not the reforms had positive results.

Finally, chapter seven presents the conclusions drawn from all the discussions in the previous chapters. The conclusions are related to three important points. The first is concerned with the nature of reforms and modernization of state enterprises in Indonesia as viewed from the international perspective, and with factors that condition its character. The second deals with the new institutional set-up of state enterprise and its resulting effects on the management of state enterprises. The third is concerned with the probable continuation of reforms and the modernization of state enterprises in Indonesia, given their constraints and opportunities.

## ***B. The Policy Environment between 1983-1993 and its Effects upon State Enterprises***

The Indonesian government embarked on reforms and modernization of state enterprises as part of a broader economic adjustment to disappointing economic vicissitudes of the early 1980s. In fact, pressures to undertake reforms appeared as the government adopted austerity measures in 1983 due to declining government revenues. Since then the government capital participation in state enterprises was reduced from US\$550.9 million in 1983/84 to US\$69.4 million in 1988/89<sup>4</sup>. Various subsidies which also included those given to state enterprises were cut to the value of US\$566 million in the 1982/83 budget<sup>5</sup>.

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<sup>4</sup> Attachment to the President's speech, 16 August 1990.

<sup>5</sup> H. Dick, "Survey of Recent Developments", *Bulletin of Indonesian Economic Studies*, 23 (1), 1982.

Projects of state enterprises which involved massive direct state investment at a value of US\$20 billion were also shelved, re-phased or canceled. Above all, the government began to call for the efficiency of all state enterprises.

The first reform started in state enterprises in the banking sector when in 1983 the protagonist of deregulation policy consisting of the Finance Ministry, the Central Bank, and State Planning Agency (Bapennas) initiated the banking deregulation which then thoroughly affected the operations of seven state-owned banks: BNI 46, BDN, BRI, BBD, EXIM, BAPINDO, and BTN. Government subsidies to all state banks given in the form of liquidity credits were reduced. The effect was that the state banks had to mobilize funds from the public. While all state banks were undergoing adjustment, the government launched a banking liberalization program in 1988, which in turn forced state banks to make further adjustment. The banking liberalization in 1988 brought about significant effects on banking operations. Especially for all state-owned banks, it forced them to compete with private domestic and foreign banks in the mobilization of funds and in the provision of credit to the public. Under pressures to compete, the adjustment of state-owned banks had to involve comprehensive changes in the organization and the management of banking operations as well as in their organizational culture.

Prior to banking deregulation and liberalization, the seven state-owned banks dominated the banking industry. The monetary authority made this possible by imposing various entry barriers such as tight requirements for private banks. As part of the efforts to promote economic nationalism or economic indigenism, the government also provided the five state-owned banks with various facilities including liquidity credit from the Central Bank. Besides, all state enterprises were also obliged to put their deposits in state banks. Since competition was almost absent and the government supported them with a financial facility up to 25-50 percent of their total funds, state-owned banks had no strong desire to mobilize funds from the public. Thus, when the banking deregulation and liberalization during 1983-1988 lifted all barriers which inhibited competition and removed all facilities which made state banks in favorable positions, all state banks had to make a complete turn around in the way they carried their business.

The government also launched deregulation in other sectors. In 1988 the telecommunication sector was de-monopolized by allowing private enterprises to enter this sector. This deregulation, which was intended to overcome the infrastructure bottleneck, in turn affected two state telecommunication companies, Indosat and Telkom. The companies had to restructure their organization and management in order to meet the objectives of the deregulation, which among others included the accelerated development of the telecommunication system at 5 million telephone lines during the Sixth Development Plan (1993-1998) and the improvement of services in urban areas.

Meanwhile various restructuring measures were introduced, which subjected all Indonesian state enterprises to one or more of the following actions: 1. change in legal status; 2. consolidation through a merger or splitting up; 3. establishment of a joint venture or joint operations with the private sector; 4. management contracts; 5. partial privatization through selling of shares on the capital market; 6. complete sale to the private sector; and 7. liquidation. Following these actions, the structure of Indonesian state enterprises has undergone significant changes. Some state enterprises in sectors considered to be unimportant were transferred to the private sector while others in more strategic positions either continued to be in government hands, or part of their shares was sold in the capital market. Various forms of partnerships between state and private enterprises in the provision of services have also emerged, which to a certain degree involved cooperative organizations.

Following the telecommunications sector, electricity also underwent deregulation in 1990. Barriers to the entry of private operators into the sector were removed, resulting into the electricity sector being de-monopolized. Just like Indosat and Telkom, the state electricity company PLN had to embark on restructuring. Indeed, the government took the same measures in some other sectors. Air transportation was deregulated in 1989 as part of the efforts to promote tourism. Also the industrial sector began its deregulation in 1992 as the government shifted its industrial strategy from import substitution to export orientation. As a result Garuda Indonesia and Krakatau Steel, two of the most important state enterprises respectively engaged in air transportation and the industrial sector, were exposed to competition from private enterprises. This in turn forced them to undertake restructuring.

The combination of competition, demands for efficiency and less government support created strong pressures for state enterprises to undertake thorough restructuring and reorientation of their organization and management. Meanwhile, the government also expected that the restructuring will either increase the contribution of state enterprises to government revenues at an average increase of 10 percent each year in the Six Development Plan (1993/94 - 1997/98) or a decrease in subsidies and investments given to them from the state budget. In this respect, the introduction of various management strategies such as commercialization, corporate re-engineering, delayering and downsizing the organization, and the professionalization of management became imperative at the enterprise level.

However, the restructuring of Indonesian state enterprises has become a controversial issue since the beginning. For example, privatization as the solution for inefficient state enterprises was opposed from inside and outside the bureaucracy. At issue here was a view that privatization was alien and contradictory to the state ideology 'Pancasila' and the 1945 Constitution which are based on the spirit of the 'family principle' and stipulate that state enterprises have a legitimate place and should be superior to private enterprise in the

economy. Furthermore, the opposition was rooted in a deep fear that privatization would put state enterprises either in the hands of Indonesian Chinese entrepreneurs who have dominated the private sector or, in the hands of a few indigenous businessmen with strong political connections.

A conflict of interest also flared up at the bureaucratic level between the Finance Ministry and the Technical Ministries. The conflict has been rooted in the claim over who was the right owner and hence the controller of state enterprises. The role of President Soeharto was very crucial in the course of this conflict because his final decision resolved the conflict over certain issues. In 1989 the Finance Ministry as the main protagonist of this restructuring gained a stronger position after acquiring the mandate from the President to proceed further with the implementation of restructuring. This helped to diffuse much of the opposition from the Technical Ministries. The cabinet reshuffle in 1993, which resulted in the appointment of more ministers with a pro-restructuring view, further weakened the opposition and smoothed the path towards partial privatization of state enterprises through share floating in international and domestic stock markets.

Some members of Parliament and the general public also became involved in the debate over many issues of restructuring. The press played an important role in exposing and clarifying various opinions during the stage of policy formulation about restructuring in 1986-1989 and its implementation in 1989 and onwards. As stated by McIntyre, the press coverage influenced the policy formation by drawing areas of controversy to the attention of opponents and proponents and stimulating a debate between the government elites<sup>6</sup>. The issue of privatization, bureaucratic hindrance to a commercial orientation, and the entry of politically well-connected business groups into some de-monopolized sectors of state enterprises were the main bones of contention which were intensely highlighted by the press. In a more general sense, the controversy was partly concerned with various notions such as private provision, autonomy or self-organization and management, commercial orientation, strategic business units, and market-driven organizations, all of which have been practiced in many countries as the solution to many problems of state enterprises.

In a less intense degree such issues remain controversial in the Sixth Development Plan (1993/94-1997/98). The reforms will continue, pending external and internal conditions of the economy. Ideological and political aspects that deal with economic nationalism and perceived imbalances between indigenous and non-indigenous ownership of the economy continued to slow down their pace. The implementation of reforms and modernization of state enterprises in Indonesia is ultimately confined to a gradual process and conciliatory measures requiring a decisive role by President Soeharto at some critical points.

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<sup>6</sup> A. Macintyre, *Business and Politics in Indonesia*, Sydney: Allen & Unwin, 1994, p.37.

### *C. Towards the Commercial Organization of State Enterprises*

At the enterprise level, various modernization programs have been embraced by management. State-owned-banks were the first which to have followed this path, starting gradually in 1983 and ending in the mid 1990s. It was followed by some public utilities in 1988 and then other state enterprises in industry, transportation, and agriculture in 1990. For government, the programs constituted a desired continuance of the changes in the institutional set-up of state enterprises. For state enterprises, reforms constituted the adaptive and transformational strategy to cope with the far-reaching consequences of various deregulation policies launched gradually since 1983.

For management, it appeared the propitious opportunity to move along this path, as Presidential Instruction No.5/1988 and Finance Ministry Decree No. 740/1989 paved the way for the corporatization of state enterprises, that is, through a change in their legal status from a government agency and public corporation into a limited company. While increasing autonomy and flexibility to run the enterprise, this corporatization provided state enterprises with the same legal framework as private enterprises. Instead of public law, they have been subjected to commercial law. This helped in the implementation of modernization programs.

At the heart of the modernization program were efforts to professionalize management and to streamline the organization in order to cope with a volatile environment. The organization of state enterprises has been redesigned more and more on the basis of market characteristics, types of business, or functional decentralization, depending on the scope and the extent of the implications of deregulation for their respective sectors. This was generally done in combination with down-sizing and delayering so as to make the enterprise closer to consumers and to improve services. The formation of profit centers also formed part of the modernization program. In this respect, potential profitable units were segregated from the enterprise and given greater autonomy or transformed into a joint venture company with private enterprises. On the management side, the improvements touched various aspects of management, including human resources, finance, and marketing. As part of this improvement, performance appraisal, assessment centers, and management of total customer satisfaction were introduced into the existing management system. The quality of human resources also became the main concern of almost all state enterprises. As a result a lot of effort was spent on training and development. Basically, such

efforts under the modernization program reflect an anti-bureaucratic or anti-Weberian view<sup>7</sup>.

From a long term perspective, modernization together with corporatization may become an interim step towards partial privatization. In this respect, the modernization program prepares state enterprises to be more commercial and professional in managing their business and finally to make them healthy. Whereas, corporatization by itself provides state enterprises with the institutional feasibility to be run as private enterprise, both facilitate partial privatization. But according to Presidential Instruction No.5/1988, partial privatization is one of many alternatives which is likely to be taken only when the government does not have sufficient financial resources to support the development of state enterprises. Other alternatives also remain open<sup>8</sup>. However, regardless of which alternatives are taken, modernization programs remain critical at the enterprise level, given that state enterprises are supposed to survive in a competitive market environment.

To explain a such a long term direction, changes at different levels must be taken into account and viewed from the context of the politics, economy, and culture of the country. This will be addressed in the following section with the help of several concepts and notions.

### *D. Theoretical Concepts and Notions Underlying This Study*

This study approaches reforms and the modernization of state enterprises in Indonesia using the concept of administrative ecology developed by Riggs<sup>9</sup>. In essence, the approach puts administrative dimensions within the contextual environment comprising of, among others, politics, economy and culture. Its general argument states that these environmental variables affect the administrative dimensions. In a study of state enterprises in Chile, Allende<sup>10</sup> used more or less a similar approach. His study tried to explain the structure, behavior, performance, and development of state enterprises with reference to the general external environment including the political, cultural, economic, and

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<sup>7</sup> H. Klages and O. Haubner, "Strategies for Public Sector Modernization", in A. Halachmi and G. Bouckaert, *The Enduring Challenges in Public Management*, San Francisco: Jossey-Bass, 1995, p.349.

<sup>8</sup> These include contract management, joint venture, joint operation, company split, go-public, etc. See chapter five of this thesis.

<sup>9</sup> Fred W. Riggs, *Administration in Developing Countries: The Theory of Prismatic Society*, Boston: Houghton Mifflin, 1964; See also, F. W. Riggs, "The Ecology and Context of Public Administration: A Comparative Perspective", *Public Administration Review*, March/April 1980, p.107-115.

<sup>10</sup> J.A. Allende, *State Enterprises and Political Environments: Chile's National Copper Corporation*, unpublished Dissertation, 1985.

international factors. The important proposition is that these external factors constitute the crucial macro-societal context in which state enterprises are rooted. Changes in these dimensions are reflected in state enterprises' structure, behavior, development, and performance. While Allende gives a concrete example of how the approach may be used in studying state enterprises, Riggs offers some valuable concepts which are relevant for a study of administration in developing countries, particularly in Indonesia. Some of these concepts include marketization, bureaucratic polity or bureaucratism, bureaucrat capitalist, etc.

In the original study of Riggs, the use of these concepts revolves around the explanation of administration in prismatic societies. Riggs used the term 'prismatic' to describe societies undergoing transition from traditional to modern industrial society. In such societies while the fused structure of traditional society is being differentiated, the diffracted structure of modern society remains incomplete<sup>11</sup>. Thus like a situation within a prism, to quote his phrase, "fused white light passes to emerge diffracted upon a screen as a rainbow spectrum ...[but] the separate colors, though differentiated are captive, imprisoned"<sup>12</sup>. What is important and relevant from this prism metaphor is the idea of an overlapping interrelationship between the traditional social and cultural system and modern administration. By an overlapping interrelationship, as Riggs has argued, it means that modern administration in developing societies is not autonomous but is influenced by remnants of the traditional social and cultural system<sup>13</sup>. Riggs highlighted the salient characteristics of prismatic administration due to the influence of such a traditional social and cultural system:

- a) bureaucracy has a considerable power which is often beyond the effective control of outside forces<sup>14</sup>,
- b) top bureaucratic officials play also a role as bureaucrat capitalists whose interests are to exploit their control over a government agency to give contracts or licenses to firms in which they hold an interest or have familial relations<sup>15</sup>,
- c) bureaucracy has the characteristic of excessive centralization, strong control, and lack of delegation<sup>16</sup>.

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<sup>11</sup> Working on structural-functional approach, Riggs defined fused structure as functionally diffused since it performs a large number of functions. On the other hand, diffracted structure is functionally specific. See: Riggs, *loc.cit.*, p.22-27. A deeper analysis of distinction between functional specificity and functional diffuseness should be seen in T. Parson, *Towards a General Theory of Action*, Cambridge: Harvard University Press, 1959.

<sup>12</sup> F.W. Riggs, p.27.

<sup>13</sup> F.W. Riggs, p.15.

<sup>14</sup> F.W. Riggs, p.262.

<sup>15</sup> F.W. Riggs, p.190-191.

<sup>16</sup> F.W. Riggs, p.253, 281-283.

These characteristics have particular relevance for this study. They are used to describe the Indonesian bureaucracy. As described later in the following sections, the Indonesian bureaucracy fits these characteristics. In connection with state enterprises, the characteristics described by Riggs are manifested in the strong control of technical ministries over state enterprises, bureaucratic interference, less autonomous managers, etc. However, the process of reform and modernization of state enterprises in particular and economic reform in general has generated changes towards a more open bureaucracy, regularization, and decentralization. For state enterprises, these changes constitute the necessary step for their efficient and effective functioning in the market economy.

To look at such trend, this study conceptualizes the reform and modernization of state enterprises on three levels of change: political economy, institutional set-up, and organization. This inclusion of macro and micro aspects into the analysis of reform and modernization of state enterprises conforms to the view of Waterbury, Suleiman, and Olsen. Waterbury and Suleiman have argued that state enterprise reforms are embedded in other issues pertaining to structural adjustment, degrees of state intervention in the economy, and the regulation of markets. All these are politically linked to the political issues of public resource allocation, the provision of collective goods, and the distribution of wealth in society<sup>17</sup>. It is also related to micro level issues of reshaping state enterprise along the market line. Olsen stated that this is concerned with the adoption of variety of modernization programs by state enterprises to improve effectiveness, efficiency, and productivity<sup>18</sup>.

As constructed in this study, such three levels of change assume that the structural adjustment creates some effects on the institutional set-up of state enterprise, and this institutional set-up in turn affects individual state enterprises. In the following discussion, the conceptualization of reform and modernization of state enterprises at three levels of change as mentioned above is elaborated one by one by using the concept of marketization, de-bureaucratization, commercialization, corporatization, professionalization, and privatization.

## 1. Marketization and De-bureaucratization

A sudden decline in government revenues by 1983 and 1986 due to the drop in oil price which was then followed by the decision to embark on economic reforms precipitated changes in the economic and political ecology of

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<sup>17</sup> E.N. Suleiman and J. Waterbury (eds.), *The Political Economy of Public Sector Reform and Privatization*, Oxford: Westview Press, 1990, p.1; See also H. Bienen and J. Waterbury, "The Political Economy of Privatization in Developing Countries", *World Development*, 17(5), p.617-32.

<sup>18</sup> J.P. Olsen, "Modernization Programs in Perspective: Institutional Analysis of Organizational Change", *Governance*, 4(2), April 1991, p.125-49.



administration in Indonesia. The changes were necessary to shift the economy from a heavy dependence on oil revenues, which contributed almost 70 percent of the total government revenue, and on other primary commodities with high elasticity of demand and supply in the world market, to a more diversified and export-oriented revenue sources. Among the most important changes following this are : 1. shifting the strategy of industrial development from import substitution to export orientation; 2. increasing the role of the private sector in the economy; and 3. increasing mobilization of domestic resources. The government pursued such changes in the economy by gradually letting market forces work.

In politics, as the market forces were set in motion the government also changed its role in the development process from leading into facilitating. This was done by redefining the scope and the instruments of its intervention. In terms of scope, the government scaled down its direct investment and encouraged private sector to take a greater share. Various regulations which led to the omnipresence of government were terminated. In terms of instruments, preference has shifted from direct to indirect instrument such as regulations.

To appreciate the effect of changes just mentioned on state enterprises, it is better to look first at the general explanation of the relationship between the economic and political dimensions as developed by Riggs. He has argued that in developing countries market and politics are closely intertwined. Political influence affects economic transactions. Political patronage and other non-economic factors go hand in hand with technical and rational economic criteria in determining price<sup>19</sup>. Given this view, allowing market forces to work, thus means reducing or discarding the political influence and other non-economic factors from economic transactions. In other words, this is the regularization and rationalization of the economy. As a process this is called marketization. The concept of marketization may also be used to describe the broader coexistence of public and private sectors<sup>20</sup>, privatization<sup>21</sup>, returning to the competitive conditions of the market, and the use of various strategies to strengthen market discipline, all of which are concerned with the regularization and rationalization of the economy.

With regard to politics, Riggs has pointed out that in developing countries the bureaucracy monopolizes power, frequently at the expense of all other social groups. This bureaucratic domination was clearly seen in at least three aspects: 1. excessive state interference and control; 2. weak extra

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<sup>19</sup> For the same meaning as I used here, Riggs used the terms market and arena factor. He stated that "in the prismatic society (read: developing country), both arena and market factors combine to determine prices". F.W. Riggs, *loc.cit.*, p. 105-106.

<sup>20</sup> Klaus Konig, "The Transfer of Public Functions: A European Perspective", in N.C. Yuen and N. Wagner (eds.), *Marketization in Asean*, Singapore: ISEAS, 1991, p. 53.

<sup>21</sup> T.M. Heng and L. Low, "Marketization of Telecommunications in Southeast Asia", in N.C. Yuen and N. Wagner, *op.cit.*, p. 80.

bureaucratic forces which make them incapable of fulfilling the role in input-output theory; 3. a powerless legislative body to control the bureaucracy<sup>22</sup>. However, this bureaucratic domination and control, which is called bureaucratic polity or bureaucratism in the terminology of Riggs, came under pressure to de-bureaucratize in 1983 because the new role of the state in the development process as facilitator assumed the lessening of bureaucratic interference. Bureaucratism is inimical to price determinacy. It has created a "high-cost" economy. Debureaucratization therefore becomes the necessary condition for the success of marketization.

The general concept of marketization and de-bureaucratization as used here implies a challenge to bureaucratic polity. The significance of this challenge will be more obvious if we put it against the character of the bureaucratic polity given by Riggs, which is exactly applied by Karl D. Jackson to the case of Indonesia<sup>23</sup>.

In Jackson's analysis, the bureaucratic domination in Indonesia is held by the President, his personal advisors, generals in defense and security (Hankam), members of the cabinet, and a few top bureaucrats. They all exercise decisive power over national policy making without significant participation from the existing political parties and the masses. It was shown that elite circles make up the ruling elite. Each has its own supporters whose connection with the top elite is vertically integrated through patron-client relationship. According to Riggs<sup>24</sup> and also Jackson, the leader or patron is regarded as a father and client, as children, each with rights and obligations almost similar in a family. Competition for power among elite circles in close proximity to the President and the final arbiter role of the President constituted the important political dynamics in Indonesia.

Furthermore, Jackson showed the inherent tendency of individuals and groups to appropriate state resources for their personal gains. In his analysis this is due to the insulation of decision making from social and political forces outside the highest echelons and the non-existence of powerful forces capable of controlling elite activities. Problems of organizational inefficiency therefore became difficult to solve. In some instances, the appropriation of state resources are precisely what leads to organizational failure<sup>25</sup>. But in general, as Jackson

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<sup>22</sup> F.W. Riggs, *loc.cit.*, p.230-234, and 260-285.

<sup>23</sup> K.D. Jackson, "Bureaucratic Polity: A Theoretical Framework for the Analysis of Power and Communication in Indonesia", in K.D Jackson and L.W. Pye (eds.), *Political Power and Communication in Indonesia*, London: University of California Press, 1978, p. 3-22.

<sup>24</sup> In the case of Riggs, see: Riggs, *loc.cit.*, p.276.

<sup>25</sup> This happen to state oil company Pertamina when in 1975 the company was no longer capable of fulfilling its financial obligation as much \$10 billion to international creditors. It also occurred in state development bank Bapindo in 1994 as the Bank lost \$600 million. The scandal involved banks' managers, a minister, and chairman of State Advisory Agency.

argued, this organization inefficiency does not necessarily preclude overall organizational effectiveness since the appropriation of the state resources that creates such inefficiency does not out-distance the fulfillment of normal business operations. In judging the organization's performance, Jackson goes on to say, the important question therefore is not whether or not particular corruption exists in absolute terms. But rather to what extent the corruption as a proportion of total resources is expanding. Thus Jackson states, "corruption is increasing, but because of the existence of slack resources, organizational achievements are multiplying at an even faster rate, and hence the state is progressing albeit at less than optimal rate". At a more general level, Riggs has also explained that corruption and other kind of appropriation of state resources become rather institutionalized as the transformation of the bureaucracy, from one with a patrimonial or prebendary basis to one based on salary and professionalization, is not incomplete. In the case of the former, as Riggs has mentioned, an individual bureaucrat procures a large part of his income from outside the central treasury<sup>26</sup>.

Put against this character of the bureaucratic polity in Indonesia, marketization runs counter to the existing appropriation of state resources and authority by state officials. It creates forces that work on the basis of market considerations where economic rationality takes precedence over the distribution of largesse, patronage and other privileges. De-monopolization, the removal of protection, and regularization of organizational performance as efforts of marketization pose a direct assault on the economic base of state officials. Meanwhile, de-bureaucratization is at variance with bureaucratic domination. As de-bureaucratization is a logical measure that should follow marketization, pressures to reduce bureaucratic interference and control is strong. In the context of the bureaucratic polity in Indonesia, de-bureaucratization also constitutes an indirect attack on the personal appropriation of state resources since it is due to the possession of bureaucratic power that such appropriation is possible<sup>27</sup>. Given the pressures from marketization and de-bureaucratization, the bureaucratic polity in Indonesia is therefore at a critical juncture of transformation. To see some of the constraints and opportunities in this transformation, we should briefly explore the relationship between politics and economy not in terms of appropriation but in terms of policy, a point which has escaped from Riggs and Jackson in their analysis of the bureaucratic polity.

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<sup>26</sup> Riggs, *loc.cit.*, p.44-45.

<sup>27</sup> For instance, R. Robison stated that "bureaucratic office is commonly appropriated by a center of political power, and the authority vested in that office used to secure the political survival and personal wealth of a political faction or individuals". See: R. Robison, "Culture, Politics, and Economy in the Political History of the New Order", *Indonesia*, no.31, April 1981, p.81.

## 2. Transforming the Bureaucratic Polity by Marketization and De-bureaucratization

It is evident that marketization and de-bureaucratization are currently exerting pressure on the Indonesian bureaucracy to change. This therefore rejects the existing opinion that Indonesia has a lack of the necessary factor for transforming the bureaucratic polity<sup>28</sup>. The failure to see this factor is due to the focus solely on extra bureaucratic forces as a direct source of change. As Liddle suggests, a change in the bureaucratic polity may also happen because of the anticipation and preemption of state officials of the possible demands of the population<sup>29</sup>. As a policy action, marketization and de-bureaucratization belong to this category. They are initiated from within the bureaucracy in anticipation of the possible political repercussions of the economic crises in 1983 and 1986.

Robison has argued that economic policies in Indonesia's New Order should be understood in the context of the structure of intra-class conflict and the role played by the state in general and the individual bureaucratic elite in particular in the formation a particular economic order. The New Order itself, according to Robison, constitutes an alliance embracing foreign and domestic Chinese capitalists, middle class (urban technocrats, members of the administrative and managerial classes), and bureaucrats. The alliance is integrated in two ways; one through the provision of a political, legal, and economic infrastructure conducive to the interests of the alliance; and another through an extensive business alliance between specific bureaucrats or their families and private business groups involving domestic Chinese and foreign elements. In the latter, the bureaucrats provide the necessary political infrastructure for their partners in the form of protection, contracts, concessions, and licenses<sup>30</sup>.

These have been reflected in policies of economic nationalism and import substitution from the early 1970s to the mid-1980s. The state by default came to embark on a state-led industrialization and played the entrepreneurial role due to the weakness of the private sector to take the lead. Indeed, this has been reinforced by the ideological preoccupation that places the state in a strong role in economic life. As the policies were put into effect, however, major bureaucrat elites appropriated their power and authority to allocate contracts and grant monopolies to their family members and other business allies. The absence of powerful forces outside the state also allowed such a patrimonial style to develop to a degree that enhanced the financial base, economic power, and patronage of

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<sup>28</sup> This opinion is held, for example, by G.N. Jones, "Implementing Priority Development Programs: Bureaucratic Innovation of the Indonesian Junior Minister", *Journal of Rural Development and Administration*, vol. 38(3 & 4), 1986, p.36.

<sup>29</sup> R.W. Liddle, "The Politics of Shared Growth: Some Indonesian Cases", *Comparative Politics*, vol.19, no.2, 1987.

<sup>30</sup> R. Robison, *loc.cit.*, p. 90.

the bureaucratic elites. As Robison has argued, the policies of economic nationalism and import substitution therefore became integrated into the political interests of the politico-bureaucratic elite or bureaucrat capitalists in Riggs' term. In other words, their interests were embedded in the perpetuation of such policies<sup>31</sup>.

In view of that, then one question follows: how far marketization and de-bureaucratization may transform the existing bureaucratic polity? To answer this question, first of all it is argued that because marketization and de-bureaucratization in Indonesia were implemented gradually and in many respects on a case-to-case basis, the continuity of reform is very crucial in transforming the bureaucratic polity. This points to the importance of the dynamics of international and internal factors.

In the international sphere, the new international division of labor, the free operation of market forces, and the free movement of capital across countries have made marketization and de-bureaucratization the global policy culture. In this connection, for example, Cerny has identified three global trends relating to both concepts: 1. A shift from macroeconomic to microeconomic interventionism; 2. A shift in the focus of such interventionism from comparative advantage to competitive advantage; and 3. A shift in government politics from the general maximization of welfare to the promotion of enterprise, innovation, and profitability in both public and private sectors<sup>32</sup>. The World Bank contributed to the diffusion of this market ideology as a conditionality of its loans imposed on developing countries, including Indonesia.

Such international forces reinforced internal pressures for marketization and de-bureaucratization. The internal pressures stem from the fact that after the oil price decline the government had to increase and diversify its revenue base and decrease its foreign loans. The need to increase the efficiency of the national economy added to that. This meant that the financial base of major bureaucratic elites which had caused the high cost economy was reduced and the state apparatus was to be regularized. These internal pressures in turn have been generating major differences over economic policies. As Robison puts it, this was particularly between those in defense of state-led industrial deepening and protectionist policies and those that promoted the reduction of state economic control and the opening up of the market<sup>33</sup>. It is obvious that as long as the latter gained increasing influence over economic policies due to strong internal pressures, marketization and de-bureaucratization should continue. Hence, this further results in the regularization of the state apparatus and the reduction of the

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<sup>31</sup> R. Robison, "Authoritarian States, Capital-Owning Classes, and the Politics of Newly Industrializing Countries: The Case of Indonesia", *World Politics*, 16(1), October 1988, p.52-71.

<sup>32</sup> P.G. Cerny, "The Limit of Deregulation: Transnational Interpenetration and Policy Change", *European Journal of Political Research*, no.19, 1991, p.175-190.

<sup>33</sup> R. Robison, *loc.cit.*, p. 68-69.

powers of the bureaucrat capitalist elite to provide their business allies with the necessary political infrastructure.

However, how far is this transformation of the bureaucratic polity possible? In this respect, structural and cultural conditions should be taken into account. Structurally, marketization and de-bureaucratization are initiated from within the bureaucracy, and are not the result of the pressures from extra-state forces. Besides, no powerful and independent forces outside the bureaucracy currently exist. Because of this, it is hard to believe that the transformation of the bureaucratic polity would be radical. The face and scope of transformation would be gradual and controlled by the state. Culturally, marketization and de-bureaucratization are also under constraints. The existing cultural predilection hardly possesses any elements which support the notion of capitalism, competition, and the marginal role of the state in the economy. Indeed, the existing ideological preoccupation is with equity, solidarity, and economic democracy, and these call for a strong role of the state in the economy. The problem is, as mentioned earlier, this strong role of the state is often harnessed by the politico-bureaucratic elite to advance its own interests. Thus, the combination of such structural and cultural factors sets limit to how far marketization and de-bureaucratization may transform the bureaucratic polity.

### 3. Commercialization and Corporatization

The concepts of marketization and de-bureaucratization at the economic political level relate to the concept of commercialization and corporatization at the level of the institutional set-up of state enterprises. The meaning of both concepts implies the current thinking of how government should be reformed. Hood embraced the idea of reform in terms of new public management (NPM)<sup>34</sup>. Osborne and Gaebler coined the same idea in terms of reinventing government<sup>35</sup>. Pollit, Lan and Rosenbloom respectively pointed to terms managerialism<sup>36</sup> and market-based public administration for the same idea<sup>37</sup>. All these terms have several common ideas: the separation of policy management from service delivery, the use of explicit performance indicators, the introduction of competition, corporatization of bureaucratic units on an 'arm-length' basis, a strong orientation towards results and customers, and commercialism. As these

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<sup>34</sup> C. Hood, "A Public Management for All Seasons", *Public Administration*, 69(1), 1991, p.3-19.

<sup>35</sup> D. Osborne and T. Gaebler, *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*, Reading MA: Addison-Wesley, 1992.

<sup>36</sup> C. Pollitt, *Managerialism and the Public Services: The Anglo American Experience*, Oxford: Basil Blackwell, 1990.

<sup>37</sup> Z. Lan and D. H. Rosenbloom, "Editorial", *Public Administration Review*, 52(6), 1992.

ideas are put in the context of reforming state enterprises, they appear in two fundamental ideas. First is the necessity to expose state enterprises to market forces. Second is the necessity to reduce government interference and excessive control over state enterprises. The reason is that poor performance of state enterprises is the result of a lack of competition and autonomy. Hence to remedy them, the government must create the appropriate environment by letting market forces work and grant state enterprise managers with enough autonomy to deal with these forces. The argument is that the former triggers innovation and cost-efficient behavior while the latter provides flexibility to optimize factor mix, diversify business, and raise capital. With regard to the use of performance indicators in reforming state enterprises, it comes as the consequence of a shift in government control on the basis of input and process to that of output. This performance indicators serve as a monitoring system, which Bouckaert and Halachmi have argued as "necessary to steer and to control improvements"<sup>38</sup>.

Thus, the concept of commercialization refers to the process of change in the structure governing the relationship between state enterprise and market, that is, from protective or monopolistic to competitive and/or cooperative. This implies the removal of barriers to the entry of new firms through de-regulation and de-monopolization or the creation of a contestable market. The result of this commercialization is the emerging pluralization of enterprises to include state, private, and to a limited degree cooperatives, too, as well as the removal of inefficient state enterprises. The idea underlying the concept is that a broader coexistence of state and private enterprises takes place as private enterprises get a larger share in sectors previously dominated or monopolized by state enterprises. In the Indonesian politico-cultural context, this cannot be set apart from the economic democratization which reflects the family principle of the state ideology Pancasila.

The change from a protective or monopolistic into a competitive and/ or cooperative structure requires corresponding changes in the relationship between state enterprises and the government. The term corporatization represents this change, and its general meaning implies the process towards a point at which, as Abranches has mentioned, state enterprises operate semi- independently and are integrated only at the very highest level of policy formation<sup>39</sup>. In other words, state enterprises are segmented from the core bureaucracy. The specific meaning of corporatization is the transformation of state enterprises into commercial entities either through a change in legal status which enables them to operate on a

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<sup>38</sup> A. Halachmi and G. Bouckaert, "The Challenge of Productivity in a Changing World", *International Review of Administrative Science*, Vol.59, 1993, p.10

<sup>39</sup> S. Abranches, in D. Rueschemeyer and P.B. Evans, "The State and Economic Transformation: Towards an Analysis of the Conditions Underlying Effective Intervention", in P.B. Evans, D. Rueschemeyer, T. Scokpol (eds.), *Bringing the State Back In*, Cambridge, 1985, p. 59.

commercial basis<sup>40</sup> or through a separation of non-commercial functions from commercial ones. Other measures to corporatize state enterprises include: 1. imposing greater autonomy and authority of managers; 2. devising appropriate performance criteria and monitoring; 3. creating an incentive system; and 4. removing various advantages and disadvantages to state enterprises. The main objective of this corporatization is to improve the functioning of state enterprises to a point that they are finally capable of behaving like a normal private enterprise without transferring the ownership from the public sector to the private sector. Under corporatization measures the relationship of state enterprises with the government is shifted from an administrative to a managerial relationship. The difference between these two terms may refer to the terms 'compelling control' and 'preventive control' used by Kochen and Deutch. The former is linked with the centralization of power and the latter is linked with decentralization and autonomy<sup>41</sup>.

In the context of Indonesia, the term administration above also has a meaning close to hierarchical and patrimonial style of management, which according to the observation of Jackson and Emerson on Indonesian bureaucratic polity contains the following: 1. power is concentrated at the top of the bureaucracy with little delegation of authority to the subordinates and a tendency towards paternalism. 2. subordinate units are preoccupied with procedures rather than results. 3. communication tends to be one-way from the top, thus lacking feedback from the bottom. In the view of Jackson and Emerson, even though these characteristics are typical of the Weberian bureaucracy, they are also rooted in the Javanese values of an appropriate leader-follower relationship, interpersonal behavior, and the conception of power<sup>42</sup>. Fatherism, deference to superior, and the stress on harmony are among the values considered to be important in giving substance to these characteristics.

#### 4. The Politics of Reforms

The change in terms of segmentation and pluralization as described above started with the banking deregulation in 1983, and with state enterprise restructuring in 1986. Then, it continued with the deregulation in other state enterprise sectors including transportation, telecommunication, and electricity in

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<sup>40</sup> See: World Bank, *World Development Report 1994: Infrastructure for Development*, New York: Oxford University Press, 1994, p.40; also Ian Thynne, "Transformation of Public Enterprises: Changing Patterns of Ownership, Accountability and Control", in Ng Chee Yuen and Norbert Wagner, *loc.cit.*, p.42-44.

<sup>41</sup> M. Kochen and K.W. Deutch, *Decentralization: Sketches towards Rational Theory*, Cambridge, Massachusetts, 1980, p. 212.

<sup>42</sup> K.D. Jackson, *loc.cit.*, p.3-42; D.K. Emerson, "The Bureaucracy in Political Context: Weakness in Strength", in K.D. Jackson and L. Pye (eds.), *loc.cit.*, p. 82-136.



1988, some of which are still continuing up till now. It is obvious from more than a decade of reforms that the change is slow and gradual due to various political obstacles. To explain the political dimensions of change, we should take a look at: 1. the consequences of reforms for various interest groups; 2. the existing institutional context; and 3. the political will or government capacity<sup>43</sup>. The assumption is that competition, and various strategies of reforms including whole or partial privatization alter the institutional framework through which various forces pursue their interests. This in turn creates support and opposition from various forces.

As we use these factors to analyze the obstacles to change in the sense of segmentation and pluralization above, several things became obvious. First of all, it is clear that the Finance Ministry and the Technical Ministries are the most concerned parties in the reform of state enterprises. Their interests are affected directly by any particular reform strategy. Thus conflicts over reform policies break out between them. The root cause of this conflict is competition to control the strategic apparatus of the economy. State enterprises serve not only as a ministerial policy instrument but also as an important source of patronage and additional income for individual bureaucrats. Other parties involved are members of parliament, the general public, and also other state agencies. Issues, interests, and their articulation that affect reform policies are embedded in the existing institutional context. Thus, the picture of the bureaucratic polity and bureaucratic capitalism as already argued respectively by Riggs, Jackson and Robison serve as useful models to explain how reform policies have evolved. Finally, the role of President Soeharto was crucial in the evolution of reform during the period 1983-1995 because it is in him that the political will for reform resides. The President also played the role as an arbiter in the bureaucratic conflicts over reform policies involving different interests of ministers. Chapter four describes in detail how these factors interacted and thus affected the face and scope of reforms.

## 5. Professionalization and Privatization

Professionalization and privatization refer to changes at the level of the state enterprise. Professionalization is linked with increasing organization and management competence, creating organizational excellence, and improving relationship with consumers by acting more in functional and market-based

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<sup>43</sup> These explanatory factors are drawn from various authors, See: H.B. Feigenbaum & J.R. Henig, "The Political Underpinnings of Privatization: A Typology", *World Politics*, 46, January 1994, p.185-208; R.S. Milne, "The Politics of Privatization in the Asean States", *Asean Economic Bulletin*, 7(3), 1991, p.322-334; R.S. Milne, "Changing Directions of Research on Privatization in the Asean States: An Overview", *The Indonesian Quarterly*, 29(4), p.344-362.

ways<sup>44</sup>. In a similar vein, Flamholtz used the concept of professionalization of organization in the sense of developing a management system and corporate culture to cope with more complex tasks<sup>45</sup>. Hall argued that professionalization is inversely related to bureaucratization<sup>46</sup>. It results in decentralization and expanding choice. Perhaps, the meaning of the professionalization of Indonesian state enterprises was poignantly expressed by Minister Ali Wardhana with the phrase "stop acting as subordinate bureaucratic units and start behaving as profit-maximizing businesses"<sup>47</sup>. This carries implications similar to the meaning of professionalization above: customer service orientation, organizational competitiveness, and adaptive organization.

The classic writings of Lawrence and Lorsch, Galbraith, and in particular Miles, Snow, Child, and Mintzberg who worked on the strategic contingency approach offers useful insights into the understanding of organizational and management changes of state enterprises. Following the idea of Lawrence, Lorsch, and Galbraith, professionalization in the sense above reflects rational adaptation to shifting contingencies and the need for creating appropriate matches between structure and contingencies<sup>48</sup>. Lorsch's concept of organizational design including organizational structure, planning, rewards, and training and Mintzberg's design parameter serves as a useful indicator of organizational and management change for this study<sup>49</sup>.

Meanwhile, Miles and Snow put explicitly the need for aligning an organization with its environment through the formation of strategies. Child argued that strategies determine the structure and process of organizations<sup>50</sup>. Their view implies the imperative to match strategies to environmental constraints and opportunities and to match internal structure and process to these

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<sup>44</sup>This definition is concluded from various authors which use the term 'professionalization' at individual and organizational level. See: T.J. Johnson, *Profession and Power*, London, 1972; G. Benveniste, *Professionalizing the Organization*, London: Jossey-Bass, 1987; and also Mintzberg, *Structure in Fives*, Englewood Cliffs, 1983.

<sup>45</sup> E.G. Flamholtz, *How To Make The Transition From An Entrepreneurship To A Professionally Managed Firm*, London: Jossey-Bass, 1986, p. 79-101.

<sup>46</sup> R.H. Hall, "Professionalization and Bureaucratization", *American Sociological Review*, 1968, 33, 92-104.

<sup>47</sup> Ali Wardhana, "Structural Adjustment in Indonesia: Export and the "High-Cost Economy", *The Indonesian Quarterly*, 27(3), 1989, p.214.

<sup>48</sup> P. Lawrence and J. Lorsch, *Organization and Environment*, Cambridge: Harvard University Press, 1967; J.R. Galbraith, *Designing Complex Organizations*, Reading, MA: Addison Wesley, 1973; J.R. Galbraith, *Organization Design*, Reading, MA: Addison Wesley, 1977.

<sup>49</sup> J.W. Lorsch, *Organizational Dynamic*, Amacom, 1977; H. Mintzberg, *The Structuring of Organizations*, Englewood Cliffs, N.J.: Prentice-Hall, 1979.

<sup>50</sup> J. Child, *Organization: A Guide to Problems and Practice*, London: Harper and Row 1977.

strategies. The current view also stresses organizational culture as one determinant of performance. Indeed, Peter and Waterman have emphasized strongly that shared values are a salient characteristic of successful organizations<sup>51</sup>. Given this, the question of which comes first to be reformed, whether structure or administrative culture, marked one of the debates in the current literature on the modernization of public sectors<sup>52</sup>. This study argues that since structure and culture condition each other, both should be reformed simultaneously. Thus following the logic of strategic contingency, it is necessary to match environmental demands and opportunities, strategies, and culture. In connection with this, Peter and Waterman goes further by matching what is called the Seven 'S' comprising: 1. structure; 2. system; 3. strategy; 4. style; 5. staff, 6. skills, and 7. shared values (culture)<sup>53</sup>. The notion of matching among these various elements underlies the logic of current organization and management changes of Indonesian state enterprises.

Privatization is meant here as the transfer of function, activity, or ownership (either partially or completely) of state enterprises from the government to the private sector. Of particular importance here is the strategy of selling parts of shares in capital markets. This partial privatization is regarded as a necessary step to improve transparency and public scrutiny. The assumption is that the entry of a third party in the ownership of state enterprises would restrain the government inclination to advance political goals at the expense of commercial goals and ensure arm length basis in the relationship between government and state enterprises. Because of this, partial privatization becomes the next step after corporatization. The latter is concerned more with internal consolidation in terms of the relationship both with the market and with the government. It exposes state enterprises to market discipline and prepares it for entering capital markets. In short, in the evolution of state enterprises, particularly in the present context of reforms, corporatization becomes the necessary condition towards privatization.

Change at different levels as described so far is depicted in figure 1.1 in the following page.

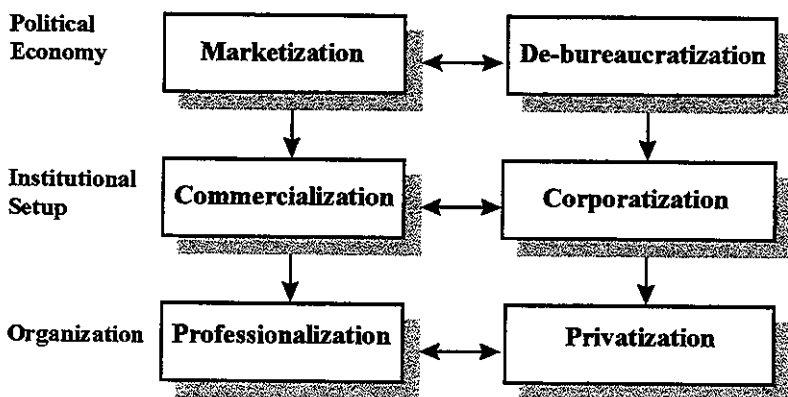
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<sup>51</sup> T.J. Peter and R.H. Waterman, *In Search of Excellence: Lessons from America's Best Companies*, New York: Harper & Row, 1982.

<sup>52</sup> H. Klages and O. Haubner, *loc.cit.* p. 364.

<sup>53</sup> Peter and Waterman, *loc.cit.* p. 35.

**Figure 1.1 Change at Different Levels of Analysis**

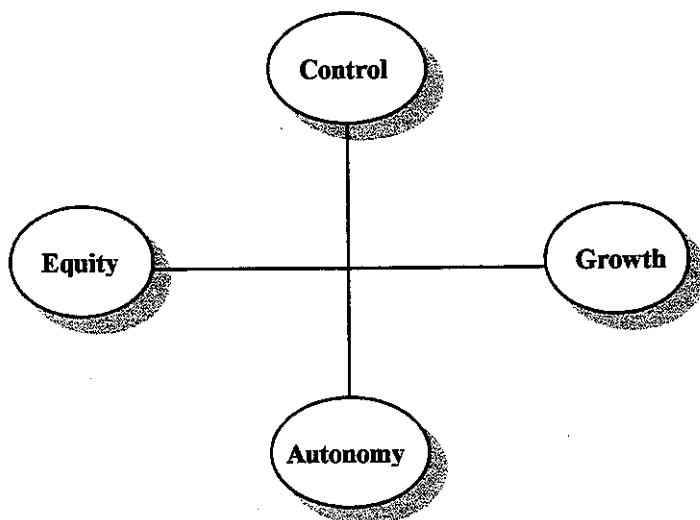


## 6. Four Forces in the Course of Reform

The fiscal crisis in 1983 and 1986 led the government to be caught between four contradictory forces. The first force was the necessity to allow state enterprises to seek maximum growth. The rationale is that maximum growth and maximum profit would enable state enterprises to finance their operation and investment from their own internal or external resources outside the government and also to contribute to the government budget. A logical consequence which constituted the second force then follows. The government must provide state enterprises with greater autonomy in strategic and operational matters. The third force is the requirement to involve state enterprises in addressing social and economic equity. To be sure, state enterprises must help in the development of cooperatives and weak economic groups. This especially became politically imperative as the post-1983 economic reforms widened the economic gap between the indigenous Indonesians and the Indonesian Chinese minority. This concern resulted in the constitution of a fourth force, that is, the government must retain significant control over state enterprises. These four contradictory forces which are control, autonomy, equity, and growth<sup>54</sup> are depicted in figure 1.2.

<sup>54</sup> Equity and growth have some parallels with legitimacy and efficiency as defined by Maes. Equity also implies the protection of interests. However, here it is not approached from the administrative law, but from the perspective of redistribution. Growth implies the same meaning as the term 'efficiency', of which Maes has defined in terms of value for money, economy, efficiency, and effectiveness. See. R. Maes, *Public Management Between Legitimacy and Efficiency: A Case-Study of Belgian*

**Figure 1.2 Four Forces in the Course of Reform**



The forces toward equity and control are strongly rooted in the environment of the Indonesian political culture which is characterized by a strong predisposition against capitalism and the belief that the government should play a strong and important role in the economy. At a deeper level, this predisposition and belief fit in well with the notion of harmony and a paternal form of government in the Javanese culture<sup>55</sup>. According to this notion, 'liberal' capitalism which stresses conflict and competition of private-self interests is inferior to pre-colonial, traditional, and indigenous values of consensus and cooperation, and the paternal role of the state is best to protect the poor against 'greedy' capitalists. Within this value system, state enterprises play as instruments of state policy to reconstruct the economy and society.

On the other hand, the forces toward growth and autonomy reflect the influence of the global ascendancy of Neo-Liberal ideology. The World Bank contributed to the dissemination of this ideology to policy makers in the Third Development Cabinet of President Soeharto through its recommendations for more market-oriented policy reforms and more efficient and less bureaucratic

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Public Administration, Paper for Annual Conference of European Group of Public Administration, Rotterdam 6-9 September 1995.

<sup>55</sup> The Influence of Javanese cultural values upon political behavior has been discussed by various authors. See for example, Benedict R. O'G. Anderson, "The Idea of Power in Javanese Culture", in Claire Holt (ed), *Culture and Politics in Indonesia*, Ithaca: Cornell University Press, 1972; K.D. Jackson, "The Political Implications of Structure and Culture in Indonesia", in K.D. Jackson, *loc.cit.*, p. 23-42; R.W. Liddle, "The National Political Culture and The New Order" in *Prisma*, vol.47, 1987, p.4-20.

intervention in economic development. Driven by the necessity to adjust to the oil price decline, the Indonesian government followed such recommendations by undertaking deregulation and liberalization of the economy starting in 1983. However, ideological aversion to liberal policies diminished such influence. Support for strong state enterprises, cooperatives, and small and medium sized businesses continued with the same fervor as ever.

## **7. Theoretical Summary**

To sum up, the theoretical notions underlying this study have been elaborated so far, first of all, by referring to the concept of administrative ecology developed by Riggs. This concept considers cultural, economic and political factors as affecting the administrative dimensions in developing countries. Central to Riggs' administrative ecology is the idea of an overlapping interrelationship between the traditional social and cultural system and modern administration. By an overlapping relationship, it means that modern administration is not autonomous but is influenced by the remnants of the traditional social and cultural system. In Riggs's analysis such an overlapping relationship resulted in the characterization of bureaucracy in transitional or prismatic societies in terms of the bureaucratic polity, the role of state officials as state managers and as bureaucrat capitalists, excessive centralization, a strong control, and lack of delegation. This characterization constituted a useful insight for this study. It described the Indonesian bureaucracy in general and helped to explain the specific direction of reform and modernization of Indonesian state enterprises.

The reform and modernization of state enterprises are then conceptualized in terms of marketization and de-bureaucratization at the political and economic levels, commercialization and corporatization at the institutional level, and professionalization and privatization at the organizational level. The underlying logic is that marketization and de-bureaucratization which are driven by the necessity to adjust to new economic vicissitudes required corresponding changes at the institutional set-up and the organization of state enterprises. That is in terms of commercialization and corporatization, and professionalization and privatization, respectively. Given the process of reform and modernization as conceptualized above, changes are underway towards a more open, regularized, and decentralized bureaucracy.

Finally, the changes toward that direction are placed against the background of four forces comprising control versus autonomy and equity versus growth. Control and equity have a strong historical root in the Indonesian political and cultural environment. Whereas autonomy and growth underlies the current reform and modernization of state enterprises.

## *E. Methodology*

The design of this study is anchored around the study of a social drama. According to Pettigrew, the social drama is a critical event where major structural changes take place. This includes changes in systems of belief, power relationships, and culture, the birth of new organizations, and structural emergence and transformation. All these constitute the points of a dramatic social process which might raise important consequences and meaning for the existing social system. Pettigrew has argued that in this sense social drama provides a transparent look at the growth, evolution, and transformation of a social system. Since it provides a dramatic glimpse into the current working of the social system, social drama can act as an in-depth case study, according to Pettigrew<sup>56</sup>.

This study assumes that seen from the long term development of Indonesian state enterprises, the period between 1983-1995 constituted a critical event in the sense above, and hence deserves to be called a social drama, and can act as an in-depth case study. One can appreciate this event critically by referring to the fact that this period, as shown in the earlier section, was characterized by a major shift in government policy orientation towards state enterprises and by various changes in the institution of state enterprises.

Following this methodological approach, the period between 1983-1995 is broken down further into three 'acts' in a social drama; respectively concerned with changes in the politico-economic environment, changes in the institutional set-up governing the relationship of state enterprises with the market and with government, and the adjustments of state enterprises. Given this, this study started with the analysis of politico-economic environment between 1983 and 1986 which precipitated the deregulation and liberalization of the banking sector and other sectors of the economy. The analysis continued with the examination of state enterprise restructuring between 1986-1995 which brought about major changes in the institutional set-up of state enterprises due to the introduction of various reform strategies including status change, management contracts mergers, privatization, liquidation, and various forms of cooperation between state enterprises and private firms such as joint ventures and joint operations. Finally, the analysis addressed the follow-up of this restructuring at the enterprise level with reference to four state enterprises. Since 1986 state enterprises have been undergoing transformation and reorganization.

One important consequence of this analytical approach was that it required the application of different techniques of data collection and access to different sources of information at different levels. Basically, this study used two techniques of data collection: interview and documentary sources. With regards to the analysis of the politico-economic dimension of reforms, this study relied on

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<sup>56</sup> A.M. Pettigrew, "On Studying Organizational Culture", *Administrative Science Quarterly*, vol.24, December 1979, p.570-581.

literature, documentary materials, and newspapers. Reports, observations, and reviews on deregulation and liberalization policies in Indonesia made by leading media and journals including *Far Eastern Economy*, *Bulletin of Indonesian Economic Studies*, *Asiaweek*, *Asian Survey* constituted important sources of information for the analysis of changes in the government policy orientation during 1983-1986.

With regard to the restructuring of state enterprises, the policy documents were collected from the Finance Ministry. The opportunity as a privileged witness who participated in the routine activities of the Directorate General of State Enterprise Affairs of the ministry during the field work allowed me to have good access to unpublished policy statements and other important documents of the ministry concerning state enterprise reforms and regular financial reports of all state enterprises. This also helped me to conduct interviews on many subjects surrounding the reforms with thirteen persons consisting of several different section heads and their staff dealing with different affairs of state enterprises. Their participation in the interview was very important as they knew the details of policies and their implementation.

Opinions, observations, reports, and editorials on state enterprise reforms over the period 1986-1992 were also compiled from several newspapers such as *Kompas*, *Republika*, *Suara Karya*, *Angkatan Bersenjata* and other periodicals. These constituted relevant information for this study as it helped to highlight the various issues and different interests involved in the formation and implementation of reforms policies of Indonesian state enterprises. Of particular importance was the intense public debate over the privatization of state enterprises which involved policy makers, representatives of interest groups, scholars, and the general public. Indeed, this debate was the most controversial issue in the government policy agenda after the fall of oil prices in 1983.

Finally, the analysis of the transformation and reorganization of state enterprises required access to information about individual state enterprises. Once again, the Finance Ministry made it possible for me to meet this requirement. The ministry facilitated my introduction to the respective directors who then gave me permission to conduct research in their enterprises. Four state enterprises were then selected to be studied intensively by using the case study method. The bases for the selection were the following: 1. a strategic importance in a political and economic sense; 2. being in different sectors of the economy; 3. having differences in legal status, and 3. possessing the possibility for privatization, either partial or full. BNI 46 (state bank), Telkom Indonesia (public utility/telecommunication), Garuda Airline (transportation), and Krakatau Steel (industry) met all these requirements.

Data collection at state enterprise level relied on in-depth interviews and document archival. Special permission from the Ministry of Finance helped me to conduct interviews with some directors, their staff, and managers responsible for designing and implementing transformation, reorganization, and consolidation of



the enterprises. The number of persons interviewed in four state enterprises reached seventeen, some of whom were interviewed several times. This opportunity was very important for this study. It gave me access to first hand information about company strategies, reform plans, and related policies taken by top managers. Meanwhile, document archival was focused on company historical data including financial reports, company policies, and reports on minutes and/or results of staff meetings. Data from secondary sources related to the enterprises were also collected from several economic magazines and newspapers, e.g. Business Review Indonesia and Warta Ekonomi, Prospek, Asiaweek, Asian Wall Street Journal, etc.

Following the methodological approach of social drama mentioned earlier, the following chapters will discuss changes respectively in the politico-economic environment, in the institutional set-up of state enterprises, and in the organization and management of state enterprises. However, before taking up these subjects, the historical context of Indonesian state enterprises will be discussed immediately in the following chapter. This will identify important factors and forces in the historical evolution of state enterprises between 1945-1983 that may have affected the formation and implementation of state enterprise reform policy during 1983-1995.