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Formal and Informal Finance in Contemporary Indonesia

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1. Introduction

For long, policy makers have tried to restrict informal finance. The main resentment and prejudice are that informal lenders exploit their clientele, that informal credit is used only in an unproductive way and that informal finance is not under the control of financial legislation and may undermine financial policy. The colonial and post-colonial administration tried to legally prohibit informal finance or provided subsidised credit and public finance to the people to create competition with the high informal interest rates to bring them down. This market-compatible policy is in contrast to former market restrictions through government monopolies and tax farms. Only recently, policy makers realised that formal and informal finance may not necessarily be in competition but indeed may complement each other, as both aim at different target groups. Strategies applied to cope with informal finance are the downgrading of formal finance to the village sphere, the upgrading of financial self-help groups by formalising them and the interlinking of banks and self-help groups. As a first step, I provide a description of the current financial landscape in Indonesia with regard to both formal and informal finance and their relation. As a second step, I consider the present role of Chinese capital and its involvement in finance. The point in question is whether they could use their accumulated wealth and knowledge from their intermediary function during the colonial period (see Schrader 1994a, b, c) to defend their dominant position in commerce, industries and banking in independent Indonesia.

2. Financial Policy: From Regulation to Deregulation

McLeod (1994) characterised Indonesia's post-colonial politico-financial development in a short and apt way. Sukarno, he argued, interpreted the

1 For a more detailed description which put an emphasis on the relation between foreign, Chinese, indigenous and state capital, see Robison (1986). For a description of formal

Indonesian constitution in such a way that it aimed to establish an economy with more collective rather than private enterprise. The state was to control particular key sectors of the economy, such as certain industries and banking. The 'socialist' command economy,[2] mere state capitalism, that regulated markets and prices, was the response to colonial exploitation which was assumed to be representative of capitalism. Overlooked was the fact that the Dutch colonial system was far from being a liberal market and private enterprise characteristic of capitalism. In addition to the Dutch, Chinese private enterprise and its *comparadore* (intermediary) position in the colonial economy were made responsible for colonial exploitation during the colonial period and the Chinese were considered one main factor impeding post-colonial development.

The first OPEC boom in 1973, which turned Indonesia's balance of payment into black figures, concealed the weaknesses of its command economy because a transfer of money between sectors became possible which hid the non-profitability of various state enterprises (see Robison 1986). Resources were also available to design large subsidised financial programmes to eradicate the supposed dependence of small-scale businesses (farmers, fishermen, and so on) on self-finance and informal finance.

Until 1983 formal finance was tightly regulated. The policy aimed at replacing informal finance by a formal and semi-formal one and was characterised by the channelling of large funds into the formal financial sector to promote a highly dispersed rural infrastructure of the state-owned smallholders' bank (Bank Rakyat Indonesia, BRI), which set up 3,600 village units. On the other hand, the government simultaneously restricted the growth of formal finance. In 1968 the New Order reformed the banks and laid down the banking structure (see Lee 1982).[3] After 1971 no new

finance, see Panglaykim (1974), Lee (1982), Arndt (1987), Bank Bumi Daya (1988); for a review of rural finance, see Schmit (1991). A good contribution to the Sukarno era was made by Dahm (1978).

2 This belief was strongly and consistently held during the Sukarno era. Under the New Order, the regime's policy changed several times from a command economy to greater freedom for private enterprise and vice versa. Robison (1986) argued that this political orientation resulted from the power of the technocrats in the National Development Planning Board, *Bappenas*, who had been trained in the US, on neo-liberal grounds. Their power has always risen and fallen with the dependency of Indonesia on foreign capital. During the second half of the 1980s, this dependency became so overwhelming that the whole economy had to be deregulated by the pressure of IMF and World Bank.

3 Five government-owned banks were integrated into one institution with five units: Bank Negara Indonesia (BNI) Unit 1, now Bank Indonesia, the Central Bank; BNI Unit II, now split into Bank Rakyat Indonesia and Bank Exspor Impor Indonesia; BNI Unit III, now Bank Negara Indonesia (1946); BNI Unit IV, now Bank Bumi Daya; and BNI Unit

banks were permitted to be established (there were scores of private domestic banks, the seven large state banks, twenty-seven provincial banks, and eleven foreign banks), and the banks required official permission to extend their branch networks. In addition the government fixed growth limits for the banks in order to control the money supply. On the basis of this structure and the 1971 decree, the growth of existing 'hybrid' decentralised institutions such as *Bank Kredit Desa* or *Bank Pasar* (the roots of which go back to the Netherlands-Indian *Volkscredietwezen)* was restricted, while simultaneously various provincial government credit institutions and government programmes emerged (see Kern 1986: 120-1).

Rural credit provision belonged to the *Bimas* (mass guidance) Programme, which was implemented in 1965 to promote Indonesia's rice production to the level of self-sufficiency by providing seed, fertilisers, pesticides etc. on cheap, subsidised credit to groups of farmers. On the whole, three different sub-programmes were introduced. With the *Group Bimas* emphasis was placed upon co-operative organisation; with the *Bimas Gotong Royong* foreign contractors helped to supply the means of production; and the *Improved Bimas* gave support to the use modern technology, loan organisation and procedure, learning the distribution of the means of production to the cultivators and the purchasing, processing and harvesting to obtain good profits and prices. The credit programme categorised the borrowers into four loan groups with different loan purposes and loan conditions.[4] The main problem of the credit scheme was the risk

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V, now Bank Tabungan Negara. The General Law of Banking of 1967 reorganised the banking structure into four categories, namely: commercial banks (state commercial banks, national private banks and foreign banks), savings banks (state-owned and private), development banks (state-owned and private) and other (rural) banks. The New Legislation of 1968 dissolved the five BNI units under the roof of the BNI into eight state-owned banks: Bank Indonesia, the central bank (established in 1953); five commercial banks: Bank Negara Indonesia 1946, Bank Rakyat Indonesia, Bank Ekspor Impor Indonesia, Bank Degang Negara, and Bank Bumi Daya; the government-owned development bank Bank Pembangunan Indonesia (Bapindo); and the savings bank Bank Tabungan Negara. Besides these government-owned banks there were a number of small, private indigenous and foreign banks. The last were allowed only in Jakarta. Outside the capital they had to seek domestic financial institutions as partners.

4 Group I: 12 percent interest per annum for loans in the fields of fertiliser import and distribution and for special areas like *bimas*, rice; Group II: 15-18 percent interest per annum for loans in the field of poultry farming, crude rubber production and export of Java tobacco; Group III: 21-24 percent interest per year for loans in the field of export products and for the distribution of nine basic commodities, agricultural products, animal husbandry, fisheries, industries and public transport; and Group IV: 25-36 percent interest per year for loans in the field of trade and other distribution activities not covered in the other groups. The total credit volume was divided among the groups (Group I 10 percent, group II 10 percent, group III 45 percent, group IV 35 percent).

in the field of agricultural loans, such as natural disasters and pests. The *Bimas* was given as a parcel containing the means of production like fertiliser, seed and insecticide, together with cash to help the farmer until harvest (for details see A.I.D. Spring Review 1973; Schmit 1991). Loans were distributed by the BRI branch network and the BRI was refinanced by the central bank with subsidised rates. The scheme was ultimately a misfortune because of a very high default rate and a continuous flow of state bank funds into the programme.

Another programme was the KIK/KMKP (*Kredit Investasi Kecil/Kredit Modal Kerja Permanen*) small business programme (see e.g. McLeod 1980, 1983), which was operating in a similar way, but also supplied credit to individuals. But this time the credit risk was insured by the government-owned *PT Askrindo* insurance company. This scheme was less disastrous, although it also required subsidies and was finally terminated in 1990. These and similar programmes, which are characteristic for this period in a number of developing countries, have been increasingly criticised because they neglected the savings side of finance.

Interference with the financial market went further. The government tried to reactivate the Jakarta stock exchange, but it overestimated private demand for shares. The government therefore established a national investment fund, *PT Danareksa*, which was to purchase large quantities of shares and resell them in very small bundles to the poor. But this scheme was not successful either. The target group preferred traditional informal savings or bank savings.

According to McLeod (1994) the government itself was the primary obstacle to the growth of the formal financial sector. Another factor which restricted growth was the continued flow of funds from the state bank to the state owned-commercial banks. On the whole, the Sukarno regime and, until 1983, the New Order more or less suppressed the price mechanism in the financial market. All state bank loans had subsidised rates and were in turn subsidised by the state bank. In spite of this policy, the aim of supplanting informal finance by providing cheap formal credit to the poor, with an extensive rural branch system and government credit programmes, was only partly achieved. In spite of the fast growth of small, medium and large firms, many of these continued to finance themselves, at least to some extent, through informal sources, while certain private large- and medium-scale enterprises benefited from subsidised credit. According to Robison (1986), these were particularly Chinese and indigenous enterprises under the patronage of the government or military and bureaucratic capitalists who went into partnership with WNI Chinese.[5]

5 WNI: *warga negara Indonesia*, i.e. Chinese with Indonesian citizenship.

Being aware of the limited results of financial policy and the unintended side-effects, and on the advice of the IMF and World Bank, the government introduced two major packages of deregulation in 1983 and 1988, and various laws in 1992 to regulate banking, insurance and pension funds. Broadly speaking, the state partly withdrew from the control of the financial market and created more room for private initiative.

The 1983 deregulation of the financial landscape opened the market for the setting-up of new banks which have since then mushroomed in Jakarta and other commercial places in Indonesia. How far Chinese, the colonial non-Western commercial elite, are involved in private banking shall be investigated in the second part of this paper. Most interest rate controls were ended. When the banks began to offer high savings interest rates, bank deposits could be substantially increased. Lending rates rose by 24-30 percent. Currently they cover inflation and reflect market conditions. Comparatively speaking, Indonesia's formal interest rates are among the highest in the whole region which has reduced capital exports.[6] According to Seibel (1989):

> "the present financial situation in Indonesia bears the marks of both old and new, regulated and free market policies. Financial markets are segmented into formal, informal and semi-formal financial markets. Banks are the core institutions of the formal financial sector. This sector also includes a number of small second-tier institutions, which are defined as non-banks, such as BKK[7] in central Java (...) and others, which are supervised by primary banks (...) as well as registered co-operatives (...) which fall under the co-operative law. There are numerous informal financial institutions (...) which operate without legal status and outside state control: moneylenders, financial self-help groups (rotating and non-rotating savings and credit associations, unregistered credit unions) and numerous other groups with secondary financial functions (...). Semi-formal financial institutions include PVOs as well as GOs [private voluntary organisations and government organisations, H.S.], which act as intermediaries between domestic or foreign donors and informal self-help groups or final individual borrowers. They are

6 In 1983 the nominal deposit rate in Indonesia was fixed to 18 percent, which means that only then the real deposit rates turned into positive figures. Time deposits amounted to between 16 and 24 percent. The deposits per economically active population increased from about US$ 50 in 1983 to US$ 150 in 1990. The annual nominal lending rates increased to more than 20 percent during the 1980s, which means that the real lending rates amounted to more than 10 percent (UN Statistics, own calculations, see Schrader 1993).

7 *Badan Kredit Kecamatan*, a regional government credit programme for rural finance (see below).

extra-legal in their financial activities, but so far have obviously enjoyed the tacit tolerance of the state. In addition, one may include officially recognised but unregistered pre-co-operatives in this sector" (Seibel 1989: 10-11).

The deregulation package terminated different credit programmes, such as the *Bimas* in 1983, and the state banks had to do without the subsidies of BI. They therefore heavily increased their time deposits. To maintain their market shares private banks followed the example. The whole banking sector experienced considerable growth with competition between state and private banks.[8] By 1983-1987 the number of banking offices increased from 1,210 to 1,460. The largest share of banking offices were found on Java (excluding Jakarta) with 32.64 percent, Sumatra with 24.07 percent and DKI Jakarta with 14.97 percent, whereas the rest of Indonesia had a share of only 10.3 percent. From the perspective of assets, the non foreign-exchange private national banks experienced the fastest growth. They held the largest average share of banking funds with 68.41 percent. During 1983-87 banking credit grew by an average of 26.5 percent. The state foreign-exchange banks held the largest average share with 67.12 percent of total value. In second position were the national private foreign exchange banks which supplied an average of 9.02 percent per year. Development banks supplied an average of 7.7 percent, but experienced a downward trend throughout the whole period. Non-foreign-exchange national private banks had an average share of 7.45 percent, with an upward trend throughout the period. Foreign banks had an average share of 4.61 percent with a downward trend. The savings banks had the smallest share with 4.1 percent, with a slight upward trend. Considering the average growth rates of credit supply per year of the different institutions, private foreign-exchange banks had growth rates of 47.94 percent, non-foreign-exchange banks of 42.27 percent, savings banks of 30.97 percent, state foreign-exchange banks of 24.8 percent and development banks of 20.02 percent. Considering the allocation of bank credit the largest share was distributed in Jakarta (averaging 53.1 percent per year) followed by Java (excluding Jakarta, 25.09 percent) and Sumatra (12.45 percent). Kalimantan's share averaged 4.16 percent, Sulawesi's 2.68 percent and Malakku

8 According to Arndt (1987) the contemporary state commercial banks are: (1) Bank Bumi Daya (specialising mainly in export production, estates, mining, with 76 branches); (2) Bank Dagang Negara (export production, mining, 93 branches); (3) Bank Negara 1946 (industry, agriculture, export production, with 218 branches including sub-branches); (4) Bank Rakyat Indonesia (agriculture, livestock, 293 branches including payout stations, mobile units and village units); and (5) Bank Ekspor Impor Indonesia (export production, estates, with 49 branches).

and Irian Jaya's share was 1.11 percent (Bank Bumi Daya 1988). Outside the banking system, a number of heterogeneous financial institutions are mushrooming, such as insurance companies, capital investment companies and pension-fund corporations.

The 1988 deregulation package removed barriers to institutional development, such as the regulated access to the banking sector and the opening of new branches. This resulted in a doubling of the number of private domestic banks (126 by the end of 1991) and an increase of the new foreign joint venture banks. The number of branches increased from 1,700 in 1988 to more than 4,200 in 1991, with a share of one quarter and half of private banks, respectively. In addition, 600 new secondary banks (*Bank Perkreditan Rakyat*, BPR) were established. According to McLeod (1994), the growth of banks is inhibited by the necessity to maintain an appropriate balance between the asset portfolio and capital available to absorb potential losses.

Downgrading, Upgrading and Linking

With the abolition of the *Bimas* programme in 1983 and the KIK/KMKP programme in 1990, BRI downgraded its banking services to the village level by offering new banking services under market conditions (or almost market conditions) through the existing branch network. The strategy to refrain from subsidised credit emerged during the 1980s as a response to the failure of such programmes and was applied in two credit schemes: *Kupedes* and *Simpedes*. *Kupedes* is a loan for either investment or working capital supplied to individuals. The *Kupedes* interest rates are still below the market rates (33 percent p.a.) but rather high compared to the *Bimas* programme (9 percent p.a.). They cover the costs of funds, transaction costs, a reserve for bad debts and a profit margin, and contrary to former experiences with subsidised programmes the repayment rate is almost 98 percent. *Kupedes* loans range from Rp. 25,000 to Rp. 2 millions (Seibel 1989). *Simpedes* is a rural savings programme, which was introduced in 1986 and has enjoyed great success.

Another example of downgrading is BKK (*Badan Kredit Kecamatan*), a regional government rural credit program in Central Java, which has been operating since 1972 through almost 500 independent small delivery units. Each BKK is owned by the local government of the *kecamatan* (subdistrict), supervised and refinanced by BPD, the Provincial Development Bank, and technically assisted by USAID. This programme belongs to semi-formal finance, since it does not fall under the control of the credit law. BKK loans are small-scale, short-term and determined by market conditions. Transaction costs are minimised by having mobile offices, teams travelling throughout the region according to a fixed schedule. From the beginning of 1972 to December 1986, a total of Rp. 4.8 million in small and very small loans were granted to small farmers, tenants and micro-entrepreneurs. The rate of repayment was, according to Seibel (1989), close to 98.8 percent. The operational costs (costs of fund, salaries, administrative expenses, default losses) are covered by the interest margin.

Contrasting the strategy of downgrading is one of upgrading private voluntary organisations and self-help groups in Indonesia to form their own banks. An example are the LPN (*Lumbung Pitih Nagari*), savings and credit associations in West Sumatra, which have been integrated into the formal regional banking system. In the late 1980s, 40 percent of the LPN, the self-help LPN, operated successfully with repayment rates of almost 100 percent, while many government LPN which consider themselves as agencies channelling government funds to the target groups were less successful. Self-help LPN rely mainly on their own funds, i.e. the savings of their members and profits. Loans issued to members run mostly between six and eight months, with a maximum of twelve months, and vary between 10,000 Rp. and 1 million Rp. The effective interest rate is about 40 percent per annum (Seibel 1989).

A third strategy of rural finance is the provision of formal credit to borrowers who individually have no security to offer but who form joint liability groups to compensate for this lack. APRACA[9] is an Asian-Pacific association of central banks, rural development banks and commercial banks, which aims at constructing a financial intermediary system between existing banks and grassroot micro-entrepreneurs around self-help groups. The emphasis is placed on both the credit and the savings sides, which will be linked in such a way that joint-liability groups build up their own savings, which are placed in the banks. Credit is delivered at market rates and the groups decide how to distribute this credit among their members. In Indonesia a pilot project was started in co-operation with BI. Grassroot groups function as intermediaries for small-scale entrepreneurs to minimise transaction costs. The interest rates include the costs of funds, gross margin for the bank (including transaction costs, reserves for bad debts, profit), gross margin for self-help primary institutions, and gross margin/incentive payment to the self-help group. Defaults have been minimised to less than five percent (Seibel 1989).

9 Asian and Pacific Regional Agricultural Credit Association, originally promoted by the UN Food and Agriculture Organisation (FAO).

Reasons for the shift in Indonesian financial policy from heavy regulation to deregulation are manifold: successful experiences of other Southeast Asian countries with private financial markets; the decreasing oil price (so that petro-dollars can no longer compensate for the losses of state enterprise and subsidise credit programmes); the bad experiences with high default rates in subsidised credit programmes; the capital exports from Indonesia; the cultivation of development aid and pressure of supranational organisations; the attempt to develop Jakarta as *the* nodal point of the Asia-Pacific trade zone; and growing confidence in private enterprise.

3. Informal Finance

Having so far shown the shift in financial policy in Indonesia from strongly regulated financial markets with heavily subsidised but rather unsuccessful credit programmes for the grassroot level to less restricted financial markets and the current strategies of downgrading formal finance, of upgrading self-help groups to formal institutions and of linking self-help groups with banks to reach the poor, the question remains how the different suppliers of informal finance developed within this changing financial landscape. First of all, it is obvious that informal finance developed earlier than formal finance and always adapted to the changing circumstances. However, with the growing importance and integration of the economy, the necessity of formal finance has increased because the complexity of financial affairs in a differentiated economy exceeds the capacity of informal financial agents and requires an integrated financial network. One important reason that the state supports the growth of formal finance at the expense of informal finance is that the latter operates outside the scope of control of the state.

On the other hand, the acceptance of and confidence in banks by the public is a very long process which took several centuries in Europe and was concluded in the twentieth century. It is however, too simplistic to believe that this slow change is only a matter of tradition. Informal and formal finance each have certain, largely antipodal advantages and disadvantages. The following reasons are mentioned as advantages of informal financial intermediaries. They are spatially closer to the borrowers and often well-known; credit is easily and quickly available; instalment schemes are adapted to the requirements of the borrowers; the lenders usually accept an interruption in instalment payments in emergency cases (although very often they take some advantage of such postponement); they do not ask for the loan purpose; security is only required for new customers, while old customers obtain preferential rates; borrowers want to maintain their long-established credit link, while they are afraid in a new, impersonal relation with a bank, and so on. Disadvantageous are the high interest rates (which often reflect the insecurity of a loan), the limitation of funds, a lack of refinancing possibilities, no provision of additional services such as consultancy, no savings facilities for borrowers, etc. From such a perspective, contemporary informal finance and the continuous change in financial intermediaries are both a reaction to common peoples' requirements and state laws. In Indonesia moneylending and private pawnbrokerage have been legally prohibited by the Indonesian government since independence but can easily be circumvented in practice. Most financial legislation refers to the sphere of formal finance and has hardly affected informal finance.

In this paragraph I refer to a number of micro- and macro-studies on credit in rural Java. First of all, it has been commonly agreed that in Indonesia (as in most developing countries) the share of informal finance has been decreasing over the last three decades. The heavy expansion of formal finance into rural regions on Java in particular creates competition with informal finance. But a decreasing share of informal finance does not necessarily mean a reduction in absolute numbers. It means no more than that the growth rate of formal finance is higher than the informal one. Sectoral developments are not visible from such a ratio. For example, recent estimates suggest that informal finance is still expanding in the petty and medium-scale trading sector.

Micro-studies point out that borrowing is an everyday affair in the rural as well as the urban context. Almost every household needs credit at least once a year. What is important is that the choice of the creditor by the borrower does not depend so much on the rate of interest, but on credit amount and reason for borrowing, as well as the collateral that the borrower can offer (Hardjono 1987).

In his 1987 survey on rural and urban households on Java and Bali for a comparative study of the Asian Development Bank (Ghate 1992), Prabowo et al. (1989: 5) found that 90 percent of the total values of loans used by individuals came from informal sources (semi-formal sources such as credit unions were counted among the informal ones).[10] Since the study includes the urban context, it goes beyond the scope of most studies. Nevertheless, such aggregated estimations are of course not very reliable. The report emphasised that the informal financial markets are segmented

10 It was based on questionnaires to 70 lenders and 240 borrowers in rural regions of Central and East Java, as well as 50 lenders and 187 borrowers in the cities of Jakarta, Semarang, Surabaya (all Java) and Denpasar (Bali).

and cover a broad spectrum of agents, institutions and arrangements. Commercial lenders and credit arrangements are professional, part-time and semi-professional lenders, private pawnshops and commercialised rotating savings and credit associations (RoSCA). Non-commercial are the traditional RoSCA, credit unions, public pawnshops and neighbours, friends and relatives. I take a closer look at this spectrum and include the findings of several other studies.

The Spectrum of Financial Intermediaries

Professional moneylenders are more prevalent in urban than in rural regions. They are called *rentenir*. The typical moneylenders of the colonial period (peddling Chinese *tjina mindering* in rural regions, Chinese and Arab lenders in towns and cities on Java, and the Chettiar at the east coast of Sumatra, see Schrader 1994c) have lost ground compared to Indonesians, although some Chinese moneylenders are still operating in Jakarta. Among the professional Indonesian moneylenders are a number of Batak who operate outside their home region (Prabowo et al. 1989; Ghate 1992). According to Bouman and Moll (1992) professional moneylenders largely operate with own funds from their homes or offices in urban regions around market places and business centres, and they only occasionally accept savings.[11] They provide credit to small and medium-scale industries, commerce and farmers. Empirical evidence suggests that they limit their number of clients to a maximum of 30. If they serve more clients, they employ brokers who often form the link to rural regions. If they operate successfully, they may set up as independent operators.

In his in-depth study on moneylenders in a sub-district town on Java, Heru-Nugroho (1993) observed that the majority of professional moneylenders are Javanese women, which contrasts the colonial period both in terms of ethnicity and gender. In many cases they were formerly engaged in trade. The partners of practising moneylenders mostly work in trade and commerce, while a few male professional moneylenders were formerly involved in the administration or the military. To set up a moneylending business, one needs a stock of capital achieved by savings, or one has to take a loan and obtain information from a large-scale moneylender. There is some competition between the moneylenders on the same level of business, but not between different levels. Interest for such starting capital usually amounts to ten percent per month, which is half the interest the

11 In Denpasar (Bali) Prabowo (1987) came across moneylenders who paid their depositors a share of the profit.

smaller lenders acquire by on-lending to their clientele. In many cases the large-scale moneylender has access to bank credit or bank savings accounts but he or she uses it only if there is a shortage of capital. Banks take 2.5 percent interest per month.

Among the professional moneylenders, Hardjono (1987) and Prabowo et al. (1989) identified so-called mobile bankers (*bank keliling* or *bank plecet*).[12] They have opened a 'bank' office or 'co-operative' to obtain a licence but peddle from door to door. They provide small and medium-scale instalment credit to traders and factory workers without collateral and without long procedures and charge interest rates of 10-20 percent per month.

In addition to professional moneylenders, there are various *occasional moneylenders*, people with some wealth or the wives of husbands with regular incomes from teaching, civil service, etc. who prefer the option of moneylending to the alternative of savings in a bank because of higher returns. Since they often have access to formal credit, the more enterprising take a bank credit themselves to enlarge their working capital and on-lend to informal borrowers. Bouman (1989) observed for India that this group is growing rapidly at the expense of professional lenders, and this is probably also true for Indonesia. For both professional and part-time moneylenders interest rates range from ten to twenty percent per month. I agree with Bouman and Moll (1992) that these relatively high interest rates are not so much due to monopoly profit than reflect the nature of the financial services offered and the characteristics of the borrowers. They cannot offer collateral, require small-scale and short-term loans, the default rates are high, and so on.

In rural regions moneylending is almost always combined with other occupations. *Semi-professional lenders*, who usually do not consider themselves as moneylenders, include shopkeepers, crop merchants, suppliers of fertilisers and farm machinery, landlords, millers, craftsmen, transport dealers and peddling traders. They either provide cash credit to be repaid in kind like landlords and crop merchants, or they sell on credit. Dewey (1964), Hardjono (1987) and Bouman and Moll (1992) maintained that the purpose of their credit provision is not only, if at all, to make large profits by lending, but to facilitate other exchanges. For example, shopowners sell on credit and charge no interest or hidden interest through higher prices. The reason is that in many cases they do not undercut each other with prices (since the profit margins in the price calculations are already at a minimum level) but offer preferential conditions to their customers. An-

12 On Java they are often called *bank plecit*, meaning that the lender hunts the borrower and there is no way of escaping timely repayment.

other reason is that in many cases customers cannot pay in cash but have to balance their bills with their next income. Most shopowners, both urban and rural, have obtained their stock on credit (see e.g. Alexander 1986) and most small-scale industries and artisans obtain trade credit from input suppliers and themselves offer trade credit to wholesalers and retailers, so that complex networks of trade credit can occur. *Ijon*, the selling of the green crop to an agricultural trader, and similar arrangements of crop dealers are not very different from those during the colonial period. *Ijon* was prohibited by Law No. 2/1960, *sewa* (land lease) and *gadai* (land pawning) by Article 53 of the basic Agrarian Law. Nevertheless these systems are still flourishing.[13]

Until the 1950s most itinerant moneylenders-cum-traders were Chinese, but the Javanese subsequently took over this business. They peddle from house to house and sell a variety of products, such as glassware, plastic ware, textiles, and small electronic goods on instalment credit, whereas the lending of cash seems to be less common. No contract is signed. The instalments are fixed to every five days, comprising an interest rate of 20 to 30 percent per month, so that it becomes obvious that these lenders, the mendriks,[14] earn more from the interest than from the goods sold. Nowadays mendriks are also popular in towns.

Whether in the urban or the rural context, moneylenders have good knowledge of their customers. Officially moneylending is illegal. Prabowo et al. (1989) reported that one strategy of the lenders to avoid legal confrontation is not to attract attention by keeping their clientele and radius of action small. Another strategy is the bribing of officials. Most moneylenders in rural Indonesia provide credit without collateral, while in urban regions collateral in the form of luxury or consumer goods or titles (electronics, jewellery, motorcycles or cars, land titles, household items, insurance licences and pension documents) is frequent. The value of collateral always exceeds the value of the loan.

Arisan are the Indonesian *RoSCAs*, which are wide-spread, ranging from non-commercial to commercial forms. The *arisan call* is highly commercialised and functions by bidding. To minimise the encounters

13 *Gadai* is allowed up to seven years after which the loan is considered to be repaid. With shorter *gadai* the principal sum is automatically reduced in proportion. As a result of these laws, many transfers of land as a result of credit are made 'under the table'.

14 *Mendrik* or *mendring* has been derived from *tjina mindering* (see Schrader 1994a, b, c), which was, however, applied to Chinese itinerant lenders only. Hardjono (1987) mentioned another term that is applied, namely *tukang kredit*.

with legal authorities, the meetings are kept secret or bidding is even done over the phone.[15]

Friends, relatives and neighbours are usually a source of non-commercial credit. In rural Indonesia, loans from friends and relatives, which are small-scale, are usually interest-free, while credit among neighbours very often takes the form of a rice loan with an interest rate of 50 percent until the next harvest. With increasing differentiation of the economy social obligations such as reciprocal interest-free loans to closely-knit members of the community seem to decline.

Another supplier of credit are the private and public *pawnshops*, the former being informal, the latter formal institutions. As pawn brokerage existed already during colonial times and is by now a state monopoly, all private pawnshops are illegal. As in many other Third-World countries, the majority of Indonesians invest their savings in gold and jewellery due to high inflation and devaluation, and these valuables are occasionally pawned. Gold shops, for example, sell gold to their customers and provide the guarantee to re-purchase it a the current market rate and sell it back to the former owner at the current market rate, too. This works because the gold price has been rising steadily. Skully (1994) mentioned a number of around 500 public pawnshops in 1990. Pawns in Indonesia, in addition to gold, ornaments and luxury goods, are a variety of household articles, the latter of which is untypical for private pawnshops in most Southeast Asian countries, most of which accept jewellery and gold only. Loans amount to between 84 and 89 percent of the value of the pawn, which private pawnshops offer for gold only. Bouman and Moll (1992) reported that the turnover of public pawnshops increased from Rp. 31 billion in 1975 to Rp. 156 billion in 1981 (US$ 124 and 468 million at the time). The redemption rate was almost 100 percent. Pawning is an everyday-affair of many people and pawnshops have been called the 'poor peoples' banks'. Although public pawn houses take an interest of 3 to 4 percent only, many people prefer the pawning at private shops in spite of much higher interest because they receive larger sums for the pawns.

Loan Size and Interest Rates

Prabowo et als' (1989) survey data demonstrate that the acceptance of formal finance is not very high. In the rural areas of Central Java almost 26 percent of the 120 respondents borrowed from registered co-operatives,

15 This telephone bidding gave its name to this *arisan* 'call'. For a detailed discussion of RoSCAs, see e.g. Bouman (1983, 1994); Schrader (1991).

close to 22 percent from BKD (*Bank Pembangunan Daerah*, the provincial development bank) and about 14 percent from BKK (*Badan Kredit Kecamatan)*, a regional government credit programme for rural finance in Central Java. In east Java almost 16 percent borrowed from BRI and 9 percent from co-operatives. In Semarang only some well-off people borrowed from the formal sector, and in Surabaya and Denpasar at the same time from informal agents and institutions, too. In Jakarta, on the other hand, most respondents had access to bank credit. From these data it is difficult to assess the size of informal loans, since borrowers tend to take up formal and informal loans at the same time. Nevertheless, I suggest that an estimation of at least 50 percent of credit in Central Java and considerably more in East Java and other islands originate from informal or semi-formal sources, seems justified, while for West Java different conditions apply inside and outside DKI Jakarta.

Prabowo et als' (1989) sample provides further information. With regard to loan size, 65 percent of the respondents borrowed up to Rp. 500,000 and 35 percent above Rp. 500,000 from informal sources. The average size of formal credit was more than Rp. 1,600,000, which was about twice as large as the loan size from informal sources (about Rp. 950,000). The sample's total amount of formal credit was about Rp. 23 million (with 14 borrowers), while that of informal credit was Rp. 202 million with 217 borrowers (whereby the report does not state the mean square). Much of the informal credit was given on an instalment basis, and the repayment schemes were adapted to the requirements of the borrowers.

Heru-Nugroho (1993) outlined five different types of credit which are adapted to the requirements of the customers in length and instalment payments. The length and maximum loans are 12 days and Rp. 20,000, 24 days and Rp. 50,000, 30 days and Rp. 100,000, 60 days and Rp. 300,000 and one year and up to Rp. 100 million. While the former four types usually imply interest rates of 20 percent per month, the latter amounts to 6-10 percent. Large business loans, however, usually require collateral.

From the point of view of use of funds, Prabowo's report emphasised the increasing demand for credit for special occasions (e.g. Hindu festivals or start of tourist season in Bali, the start of the school year which requires school fees, purchase of books, etc.).[16] Such seasonally fluctuating credit demand leads to a temporary increase in interest rates. In Central Java, the main reasons for borrowing were household, subsistence and working capital requirements. Other reasons were emergency needs, schooling, house repairs, and so on. In urban regions, the average rate of interest was

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16 Fifteen years ago Prabowo found that around 75 percent of the respondents in rural areas borrowed in one way or another for subsistence purposes.

lower than in rural regions, and a large array of different credit sources was available. The demand for informal credit was higher in cities.

The sampled lenders consisted mainly of middle-aged women with higher education (high school 70 percent). More than half of the respondents had already been in this business for more than five years. Moneylenders and itinerant traders used to charge higher interest than other informal lenders, and short-term credit was more expensive than long-term credit.

Considering the *interest rates and conditions of loans*, formal and informal market rate vary on a wide range. This is due to the fact that both markets are largely complementary with different clienteles. Interest costs for formal loans are lower than informal ones. However, from an economic point of view these costs are only one component of total borrowing costs, which are the sum of interest costs and non-interest costs: transport costs, opportunity costs and miscellaneous other costs like fees for transaction and sometimes even bribe. These total borrowing costs of formal and informal credit are not much different, since the non-interest costs of banks are much higher than those of informal credit. Prabowo et al. (1989) maintained that informal rates, which typically ranged from 40 to 60 percent per annum in the survey year, express the market price of money better than the bank rates of 25-35 percent per year.

Financial policy has taken account of the fact that, from the borrowers' point of view, the level of interest is only one - and in many cases not the decisive - component of making the decision from which source to borrow. Micro-economics analysis has therefore elaborated broader cost-concepts (transaction costs, opportunity costs in addition to the costs of interest), which measure components such as spatial distance, but they have also understood that psychological components, such as social distance and long-established credit relations with a moneylender that cannot be measured in monetary terms, are equally important for the decision-making process. These additional cost-components and psychological factors are explained by the imperfection of the financial markets in developing countries (monopoly profit of moneylenders, lack of information of the borrowers, and so on) and by the partly traditional behaviour of the borrowers. Heru-Nugroho (1993) even found that one cannot assume moneylenders to act entirely means-ends rationally. Because of competition, they apply mixed strategies to maintain or gain a clientele. They provide economic incentives to their customers, persuade them to borrow and even utilise spells and magic hoping to bind the customers to themselves and thereby acquire business success.

To summarise the first part of this article: Like in many other Asian countries the absolute size of formal finance increased in Indonesia during the past decades while that of informal finance decreased. However, it is not obvious whether these changes result from a growing acceptance of formal finance in the public or whether they are related to the booming of certain cities, economic sectors and large-scale enterprise while the average population, including medium- and small-scale enterprise are still hesitant to have confidence in these new, impersonal financial institutions or are even afraid of the ponderous bureaucratic procedures of credit application.

A number of surveys from within and outside Indonesia demonstrate that there is indeed demand of capital not only on the higher, but also on the lower plain of the economy and reality shows that those who have access to formal finance combine it with informal finance to maximise their credit volume. I think this should be a lesson for a number of development planners. It is against the requirements of the population to try to extinct informal finance and substitute it against formal one, without being able offer substitutes for its advantages. With regard to this I believe that the strategies of upgrading and linking are promising attempts. They are based on the assumption that formal and informal finance complement each other.

4. Chinese-Owned Capital

The second part of this chapter reconsiders the economic position of the Chinese in contemporary Indonesia and their relation to finance. Were they able to maintain the dominant position in colonial trade and money-lending and did they use their accumulated wealth and knowledge to conquer the key positions in commerce and industries?

Even during the colonial period, but particularly during the post-colonial period the Chinese were physically attacked by the indigenous population. Buchholt (1992) argued rightly that contemporary Indonesian-Chinese conflicts are related to the colonial past because of their intermediary function and resulting economic benefits. Envy and their collaboration with the colonial system made them the target of indigenous attacks, which were, however, very often initiated by the colonisers to divert the aggression expressed against the colonial regime. During the late colonial and post-colonial periods, increasing competition occurred between indigenous people and trading minorities in the commercial field, but it is again too simplistic to see economic reasons as the only cause of pogroms.

Before considering this particular question, I shall look at political and legal restrictions to private business in general and Chinese business in particular in post-colonial Indonesia.

During the Sukarno era, policy was directed towards the nationalisation of foreign and the restriction of Chinese capital. The basic idea of the 'Guided Economy' was to develop the economy with state-owned capital. Private indigenous and Chinese enterprises were almost excluded from the most profitable economic spheres. Some of them, however, managed to have close relations with political and military leaders who provided them with licences for imports and exports or state credit. Some indigenous groups entered the import trade, too.

During the 1950s the *benteng* (fortress) policy tried to supplant the Chinese from import and export. In 1959 the monetary purge severely affected private capital, much of which was Chinese capital, when all bank deposits exceeding Rp. 25,000 lost 90 percent of their value. This experience caused many businessmen and industrialists in Indonesia to keep capital low and to run foreign accounts abroad or to invest in stock. Much more restrictive was PP 10 (*Peraturan Presiden*), a presidential decree in 1959, which prohibited Chinese to settle and retail in rural regions. This decree forced 400,000 people of Chinese descent to transmigrate, and this may perhaps explain why the percentage of Chinese moneylenders in rural regions decreased in favour of indigenous ones. On the level of personal strategies, many Chinese businessmen reacted by employing indigenous touts, by capital exporting or by even emigrating. However, considered as a whole, they maintained their economic dominance. The early 1960s again limited private imports by fixing certain quotas for bank credits to private businessmen and sectors. The anti-Communist/anti-Chinese massacres subsequent to the fall of the Sukarno regime are well-known.

Robison (1986) and Suryadinata (1988) emphasised that with the demise of Sukarno and the more economically liberal policy of the New Order, which welcomed foreign investment, the Chinese once again attained favourable conditions for their business. To my mind, this is true for the circumstances of private capital in general. With regard to the Chinese, this applies to Chinese large-scale business and industry only, while the average Chinese trader and shopkeeper was restricted by existing anti-Chinese legislation and suffered from the more or less regular looting of his property or even loss of life. In large-scale business and industry, an increasingly functional relation ('strategic group', see Evers and Schiel 1988) was established between the military and Chinese. *Cukong* is the term used for a big Chinese businessman who collaborates with a member of the Indonesian power elite, usually a high military officer. The *cukong*, the Chinese businessman, runs the business and provides the capital, while the power elite provides protection (Suryadinata 1988). According to Robison (1986) these *cukongs* obtained trading monopolies and privileged access to state bank credit and government contracts. In addition, they were part of Chinese overseas networks throughout Asia and attracted international investment capital.[17]

During the era of the New Order various Chinese-owned business conglomerates emerged with investment in manufacturing, forestry, trade, shipping and transport, banking, property and construction. While in Chinese family-firms all staff members were Chinese, many large firms, including these consortia and conglomerates, also employed Indonesians. However, the top-level employees who were involved in decision making were still Chinese.

In the early 1970s the pressure upon the *Bappenas* group to discourage foreign and promote indigenous capital, and the subsequent shift in policy also affected the Chinese. The state faced the dilemma of restricting Chinese capital by simultaneously being closely interlinked with this capital. In 1973/74, after anti-Chinese and anti-government riots in Jakarta and Bandung, the National Economic Stabilisation Board introduced the following change: capital equity share of Indonesians was to achieve 51 percent in new joint ventures within a period of ten years. All foreign investment projects were to involve Indonesian partners. In those cases where local partners were not indigenous Indonesians, i.e. mainly WNI Chinese, half of all shares were to be sold through the stock exchange to indigenous Indonesians within a shorter period. Certain investment areas were closed to foreign capital. Investment credit by the state bank was provided to indigenous Indonesians only. Domestic investment projects were to involve 75 percent indigenous equity, except in those cases where the management was largely in indigenous hands. Here the share was only supposed to be 50 percent (Robison 1986: 167, 189).

Considered as a whole, the New Order policy favoured the development of indigenous private capital on a small- and medium-scale level in manufacturing, forestry, hotels and tourism, shipping and finance. For large-scale indigenous capital, however, the patronage of the military or officials and joint ventures with Chinese or foreign capital were a prerequisite. The other side of the coin of this policy was a restriction to Chinese small- and medium-scale capital. The position of large-scale Chinese capital, however, remained strong because of its close coalition

17 For example, the Bangkok Bank, a Chinese-owned bank, provided finance to various Chinese conglomerations in Indonesia, while indigenous entrepreneurs did not generally have access to finance.

with the military. It coped with the equity-problem by raising its loan capital abroad.

Robison (1986: 278ff.) provided a list of Chinese conglomerates in Indonesia, of which several are involved in banking, finance and insurance business, too. An example is Tan Tjoe Hing (Hendra Rahardja). Besides property development, manufacturing, a motorcycle agency and a cement plant, it runs P.T. Bank Harapan Santosa, P.T. Bank Tonsea Menado, P.T. Bank Pasar Gunung, P.T. Inti Harapan, the P.T. Asuransi Harapan, P.T. Cahaya Harapan and P.T. Sumber Cipta Harapan Sakti. Another example is the Liem Group, and it is worth looking at the history of this firm. An immigrant in 1936, Liem joined his brother in peanut oil trading and the clove trade. Eventually he expanded into manufacture and became a supplier of the Indonesian army. In the 1950s he established the Bank Windu Kencana (which is now military-owned but still managed by Liem) and purchased the Bank Central Asia, of which he holds a share of 24 percent. This bank is now the largest private, domestically owned bank with assets of US $ 277 million in the mid-1980s. Nowadays the Liem group forms a major regional and international financial and industrial group (manufacture, automobiles, trade, finance) which has close relations with the military but is no longer in a *compradore* position.[18]

During the 1980s Liem also expanded internationally around trade and finance (Hong Kong, USA, Liberia, the Netherlands, the Netherlands Antilles). It makes sense to explain this international expansion by the political risk of concentrating the entire group holdings in Indonesia, because under the present regime success depends upon patronage. Since Suharto may retire in a few years, the future with regard to relations with a new political leader are uncertain. In addition, the alliance of politico-bureaucrats, *cukongs* and foreign capitalists has been increasingly criticised and led to anti-Chinese riots during the 1970s and 1980s. However, since military and Chinese big businessmen cannot be physically attacked, those who suffered were again the small and medium Chinese enterprises.

Because of their well-developed networks of finance both at the local and regional levels, their connection with international and indigenous capital and the centres of politico-bureaucratic power, the *cukongs* have maintained if not even strengthened their economic position. Robison

18 According to Robison (1986: 317), Liem finances the activities of the conglomerate in a four-fold way: through the Bank Central Asia for the daily needs, through equity funds, through attracting large-scale international bank credit and through informal credit networks between the major Chinese business groups. The Bangkok Bank seems to be involved in this network, too. Joint ventures exist between the Liem Group and the Suharto family.

(1986: 317) emphasised that the power of the Chinese conglomerates results from the fact that they not only dominate the distribution networks as before, but that they are capitalists. Their position has been strengthened from the decline in the oil revenues onward, which forced the government to rely increasingly on investment finance.

In many cases the *cukongs* transformed themselves from traders-cum-lenders during the colonial period to large-scale businessmen, industrialists, bankers and even international conglomerates. However, research on the Chinese patronage systems in colonial Indonesia and its development during the post-colonial period is barely available. One reason is that the Chinese try to conceal their business affairs with regard to internal finance. In addition, the close connection between large-scale Chinese capital and the military may discourage scholars from research.

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