INDONESIA'S ECONOMIC CRISIS AND ITS EFFECT AND THE LIKELY IMPACT OF THE IMF-REFORM PACKAGE ON SMALL-SCALE INDUSTRIES[1]

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I. Introduction

In the current economic recession in Indonesia triggered by the current economic/financial crisis, growth prospects will remain unfourable in most sec-tors of the economy, including agriculture and manufacturing for at least two years to come. The agricultural sector has experienced little growth in 1998 and no a significant improvement is expected in 1999, while the manufacturing sector in 1999 will continue to experience a significant decline in activity, as before in 1998, due to lower domestic demand, higher interest rates, and difficulties in importing raw materials. As a result of the economic recession, ILO (1998) has conducted a study which estimated that in 1998 some 5.4 million workers in the formal sector will be displaced by the current economic crisis, mainly from service (37%), manufacturing (25%), and construction (19%) sectors, and the rate of new unemployed people is expected to increase in 1999. However, because many cannot afford to remain unemployed for long, around half of them will be re-absorbed in small-scale economic activities in the informal sector, including in small-scale industries (SSIs). The employment impact of the crisis will be severe in cities and towns which account for most formal sector employment. The return of many displaced workers back to their home towns and villages (rural areas) will reverse the

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rural-urban shift in employment. ILO (1998) has estimated that urban employment will decline from a peak of 34% in 1997 to 30% in 1998.

Further, the results of the ILO's (1998) study show that, due to stagnant wages and incomes in nominal terms and the increase of displaced workers, on one hand, and high inflation on the other, around 75 million people, or about 37% of the country's population, will fall below the poverty line by mid-1998. If the economic crisis continous, that is more workers will be displaced and informal sector, including SSIs, either in urban or rural areas are not able to absorb all of them, and price will further increase, according to the ILO's (1998) study, it will push some 140 million people, or 66% of the population, below the official poverty line, at poverty levels not seen since the 1960s.

After successful negotiations with the IMF, an agreement was reached in late October 1997, under which the Indonesian government agreed to implement a reform program required to qualify for the IMF rescue package.[2]

Not only the economic crisis will have effect, but also the implementation of the agreed IMF reform package, at least some elements of it, is likely to have a great impact on the development and growth of SSIs, as also of other domestic economic activities in the country.

The objectives of this paper are threefold:

(1) to evaluate the economic crisis and its consequences on unemployment and poverty in Indonesia;

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[2] This reform program contained four major elements, including monetary policy, fiscal policy, financial sector restructuring, and structural reforms. In return, the IMF rescue package provided for a US$43 billion standby loan, including a US$10 billion standby loan from the IMF itself, US$4,5 billion from the World Bank, US$3,5 billion from the Asian Development Bank (ADB) and additional contingency loans from bilateral sourcs, including Japan, the US, Singapore, Malaysia, and Australia.

(1) to discuss theoretically and to examine empirically the effects of the current economic crisis in Indonesia on SSIs development in the country; and

(2) to assess theoretically the likely impact of the full implementation of the agreed IMF reform package on SSIs development in the country.

II. Indonesia's Economic Crisis

In May 30, 1997, the World Bank released its annual report on Indonesia which indicated that during the first half of the 1990s the Indonesian economy had been performing very well, with GDP (Gross Domestic Product) growing at an average annual rate of 8 per cent (World Bank, 1997). Not surprisingly, a similar robust growth was being forecast for 1997.

However only two months after the release of this report this rosy prospect began to unravel as the Indonesian rupiah and the currencies of other Southeast Asian countries, including Malaysia, the Philippines, and even Singapore, started depreciating steeply in the wake of the depreciation of the Thai bath. As a result of the steep rupiah depreciation, the Indonesian economy is gradually but steadily grinding to a halt. Companies are burdened with debts they cannot repay and declining revenues caused by the reduced purchasing power of the public. It has also led to the inability of many companies to import expensive raw materials or parts and components as most overseas banks are refusing to accept the letters of credits (LCs) issued by Indonesian banks on behalf of the Indonesian impor-ters. Production in many manufacturing enterprises, including LSIs as well as SSIs and MSIs, has been drastically reduced or stopped altogether. In addition, the labour-intensive construction activities have totally collapsed following the technical bankruptcy of virtually all real estate companies,

including small- and medium enterprises (SMEs) among these real estate companies. As a result, large and growing number of workers have been laid off (Dierman, et al., 1998).

Considering all the above factors, the projection made by the Central Bureau of Statistics (CBS) of a 13% or more contraction in the Indonesian economy in 1998 (Table 1) and perhaps zero or still a negative growth rate in 1999.

Table 1 Several Macro Economic Indicators of Indonesia: 1994-1998

Indicator	1994	1995	1996	1997	1998
Rate of growth of GDP (%) at constant price 1993	7,5	8,2	7,9	4,7	-13,68
Income per capita (US$)	928	1.039	1.155	1.088	440,20
Rate of inflation (%)	9,2	8,6	6,5	11,1	77,63
Total export value (milyar US$)	40,1	45,4	49,8	53,4	50,05
Total import value (milyar US$)	32,0	40,6	42,9	41,7	27,43
Current account (milyar US$)	-2,9	-6,8	-7,8	-5.8	1.58
Foreign exchange (milyar US$)	13,2	14,7	19,1	17,4	14,06
Foreign debt (milyar US$)	106,0	116,5	118,0	120,5	138.0

Source: LP3E-Kadin Indonesia (processed data from CBS).

Whereas, based on World Bank staff estimates (World Bank 1999), given the difficult institution-building problems inherent in many of the following processes such as renewed capital inflows from abroad, improvement of current account balances, and programs to recapitalize banks, recovery in the East Asian crisis countries is expected to be relatively protracted. Different countries are at different stages of the process mentioned above. Thailand and South Korea are more advanced, while Indonesia is worst off. In the base-case scenario for recovery in these countries affected by the crisis, according to this World Bank estimate, output growth will return to positive levels faster in South Korea and the Philippines than in the other countries, because of faster export growth (Table 2). In Indonesia, GDP is still expected to fall in 1999 but at a much slower rate. In the other countries, GDP is expected to raise marginally, reflecting a stabilization of output in mid to late 1999.

Table 2 Growth in Indonesia and other Crisis Countries in Asia: 1996-2000*

				Forecast	
Country	1996	1997	1998**	1999	2000
Indonesia	7,9	4,7	-15,3	-2,8	2,3
Thailand	6,4	-0,4	-7,0	0,3	2,6
South Korea	7,1	5,5	-6,5	1,0	3,5
Malaysia	8,6	7,9	-5,1	0,5	4,2
Philippines	5,7	5,2	-0,5	2,5	4,4
Total	7,2	4,5	-8,0	0,1	3,2

Notes: * = GDP in constant 1987 prices and exchange rate
** = estimate
Source: World Bank (1999)

III. Some Subsectors of Manufacturing seriously affected by the Crisis

A Cursory examination of the Indonesian economy reveals many (if not all) industries in various subsectors of manufacturing are severely affected by the economic crisis. A large proportion of manufacturing industries are still highly dependent on imported goods. As a result, the steep depreciation of the rupiah has made it very difficult, if not impossible, for them to continue. In rupiah terms these inputs have become prohibitively expensive. Moreover, as explained before, importing these inputs has also often become impossible as foreign banks have refused to accept letter of credits (LCs) issued by Indonesian banks on behalf of Indonesian importers. This has led to a large number of import-intensive industries being forced to drastically curtail their operations or to stop their operation altogether as their strock of imported goods are gradually exhausted.

-The textile industry

Synthetic fibers and cotton are the major raw materials for Indonesia spinning industries. The bulk of cotton is imported (around 500,000 tons annually) as domestic production of cotton unable to meet the needs of the spinning industry. Most of the cotton is imported from the US, Australia, and Pakistan. As a large number of spinning companies still use cotton rather than synthetic fibers as their major raw materials, the rapidly dwindling stocks

of cotton are endangering the continued operations of these spinning companies, estimated to number around 200. A severe contraction of the output of the spinning industry will have an adverse effect on the operations of the weaving industry, which in turn will adversely affect the operation of the garment industry. This, affects Indonesia's foreign exchange earnings, as much of the textile and garment industry, not only large but also small-and medium-scale industries (SMIs), is export-oriented. By early March 1998 a large number of spinning companies had already stopped operations as their stocks of cotton had run out. Since the bank's LCs were not being accepted by the foreign banks, spinning companies were not able to replenish their stocks of cotton, even though the price of cotton is currently low (Dierman, et al., 1998).

-The footwear industry

Like the textile industry, Indonesia's largely export-oriented footwear industry which has also a huge number of SMIs faces serious difficulties in importing raw materials. The stocks of raw materials have recently been depleted. As the Indonesian footwear producers fail to meet the export orders, the danger arises that foreign buyers will turn to producers from other countries, particu-larly China, Vietnam, and Thailand, and the lost market share may be difficult to recapture later (Dierman, et al., 1998).

-The Consumer electronics industry

Indonesia's consumer electronics industry is basically an assembling industry highly dependent on imported parts and components. Around 65% of all parts and components used are imported. Not surprisingly, the steep depreciation of the rupiah

has also adversely affected the operations of this industry. Because imported components and parts have become prohibitively expensive and as the domestic market has shrunk, severe electronics companies and their small-scale subcontracting industries have either reduced or halted their operations (Dierman, et al., 1998).

IV Some Serious Costs of the Crisis: the Increased Unemployment and Poverty

How the economic crisis affects unemployment and poverty in Indonesia will depend on how much output and real income decline and how income distribution evolves. Before the crisis, in the period of rapid economic growth, say between 1990-1997 agricultural employment declined rapidly from 55% to 41% of total employment, though the sector remains the largest single employer. On the other hand, industrial employment rose rapidly from about 8% in 1986 to almost 20% in 1997. With the increase of employment in other urban/formal sectors, urban employment increased from a fifth to over a third of total employment during that economic boom period (Table 3).

ILO (1998) has made an estimation about the employment effect of the crisis in Indonesia.[3]The results of its study shows that (page 2):

(a) Some 5.4 million workers will be displaced by the economic crisis in 1998. However, because many cannot afford to remain unemployed for long, around half of them will be re-absorbed in the informal sector.

(b) Open unemployment, narrowly defined as those not presently

[3] Estimates of unemployment vary widely depending on the assumptions made on the extent of the contraction in the economy, the sectoral elasticities of employment and the magnitude of the backlog of job seekers from previous years.

working and actively looking for work, will rise to 6.7 million, or from 5% of the labour force before the crisis in mid-1997 to 7% by mid-1998. The open unemployment will consist of the remaining displaced workers (about 2.8 million), the new entrants to the labour force in 1998 (1.4 million) and the backlog of job seekers from 1997 (2.5 million).

(c) The newly unemployed wage workers have been displaced mainly from the manufacturing (25%), construction (19%), and service (37%) sectors. However, all other sectors with the exception of agriculture and mining have been affected, namely trade and hotels (195), transport (6%) and finance (3%).

Table 3 ILO Estimates of Changes in Employment by Sectors and Urban-Rural Location, 1986-1998

	Percentage				Total employment (million)			
	1986	1990	1997	1998	1986	1990	1997	1998
By sector								
Agriculture	37.6	42.4	35.8	36.4	55	56	41	43
Industri*	10.8	10.4	16.5	14.2	8	14	19	17
Trade	9.8	11.1	17.2	18.3	23	15	20	22
Services	10.1	12.0	17.4	15.4	14	16	20	18
Total	68.3	75.9	87.0	84.3	100	100	100	100
By location								
Urban	13.6	18.3	29.6	24.2	20	24	34	29
Rural	54.7	57.6	57.5	60.1	80	76	66	71
Total	68.3	75.9	87.0	84.3	100	100	100	100

By Formal/Informal						
Wage employment	17.6	21.1	30.5	25.1	26	26
35	30					
Self-employed & family workers	50.8	54.8	56.6	59.2	74	74
65	70					
Total	68.3	75.9	87.0	84.3	100	100
100	100					

Note: * includes mining, utilities, manufacturing and construction sectors.
Source: ILO (1998).

As explained before, it is expected many of these new unemployed workers who cannot afford to remain unemployed will be forced to return to their home town and villages. If this is the case, this movement will reverse the past trend of movement of workers out of agriculture or the rural-urban shift in employment observed until now (ILO, 1998).[4]Further, the share of urban employment may decline from a peak of 34% in 1997 to less than 30% of total employment in 1998 (Table 3).

With respect to formal/informal sector employment, wage employment as a proxy for employment in the formal sector (in the manufacturing sector: large and medium industries and to a certain extent SIs), increased from around a quarter to more than a third of total employment in the period studied. The layoffs of over 5 million workers from the formal sector due to the crisis will result in the decline of wage employment which is estimated from 35% to 30% between 1997 and 1998 (ILO, 1998). It is expected that

[4] Though the crisis has initiated a significant urban to rural migration flow in Java, many displaced formal sector employees, who no longer maintain ties with agriculture or their home towns/villages of origin, are likely to remain in urban areas and are likely work in the urban informal sector.

at least 50% of these displaced workers will be absorbed in self-employment and family work. That can be in informal manufacturing activities (i.e. SSIs) or in other informal sectors, mainly in rural areas as many of them are expected to return to their villages.

After one year since the crisis started, due to stagnant wages and incomes in nominal terms, high inflation, and increased new unemployed wage workers from the formal sector, it is expected that by the end of 1998 around 100 million, or 48% of the population, will fall below the poverty line. The incidence of poverty in rural areas, at 53%, will be higher than that in urban areas, at 39%, by the end of 1998 (Table 4). Also, over 70% of poor people will live in rural areas (ILO, 1998).

The expected increase of poverty in rural areas is due to the expectation that many displaced workers from the formal sector are likely to return to their home towns and villages and some are likely to be absorbed in the low income activities such as in the agricultural sector and in rural industries (i.e. SSIs).

Whereas, according to World Bank projected increases in poverty in the Asian crisis countries.[5]almost 17 million more people in Indonesia are expected

Table 4 ILO Estimates of Poverty Incidence: 1998-1999

	1998	1999
Percentage		

Indonesia	48.34	66.42
Urban	39.31	56.60
Rural	53.20	71.71

[5] With the assumptions: no change in the distribution of income and a US$ 1 a day poverty line for Indonesia and the Philippines and US$ 2 a day for Malaysia and Thailand.

Poor population (million)		
Indonesia	98.80	137.80
Urban (%)	28.10 (28)	41.10 (30)
Rural (%)	70.70 (72)	96.70 (70)
Total Population		
Indonesia	204.40	207.50
Urban	71.50	72.60
Rural	132.90	134.90

Source: ILO (1998, Table 8).

to fall below the poverty line in 1998 (Figure 1). Moreover, many people in this country live only slightly above the poverty line of US$1.25 a day, for example, the number of poor people would rise by 22 million. This will bring the total number of poor in Indonesia to almost 57 million. In other Asian countries affected by the crisis, the increase of poverty would be less pronounced, but still large: 2.3 million in Thailand, 665,000 in the Philippines, and less than 500,000 in Malaysia (World Bank, 1999).[6]

Further, by using the rupiah in the definition of the poverty line, the World Bank's (1999) study has projected that in Indonesia poverty in the next couple of years would almost double in urban areas and increase by 50% in rural areas (Figure 2a); this result is different than that of the ILO's (1998) study. Further, according to World Bank's estimation, the sharpest increases are expected to be among workers employed in trade and manufacturing

[6] Poverty calculations are very sensitive to changes in distribution of income. The World Bank's (1999) study shows that with a deterioration in income distribution, or say a 10% worsening in the Gini coefficient, the poverty incidence in Indonesia would increase to more than 20%. As a comparison, in Malaysia, Thailand and the Philippines, the rates of poverty would raise to more than 25%.

(Figure b)

Figure 1 The total number of poor people expected to raise in the Asian Crisis Countries

Source: World Bank (1999, Figure 2-25).

Figure 2 Projected poverty trends in Indonesia, by urban-rural areas (A) and Sectors (B)

A B

Source: see Figure 1

V Impact on SSIs: A Theoretical Discussion and Limited Empirical Assessment

Recent data indicate that the manufacturing sector contracted by around 14 percent during the first half of 1988. According to a study conducted by Bappenas and GTZ (1998, page 1), this negative trend is mainly due to the following reasons:

(1) Domestic sales are affected by a shrinking domestic demand, and an inflation of around 60% (as of August 1998) resulting in a decline of real wages and a reduction of the purchasing power of the people.
(2) Foreign orders are dropping because buyers are afraid that Indonesian compa- nies cannot deliver on time due to present financial and economic crisis and are diverting their purchases to other countries like Vietnam, Thailand and China for similar products from Indonesia.
(3) As already explained above, foreign suppiers do not trust Indonesian LCs by reason that the banking sector in Indonesia is assumed to have no more funds, even with the Central Bank (CB) assurances that all LCs are backed by the CB/ Bank Indonesia. The foreign suppliers simply assume no credibility in the Indonesian banking sector, for the time being.
(4) The rupiah depreciation of about 70% has caused increased prices of domestic raw materials by 100-250%, and imported materials by 200-500%, if available, resulting in increased end-product prices by 30-100%.

(5) Raw materials must be paid in cash instead of the usual 1-2 months credit, affecting the working capital whilst cost of funds is now about 65%.

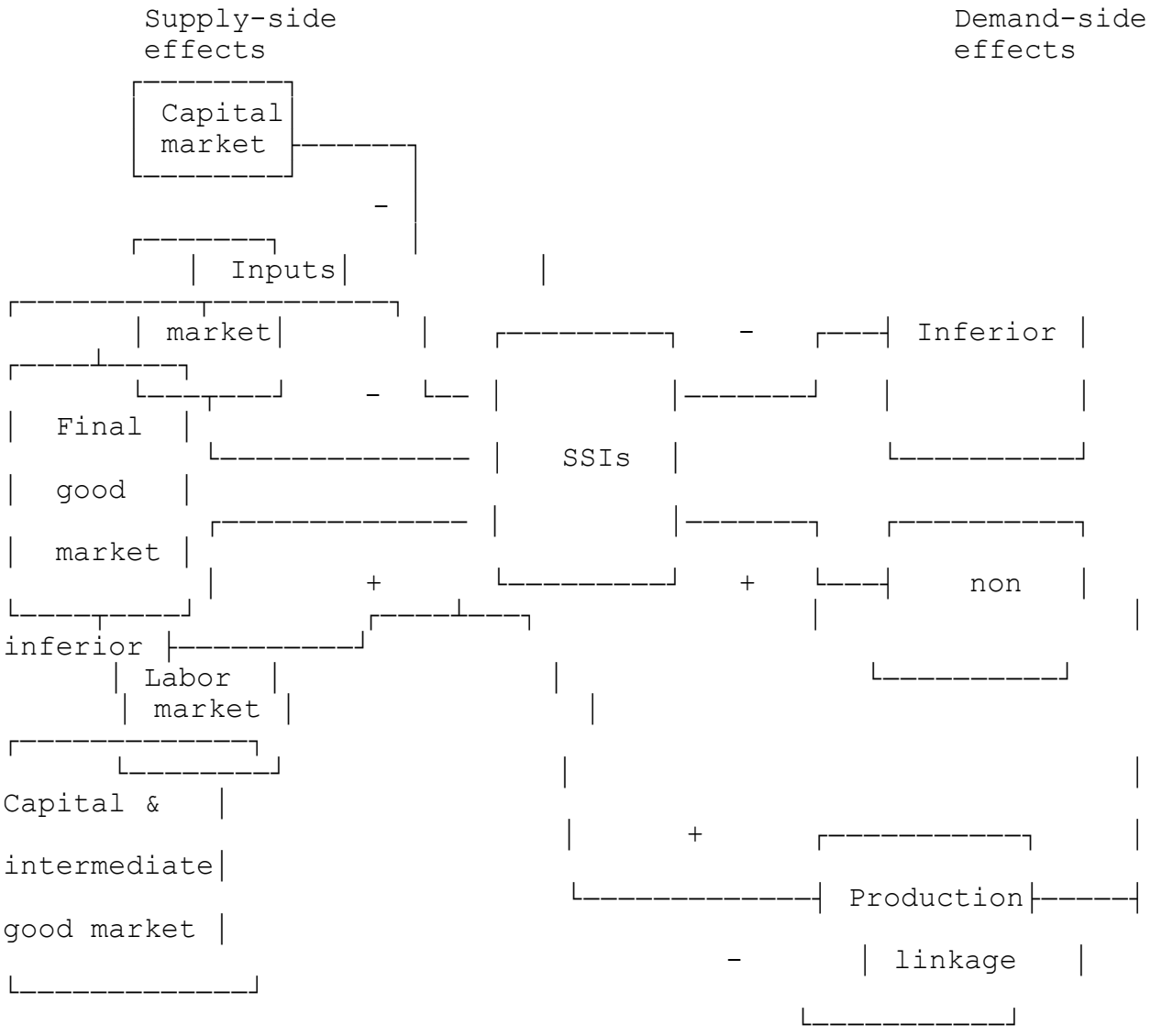
Although it can be expected that many (if not all) SSIs are severely affected by the contraction in the manufacturing sector caused by the above factors, it is not easy (if not imposible) to assess the impact of the economic crisis on Indonesia's all SSIs in view of their large numbers, the diversity of their activities, firm size within the group, types of products produced, market orientation, heterogeneity of their features and their geographical spread across the vast archipelago. In different subsectors of manufacturing, SSIs may have different experiences with the crisis, because individual entrepreneurs producing different goods or servicing different markets may face different internal as well as external conditions, e.g. internal and external constraints, challenges and market opportunities. Probably, only a few of them, especially those whose activities are mainly export oriented and used mainly local raw materials and other inputs, such as SSIs in wood and rattan subsector will benefit from the apreciation of US dollar against rupiah. Moreover, the rapid exist and entry of entrepreneurs into the SSIs, particular at the 'lower' end of the scale, means it is difficult to gauge to what extent the current crisis has affected them.

- A theoretical discussion

Theoretically, the contraction of the economy can be expected to have posi-tive or/and negative effects, or a net positive or a net negative impact on SSIs, as on other businesses (Tambunan, 1998d). Further, as illustrated in Figure 3, the impact of the crisis on SSIs can be distinguished into the supply-side and the

demand-side effects, that can occur simultanously. The supply-side effects are the effects occur through changes in the markets for factors of production, e.g. capital and labour, and other inputs or raw materials. Whereas, the demand-side effects happen via changes in the output (final and intermediate) markets.

Figure 3: A Theoretical Framework in Assessing the Impact of the Crisis on SSIs.



From the supply side, its negative effect is originated mainly

from two sources. First, capital market effects: due to tight national liquidity either as a direct policy response to the crisis or because of the shortage of money itself in commercial banks, the interest rate has increased significantly since the mid. 1998 and the availability of bank credits for all business activities in all sizes became a very short. Also, many large companies who had committed before the crisis to help small producers with capital (and other assistances) in the context of the National Foster-Parents scheme may also turned their back,
because currently they also have their own financial problems caused by the cri-sis. This negative capital market effect will reduce or even stop daily produc-tion activities of small producers who are too much dependent on formal sources of credit (e.g. bank loans) or on capital assistances from their larger business partnerships. Second, inputs market effects: the prices of raw materials and other inputs have also increased, on average more than 200 percent, not only because some of them are imported items but also because of distortions in domes-tic production and distribution systems. This will have a negative impact on SSIs development, particularly those that usually work on smaller profit margins and are less able than their large counterparts to pass price increases on to their consumers. According to some information, many (if not all) SSIs now only work on existing stock of raw materials which may last 1-2 months, whilst many other SSIs have already closed (Bappenas & GTZ, 1998).

Whereas, with respect to the positive supply side effect, the decline of employment in the formal sector will provide a ready supply of workers or/and potential enterpreneurs/producers for the SSIs, as employer of last resort.[7]As shown before, as business

[7] With respect to individual reasons or motivations in undertaking SSI or informal economic activities, a distinction which is often presented in the literature, especialy on the issue

activities of many companies in Indonesia are stagnated or many firms now are closed because of the current crisis, some 5.4 million workers are expected to be displaced in 1998, and the same situation is also expected to happen in 1999 (ILO, 1998). However, because many of these new unemployed wage workers cannot afford to remain unemployed for long, it is expected that around half of them will be re-absorbed in the SSIs and other informal economic activities in the informal sector. So, this so-called a positive labour-supply effect of the crisis is expected to increase the number of units of SSI or workers working in existing ones. But, this positive labour supply effect is not only caused by the increase of open unemployment, but partly also induced by the increase of poverty and inequality.

On the demand-side, as also valid for other businesses, the stability or continuity of demand is very important for SSIs. There are three major sources of market demand for the products of SSIs: (1) community (individual consumers), (2) businesses (firms), and (3) government (e.g. departments). The first source represents the final consumption demand in domestic and export markets, while the latter two sources comprise the intermediate demand.

With respect to the sources of intermediate demand, during the crisis the stability of demand for SSIs products depends much on whether or not the compa-nies or government departments (e.g. development projects), who have business relations in the form of production or demand linkages with the SSIs, are nega-tively affected by the crisis. If they have to reduce or stop their

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of employment movement from agriculture to rural nonfarm activities, is between "push" and "pull" factors. The former factors refer to those who undertake an activity for lack of work alternatives, thus they are "pushed" to do so. The latter ones refer to the attractions of entrepreneurs. With respect to the "push" phenomenon, it is often stated in the literature that SSIs in developing countries function mainly as a last resort for the poor/unemployed people.

activities, this may depress the demand for the SSIs products. But, the crisis may also have a positive demand effect through these intermediate demand sources, namely by creating a greater market opportunity for the SSIs. Before the crisis (before the depreciation of more than 100% of exchange rate of rupiah against US dollar), many domestic medium-and large-scale industries (MLSIs) were used to import all their needed capital and intermediate goods. But, since the crisis began they must change their behavior and start to find their needed inputs from domestic market. This can mean a new demand for domestic SSIs. In other words, currently there is a large potential for the development of small-scale import substitution industries in Indonesia.

With respect to the final consumption demand, it is the primary source for the SSIs products which generated from the incomes of domestic (rural and urban) and to a smaller extent from foreign consumers. In this respect, whether the impact of the crisis on SSIs will be negative or positive, it depends on the relation between the types of good purchased and the level of income of consu-mers. From their nature, if SSIs produce inferior (or non-inferior) goods having negative (positive and high) income elasticity of demand, then, theoretically, it can be expected that when income increases, the demand for such goods decreases (increases).[8]

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[8] According to Engels' Law, as income increases the demand shifts gradually from food to non-food or manufactured goods or from simple (traditional) towards more sophisticated (modern) manufactured goods; or as stated in Biggs and Oppenheim (1986): "On the demand side, increases in per capita income result in a shift away from basic commodities towards products which require a more sophis-ticated organization of supply and division of labor" (p.1). This structural shift in the final demand leads to the decrease in the market demand for inferior goods, which are mainly produced by SSIs, and the increase in the market demand for high income elasticity goods, produced mainly by MLSIs.

Now, given the fact that goods produced by SSIs in Indonesia are purchased mainly by consumers from low and, to a certain extent, middle income groups of the population, then the important question now is: who will be affected most by the crisis: the rich or the poor or the middle class? With an analytical frame-work (an income elasticity approach), the hypothesis can be formulated as fol-lows: if only the real income of the rich declines, then overall, the effective demand for SSIs goods will increase: the decline in purchasing power of the rich is likely to cause a substitution affect from expensive imported goods or goods made by domestic large companies to locally produced lower quality and priced goods.[9]But, when the real income of the poor is affected most by the crisis, then the effective demand for SSIs goods will decline. If the crisis affect all the three income groups, but with different magnitudes, then the net effect of it can be positive, zero or negative (Table 5).

Finally, with respect to the export opportunity for SSIs, theoretically, it can be expected that the depreciation of rupiah against the US dollar will push up the export volume of Indonesia, including SSIs producrs. But, so far there is no strong evidence which supports this theoretical expectation that the export of the country will increase significantly. Many other factors may also play an important role in determining the export performance of SSIs such as production capacity, quality of products, systems of marketing, promotion and distribution, the procurement of raw

[9] There is some anecdotal evidence that this shift is occurring. For exam-ple, a very limited survey of producers of snacks indicated that while there is a sharp downturn, the SSIs producing cassava snacks have experienced an increase in their demand as consumers switch from higher priced snacks, many of which are produced by large firms, to lower priced ones produced by these SSIs (TAF, 1998).

materials and other necessary inputs, skill, and technology used.[10]

Table 5: The Hypothesis about the Impact of The Decline of Income on the Demand for SSIs Goods by Differences in the Income Group and Nature of the Goods.

Change in Income group	The nature of product	The income elasticity of demand	demand as income increases
1. High	very inferior	negative & large	increase significantly
2. Middle	inferior/less inferior	negative & small/ positive & small	increase/decrease
3. Bawah	very non-inferior	positive & large	decrease significantly

[10] Academic researchers have sought to identify factors that support and hinder SSIs in their efforts to increase their exports or to globalise. They have found that attitudes, values, perceptions of risk, continuous learning, managerial and marketing skills, availability of resources (including financial resources), adjustment of organisational structure, and the availability and effective use of information, expanding trade and commercial movements, differen-ces in national values, language, culture, economic structures, institutions, and histories, the distribution of wealth between countries, the level of protection (i.e. tariff as well as non-tariff barriers policies), exchange rate policies, red tape and other unnecessary administration procedures, and multilateral, regional, and bilateral trade policies are key macro issues that indirectly or directly affect the ability of SSIs to enter global markets. These studies suggest that a competitive price though still important does not play as the most crucial factor in determining the successful of SSIs in entering the global market. See, a.o. Hine and Kelly (1997), Jaffe and Hanoch (1994), Axinn, et al (1994), Haar (1995), and Moini (1995).

Further, in the literature, it is generally considered a competitive advantage of SSIs that they are able to respond or to adjust their production quickly and flexibly to sudden and rapid economic or market change through close contact with their customers and by producing a large variety of goods in small batches (Baek, 1992). Also, because of the low sunk cost, it is often said that SSIs are able to close very quickly without incurring great losses (Dierman et al., 1998). In fact, this is not only a strength, but can also be seen as a weakness of SSIs. It is a strength in so far they can quickly adjust to changing market conditions, but a weakness because small but sudden economic fluctuations will cause the rapid exist of a large number of SSIs leading to unemployment and loss of income. In response to rapid change in a range of economic variables such as interest rates, cost of inputs and changing patterns of demand, may be because of their 'smallness', SSI will reposition themselves quickly by closing down and/ or starting new activities. As a general rule and given the low cost of entry and exit, the greater the economic turnmoil, the higher the rate of SSIs turnover in startups and closures (Dierman et al., 1998).

-Limited evidence

Although SSIs are said to be very flexible and resilient in comparison with their larger counterparts, a closer look at the actual situation in them would reveal that they are, on balance, more negatively than positivley affected by the current financial and economic crisis. Even many of the stronger firms have already been forced to close down. Bappenas and GTZ (1998) has estimated that in this current situation, SSIs that could be labeled as "viable and promising" that have a clear possibility for survival and growth are representing perhaps not more than 2% of the total

of almost 3 million units.

From many news-papers' reports, SSIs are likely to weather the crisis best are those that cater for export market and use much local raw materials or other inputs. For instance, handicraft industries in Bali and weaving industries in Tasikmalaya (West Java) got more orders from abroad for their products since the crisis of rupiah started last year. Another example, the exports of furniture SSIs in Jepara (Central Java), that use locally sourced inputs and hence pay in rupiah but earn their revenues in foreign currencies (mainly US dollar), have actually increased as a result of the steep rupiah depreciation.

A related case is the successful export-oriented industry in the traditio-nal lurik clothe weaving industry located in Ceper, Klaten district (Central Java), which also largely consists of SSIs. Despite the fact that these small-scale lurik producers use handlooms rather than power looms, they have been able to thrive as they procure their raw materials (e.g. fibers derived from the trunks of banana trees, rami, fibber from pineapple plants) locally, while the bulk of these products are sold overseas, mostly to markets in the US, Japan, Western Europe, and Australia (Dierman, et al., 1998).

The above evidence may suggest that particularly SSIs in agricultural based goods (agroindustry), i.e. food-processing and non-food processing such as wood, leather, rattan and bamboo products, and other goods using local natural raw materials producing for the export market should have a good chance of survival during this crisis. Their chances are better because, as previously mentioned, they do not rely heavily on formal credit, so are less affected by the letters of credit problem. Nevertheless, the picture of export-oriented SSIs in the wake of the crisis has not altogether been successful as some SSIs have difficulties during the crisis. For instance, small-scale export producers and

exporters located in and around Bandung (West Java), Central Java, around Jakarta, and in Bali. To the extent that their operations are dependent on a steady inflow of imported cloth and other raw materials, the steep rupiah depreciation and the unwillingness of overseas banks to accept the LCs issued by Indonesian banks on their behalf has caused great difficulties to these garment SMIs to continue their operations (Dierman, et al., 1998).

But, there is limited evidence shows that some local market-oriented SSIs have managed to thrive during this economic crisis. It depends on how quick the enterprises can switch their production in coping with the changing situation. For example, the metal working industry, a domestic oriented industry largely made up of SSIs, has been able to profit from the crisis by quickly switching to production of nails, latches, and door bolts. Before the crisis, these goods were largely imported from China, Taiwan and Italy (Dierman, et al, 1998).[11]In addition, as a result of the introduction by the Indonesian government of publicly funded, labor-intensive public work projects, the demand for locally made spades, rubbish bins, and hoes has increased rapidly. This increase in demand has largely been met by SSIs producing for the local market.

Since the crisis started in mid-1997 up to the present, no serious/ compre-hensive studies have been made yet to investigate the overall impact of the current crisis on Indonesia's SSIs. So

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[11] This process of adjustment can be expected to lead to significant changes in the number and distribution of SSIs by type of activity and location. For example, the crisis seems to be having a differential impact on SSIs across regions in the country. Some source of information suggests that the crisis is having a less negative impact on SSIs outside Java. This may be due to the rela-tively greater extent that SSIs in the outer islands have benefited from the rupiah depreciation as many of their activities are based on local resources and are export-oriented, including agriculture and food-processing (TAF, 1998).

far, there are only very few small surveys in certain subsectors and region, some of them are still underway, and anecdotal evidence from some newspapers as discussed above which may suggest that the crisis is adversely affecting many (if not all) SSIs but not all in the same way or to the same extent.[12]In addition, Department of Cooperative and Small and Medium Entrepreneur (Depkop & PKM) through its local offices has conducted a survey of 175,903 small enterprises in various sectors in all 27 provinces in the country. Most of these surveyed small enterprises have been found in rural areas. The result of the survey shows that 75,4532 (43%) had closed their business. Of the remainder, as shown in Table 6, 44,305 (25%) had experienced a decline in activity and 31,127 (18%) had stopped activity but not yet officially closed. Of the nine sectors, husbandry, mining, and manufacturing industry had fared the worst.

Table 6 Impact of the Current Crisis on Small Enterprises in Some Sectors of the Economy, April 1998

Sector	Decline (%)	Close (%)
Husbandry	42	31
Mining	50	23
Manufacturing Industry	28	35
Construction	12	5
Trade, hotels and restaurants	20	5
Transport and Communication	6	10
Services	41	4

Source: Depkop & PKM (1998).

The result of this survey and other evidence discussed above seem to support strongly the theoretical assessment given begore, that is, there are at least three factors which have significant

[12] As previously explained, SSIs is highly diverse not only between different subsectors but also to some extent within a subsector and, so, the impacts of the crisis may vary considerably depending on factors such as types of products made, sources of capital, internal and external constraints faced and market orienta-tion.

implications for the health of SSIs during the crisis. One on the demand side: the weak domestic demand situation for their products caused by the decline in purchasing power of the individual consumers, including from the low-income group, in combination with the decline in production volumes of MLSIs which have production linkages with SSIs,[13] and two factors on the supply side: the overall scarcity of credit combined with the steep increase in interest rate as a result of the major disruptions of the banking sector, and the steep rise in the prices of their raw materials and other inputs.

With respect to the supply side, the rise in the cost of raw materials because of the steep rupiah depreciation causes a serious problem for many SSIs especially in highly import-intensive subsectors such as textile, metals, and footwear. A result of a study from AKATIGA with a small survey conducted during January-March 1998 on SSIs in a number of location in rural West Java shows an interesting fact that even in traditional commodities such as footwear and tex-tile, SSIs are very dependent on imported materials; so, they are very hurt by the rupiah depreciation (AKATIGA, 1998). The result shows that the increase of prices in rupiah of imported inputs can reach up to more than 600%; although it varies among different groups of industry (Table 7). Also, the power of resis-tance and the strategy (response) of the individual producers in the sample in dealing with the crisis have been found vary among different subsectors (Table 8 and Table 9).

Table 7 The Increases of Import Costs experienced by SSI in the Sample in Selected Subsectors caused by the Rupiah Depreciation.

	Increase of prices

[13] According to the Asia Foundation report, SSIs supplying inputs to MLSIs, particularly those producing goods aimed at domestic markets, are among the hardest hit (TAF, 1998).

Sub-sector	Import components	of imported inputs in rupiah (%)	Percentage of production cost
Footwear	leather, leather imitation, glue, sole, etc.	45 - 500	10 - 80
Textile	yarn, equipment, polyester, colour matter, silk, etc.	100 - 614	60 - 70
Food	soybean, plastic (packing), boxes, maize, etc.	50 - 250	20 - 95
Silver handicraft	silver	100 - 600	75
Furniture from rottan	thinner, H_2O_2, plastic, stepless, paper, screw nail, polish material, etc.	145 - 400	15

Source: AKATIGA (1998).

Table 8 Power of resistance of SSIs in Selected Subsectors During the Crisis

percentage of closed SSIs	Subsector	explanation
> 80	footwear, textile, soybean cake (*tahu & tempe*)	prices of raw materials have increased extremely high, they are difficult to get, and must be paid in cash. Only entrepreneurs with strong capital can survive.

50 - 80	metal working, embroidery	the only domestic market (state companies) is collapse (for metal), lack of domestic supply of imported materials and also have to be paid in cash.
20 - 50	rottan products, food	extremely high prices of imported raw materials

Source: AKATIGA (1998).

Table 9 Strategy/Response of the Individual Producers by Size

Size group*	Strategy/response
CHIs	- stop the business - change the occupation (become trader, etc.) - reduce the quality of product by changing/reducing raw materials used - change the product
SIs	- reduce the scale of production/working hours - keep the price of output as before, while decreasing the size of goods produced - increase the price of output by 20% - 25% - diversify the product - shift the imported raw materials/inputs towards local ones - still in production by using old stock of raw materials - change the market orientation from domestic/local towards export market - use US dollar to determine the selling price of product - pay back bank loan and try to substitute it with fund from other sources

Note: * = SSIs consist of CHI: cottage and household industries (the traditional type of SSIs) and SI: small industries (the modern type).
Source: AKATIGA (1998)

As regards credit constraints, results of another survey on small enter-prises (SEs) in the manufacturing and few other sectors confirm that the crisis is having a mixed impact on the cost and availability of credit to SEs (Musa, 1998). Major findings from the survey include:

(1) Higher interest rates and the reduction in aggregate demand have reduced the demand for credit by SEs, with most firms reporting a decline in borrowing.

(2) Some firms report that it is more difficult to obtain credit, particularly credit from suppliers of raw materials. Most firms report that supliers have drastically reduced the grace period for payment.

(3) Many firms have repaid their bank debts though belatedly, despite the apparent willingness of many banks to reschedule debt.

This survey suggests that SEs are responding to tightening credit availabi-lity and high cost of capital, by reducing inventories and demanding cash in advance. There are also indications that as external source of financing has dried up, some SEs may have turned to the internal financing sources of self-generated funds and informal credit markets.

According to this study (Musa, 1998), because of the three factors stated above, about 33% of the SEs surveyed had declined the number of their workers, 21% had operated with less working hours, 36% had substituted their imported with local, cheaper raw materials/inputs, and the remainder of the sample have had to reduce the size and the quality of their products without reduce their prices.

VI The Likely Impact of the IMF Reform Package on SSIs

VI.1. IMF Reform Package

After successful negotiations with the IMF, an agreement was reached in late October 1997, under which the Indonesian government agreed to implement a reform program required to qualify for the IMF rescue package. This first IMF reform program contained four major policies: monetary policy, fiscal policy, financial sector restructuring policy, and structural reform policy. After the reluctance to implement the first IMF reform program which led to a further depreciation of the rupiah, the Indonesian government in mid-January 1998 felt compelled to sign a Revised Letter of Intent with the IMF, under which the Indonesian government committed itself to implement a wide-ranging 50-point reform package to restore confidence and to stop the decline of the rupiah, covering macro-economic policies, financial sector restructuring policies, and structural reform policies.

As regards SSIs development in Indonesia, there was a question: is this comprehensive policy package from the IMF going to affect the industries negatively or positively. The effects can be directly (supply-side effects), i.e. affecting the capacity and costs of production) or/and indirectly (demand-side effects), e.g. through production or consumption or income linkage effects.

VI.2 The Likely Impact on SSIs

To answer the above question, a study has been conducted in mid-1998 to evaluate the likely impact of economic reforms or the implementation of the IMF reform program will have on small-and medium-enterprises (SMEs) in some sectors, including manufacturing (van Dierman, et al., 1998). The summary of the reform package is given in Table 10.

In summary, the study's results reveal at least two important points. First, if fully implemented, most of the reforms will have

a positive impact on the SSIs. This is consistent with much of the literature on SSI. A review of the literature by Berry and Mazumdar (1991), suggests significant biases against SSIs have been created by the excessive use of macro-economic policies for promoting large export oriented companies. So, it means that the removal of these macro-economic distortions, as set out in the IMF reform package, is likely to have a positive effect on the development and growth of SSIs in Indonesia (van Dierman, et al., 1998).

Second, of the reform points suggested by the IMF, at least five reforms can be identified as having significant impact on SSIs in Indonesia. These are:

(1) Comprehensive and transparant system of public sector finance

(2) Restructuring and reform of the banking sector

(3) Prohibit local export, inter-provincial and inter-district taxes

(4) Assistance to the poor and community-based work programs.

Table 10 Summary of the IMF Economic Reform Policies which are expected to have impact on SSIs

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Fiscal Policy:
- eliminate fuel & elect. subsidies
- remove VAT exemptions & impose 5 percent tax on gas
- improve tax system
- bring off budget items into budget
- 12 projects and special privileges canceled

Monetary and exchange rate policy:
- keep interest rates high
- subsidized credit for SMEs
- improve exchange rate & Bank Indonesia's independence

Financial sector reform policy:
- reform banking sector, credit for small business (KUK) to continue

Structure reform policy:
- encourage an open, competitive and efficient

economy
- tariff on food items reduced
- phase out non-tariff import barriers
- phase punitive export taxes
- phase out all other export barriers
- shorten negative list for foreign investment, open wholesale and retail trade

Deregulation and privatization policy:
- promote domestic competition, remove restrictive marketing arrangements
- deregulate trade in agricultural products
- prohibit local export taxes and abolish intra-district taxes
- BULOGs monopoly limited to rice
- reform and sell of state companies

Social safety net:
- assistance to the poor

Environment:
- implement environmental laws

Source: van Dierman et al. (1998).

Discussions on the likely impact of specific policies are given below.

- Fiscal Policy

In General, the fiscal reforms can be divided into two types. First, the joint IMF-Indonesian government agreement proposes to do away with government-backed or -funded projects and several subsidies. The latter includes the elimi-nation subsidies on fuel and electricity gradually over the course of the pro-gram, starting with the sizable initial adjustment in April 1, 1998. Second, to ensure the quality and durability of the fiscal reform, it proposes to make fiscal policy more transparant and efficient.

In relation to SSI, two major effects are likely to occur. First, in the short run, the gradually elimination of price subsidies on fuel and electricity will have a strong negative impact on all business activities, including SSIs having energy as

a major component of total operating costs. This new burden is likely to reduce their competitiveness and output, impacting most on those SSIs with high use of energy (Table 11). Increases in the price of kerosene, however, will impact more on traditional SSIs who are the major users of this type of fuel. The price rise in kerosene will, however, be moderate and less than that for other types of fuel.

Table 11 Percentage of intermediate costs for SSIs by Subsectors, 1992-1993 (%)

Subsector*	Raw material	Fuel & electricity	services expenses	Industrial machinery & equipment	Building, Others	Total
31	89.37	5.51	0.06	0.15	4.91	100.0
32	94.84	1.05	1.53	0.36	2.22	100.0
33	90.85	3.14	2.15	0.37	3.48	100.0
34	76.85	8.37	1.59	1.68	11.50	100.0
35	87.87	7.49	0.01	0.06	4.57	100.0
36	42.94	42.79	4.12	0.92	9.23	100.0
38	87.04	6.93	0.05	0.07	5.91	100.0
39	83.17	3.24	3.95	0.52	9.12	100.0

Note: * = ISIC Code (2 digit)
Source: CBS

Also, a more efficient fiscal sector are likely to raise production costs
for SSIs. Several of the policies will have differentiated impact on specific subsectors. Improvements in the taxation system are more likely to affect modern SSIs (i.e. SIs) than traditional SSIs

(i.e. CHIs), since the former are more rea-dily drawn into the tax system. The removal of all VAT could also affect modern SSIs that supply components to large exporter firms in the bonded zones.

Second, while in the short run the cost of inputs rises for industries of all sizes, in the long run the domestic comparative advantage of SSIs will improve, with the assumption that they are likely to make adjustment to the increased costs. By removing fiscal policy and making it more transparant and efficient, especially LSIs are less likely to gain special benefits and privi-leges. Thus, if these fiscal reforms are fully implemented, assuming all other things are equal, in the long-run, SSIs are expected to gain in competitiveness when compared with larger industries, particularly LSIs in the same subsectors.

- Monetary and Exchange Rate Policy

The monetary and exchange rate policy reforms attempt to restore confidence in the financial sector. Specifically, it will allow interest rate to rise as determined by the market and attempt to contain inflation, originally set at a target of 20% but later set at a 45%. In line with these reform policies, the money supply will be tightened and the exchange rate stabilized. Bank Indonesia plans to limit the growth of broad money to 16% in 1998. Further, as also inclu-ding in these policies, Bank Indonesia (the central bank) will be given greater independence from the government to determine its monetary policy, and, at the same time, Bank Indonesia will also provide full autonomy to state banks to adjust rates on credit and deposit liabilities, with the objective that their rates could also reflect developments in money and credit markets.

This tight monetary policy will inevitably mean that, at least for the short period, the amount of credit available for lending to the corporate sector will remain constrained and the cost of credit

will remain very high. But, in order to alleviate the burden of this policy on SMEs, the Indonesian government is allowed to give subsidized credit to this group of enterprises through state banks. In order to ensure an adequate flow of credit to SMEs during the period of general credit restraint, in the short-term, the Indonesian government will improve the targeting and implementation of existing schemes with assistance from the Asian Development Bank (ADB) and the World Bank. If necessary, additional budgetary resources will be made available to these schemes. Over the medium-term, the government will strengthen the overall institutional framework for enhancing efficiency of the SMEs.

So, in the short term credit provision will have benefits for SMEs, as will institutional development in the medium term. Nevertheless, this policy needs to be viewed with some caution. Even though the government is willing to provide additional government resources, it is beyond the means of the government to provide subsidized credit to all SMEs. In other words, SMEs to be supported by the subsidized credit must be selected based on a number of criterion, such as export potential. Further, given the experience in the 1970s and 1980s of similar schemes of subsidized credit, the overall impact is likely to be limited and questionable (van Dierman, et al., 1998).

- Financial Sector Reform policies

As it is generally accepted that the economic crisis started with poor banking system or practices and a loss of confidence in the banking sector, the financial sector reform policies are essential for restoring confidence and economic stability. These policies aim to establish a more transparent and equitable banking system with more clearly defined rules for resolving liquidity problems and creating tighter supervision of banks.

State banks are to be made efficient and then privatized and

the banking sector to be regulated to allow greater foreign ownership. Bank Indonesia has also attempted to restore confidence in exporters' letter of credit by placing a total of US$700 million in foreign banks. Finally, the banking reforms have specifically protected the KUK scheme(small business credit) for SMEs.

It is then expected that the bank restructuring program will increase the efficiency of the sector and this will be reflected in the forms of lower "effective costs" of credit and more credit available for SMEs. Similarly, the strengthening of the legal and supervisory framework for banking, i.e. a more accountable banking system, will reduce the rate of default and thereby will lead to the gradual reduction in lending rates charged and an increase of credit availability for SMEs.

- Structural Reform, Deregulation and Privatization

In November 1998, the government set out an ambitious strategy of struc-tural reform, aimed at bringing the economy back to a path of rapid growth, by eliminating the "high-cost economy" and at the same time making the economy more open, competitive, and efficient. This structural reform strategy contains thus some of the most controversial and far-reaching reforms of the entire package.
To achieve this goal, foreign trade and investment will be further liberalized, domestic activities will be further deregulated, and the privatization program will be further accelerated. At the same time, measures on the alleviation of poverty will be continued.

Since then, the government has already made considerable progress toward the strategic' objectives. For instance, in the same month, a major step was taken toward opening up the economy and increasing competiton, when BULOG's im-port monopoly over wheat and wheat flour, soybeans, and garlic were eliminated. To ensure that final consumers obtained maximum benefits from this reform, impor-ters were allowed to market all of these products

domestically, except wheat. Similarly, to ease the adjustment costs for farmers, tariffs were simultaneously introduced on all of these products, but these rates were limited to 20% or less, and will be reduced to 5% by 2003. Farmers will also be released from the formal and informal requirements for the forced planting of sugar cane.

In addition, two other important structural measures have also been taken under the program. First, the administrative retail prices for cement was elimi-nated, thereby improving the degree of competition in this industry, and immedi-ately reducing prices for construction firms and consumers. Second, the medium-term tariff reduction program was extended to cover two key additional sectors: chemicals and metal products.

With respect to foreign trade, in the import side, the government has decided to include food and non-food agricultural products in the general program of tariff reduction (leaving motor vehicles as the only exception). As an imme-diate measure, tariffs on all food and non-food items have been cut to a maximum of 5%, while local content regulations on dairy products have been abolished, both effective February 1, 1998. At the same time, tariff rates on non-food agri-cultural products will be reduced by 5 percentage points, and will gradually be reduced to a maximum of 10% by 2003.

As another major step in assuring a level playing field, in February 1998, all import restrictions on all new and used ships were also abolished. All other remaining quantitative import restrictions, other than those which may be justi-fied for health, safety, environment and security reasons, and other nontariff barriers (NTBs) that protect domestic production, will be eliminated.

In the export-side, export taxes on a wide range of products, including leather, cork, ores and waste aluminum products will be

reduced or abolished. The government will also eliminate all other types of export restrictions, such as quotas. In addition, to support export expansion the government is now enforcing the prohibition of *retribusi* (local taxes) at all levels on export goods.

In the area of investment, the government will encourage foreign investment by issuing a revised and shortened negative list of activities closed to foreign investors.

The second major thrust of the structural reform strategy will be to dere-gulate and privatize the national economy. This will include that all of the existing formal and informal restrictive marketing arrangement, including those for cement, paper, and plywood, will be dissolved. In addition, trade in agricul-tural products is also being deregulated. Traders will have the freedom to buy, sell, and transfer all comodities across district and provincial boundaries, including cloves, cashew nuts, oranges, and vanila.

The deregulation is also conducted in the areas of export and import. As described before, to support export expansion the government is now enforcing the prohibition of *retribusi* (local taxes) at all levels on export goods. In the import area, Bulog's monopoly will be limited to rice. All traders will be allowed to import sugar and market it domestically.

In parallel with these efforts to increase private sector productivity, the government is undertaking a public sector expenditure and investment review in order to promote a more efficient use of government resources. This review will result in a comprehensive program to improve fiscal efficiency, and restructure state-owned enterprises and strategic industries.

These reforms will also be some of the hardest to implement, and the imme-diate effect on SSIs are expected to vary among different subsectors. For instance, the deregulation of BULOG's

monopolies and its inability to support prices as the rupiah devalues is likely to have the most serious short-term consequences for SSIs in food processing industry. Through BULOG, the Indonesian government has followed a policy of self-reliance and stable food prices for the country's major food commodities. In effect, BULOG subsidizes the price of seve-ral major food staples. Abolishing BULOG's monopoly at the same time the rupiah has lost 70% of its value has led to the rapid price rise of several food staples reliant on imports to meet domestic demand. Rapid price rises in the imported staples of wheat flour used in making noodles, sugar, and soybean used in making *tempe* and *tahu*, have caused major difficulties. The price of some of the most commonly consumed foods has rapidly risen at a time when most of the population is experiencing a decline in income and hence its demand for food.

This situation is expected to create serius difficulties for SSIs in the food processing industry which have experienced rapid increases in production costs and declining market demand for their products. The result has been the almost complete collapse of the *tempe* and *tahu* processing industry during 1998.

The tariff reduction program of the IMF package will have a negative impact in the short run on small-scale supplier firms of components and parts in the electronics and electrical appliance subsector to the extent that they purchase chemicals, basic steels and metals, and metal products. While, in the long run, it is expected that SSIs in this subsector will benefit from that policy.

Similarly, in the short and medium run, foreign investment deregulation, as provided under the IMF package, is likely to have a negative impact on small-scale supplier firms in the electronics and electrical appliance subsector. In the long run, it is questionable whether these domestic SSIs can survive the influx of new and more efficient foreign companies producing the same parts and components as they made. Domestic SSIs' ability in this

subsector to face compe-tition from foreign firms will depend much on their ability to raise their supply-side capabilities adequately and rapidly. It will also depend on the Indonesian government taking appropriate steps to establish a more enabling poli-cy environment for SSIs by removing the often unintended bias against them in its regulatory framework (van Dierman, et al., 1998).

VII Conclusions

With respect to the impact of the economic crisis on SSIs development, although it is varied among different individual producers which is associated with different products, raw materials and market orientations, the limited evidence presented in this Chapter shows that in general the capability of export-oriented and/or less import dependent SSIs to cope with the crisis is higher than that of domestic market-oriented and/or highly import dependent SSIs. This suggests that the key factor determining the impact of the crisis is whether industries earn foreign money and procure their raw materials locally or rely significantly on domestic market for their products and on imports for their raw materials.

As regards the evaluation study of the likely impact of the IMF reform package, several conclusions can be drawn here. First, many economic distortions caused by excessive intervention are fixed costs and therefore bear most heavily on SSIs. The IMF package will eventually eliminate a large number of these distortions and therefore favor SSIs. Second, the economic crisis will have a severe and immediate impact on SSIs, which will not in the short term be alleviated by the IMF program. Third, the likely impact of the package on SSIs will be varied among different subsectors. The short-term impact of the reforms will have a severe impact on SSIs in the food subsector, affected by the elimination

of BULOG's monopoly. In the medium term, those SSIs providing essential goods, exporting and not heavily reliant on imported goods or inputs will benefit from the IMF reforms. In the long-run, the IMF structural reforms will be beneficial for SSIs if they are fully implemented and not replaced with other market restrictions and regulations.

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