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REFLECTIONS ON INDUSTRIALISATION AND INDUSTRIAL POLICY IN INDONESIA

A.R. Soehoed

Abdoel Raoef Soehoed was born in Jakarta in 1920. After graduating from senior high school in Jakarta in 1939, he studied engineering in Bandung and subsequently graduated after the independence struggle. In 1956 Soehoed, who had become an officer of the Indonesian Air Force, resigned from military service and became an engineering consultant with a private firm. His career as a public servant started with his appointment as an Advisor to the Senior Minister for Development and Industries. He was then appointed a member of the Technical Committee for Capital Investment, which became the Coordinating Board for Capital Investment (BKPM). Soehoed was made Deputy Chairman of the Board, and head of BKPM's Division for Promotion of Foreign Capital Investment. In 1976 he was also appointed Chairman of the Asahan Development Authority, a position he still occupies. In 1978, he became Minister of Industry in the Third Development Cabinet (1978-1983) and in May 1983 he was appointed Member of the Supreme Advisory Council.

As a forceful and articulate advocate of what has come to be called the structuralist approach to industrialisation, Soehoed can rightly be considered the prime architect of Indonesia's current industrial development. On 7 September 1987 he talked to Thee Kian Wie and Hal Hill about his views on the development of Indonesia's manufacturing sector.

THE OLD ORDER

In the Old Order period, I was, as a private businessman, very much involved in industrial development. Very early it had been recognised by the government that the best way to transform the country into an industrialised society is to set up basic industries, although what was meant by basic industries was not clearly defined. As I remember, the Chief of

the Planning Board at this time, Dr Djuanda, proposed a two-pronged approach to industrialisation: (1) industry to produce goods needed in the country, and (2) industry to provide revenues to finance development of other industries; it was a complementary system. Not many of the projects planned during the years before 1965 actually materialised, although there was the first fertiliser plant in Palembang and the first large cement plant in Surabaya, presently known respectively as PT PUSRI and PT Semen Gresik. A steel plant to be built with Russian aid encountered many problems and did not eventuate. There were several plants which were initiated in the Old Order period but stalled because of the political problems around 1965, and were finally completed in the 1970s.

Nevertheless a concept was already adopted, of first setting up basic industries, making use of available natural resources, and then developing downstream industries.

NEW ORDER INDUSTRIAL GROWTH

In the New Order period I believe this concept to be even more valid. Whilst during the Old Order the means were very limited, in the New Order period conditions were different. First of all the new government adopted a policy, which is a very wise one, of opening the country to overseas private capital investment and introducing policies aimed at developing natural resources. In the late 1960s the latter was still limited mainly to oil, owing to financial constraints. By the early 70s, it was time to develop a long-range strategy, centred on basic industries and natural resources, to be initiated by the government, leaving downstream manufacturing to private enterprise. The former were to be funded by oil and very considerable aid flows, generally on favourable terms. Resource development later on went beyond oil, to include other minerals and forestry products. At that time aluminium was already thought of as one of the possible basic industries. In the meantime, private foreign and domestic investment had been growing rapidly. This tempted many enterprises to produce new goods in an import substitution fever, particularly in the domestic sector. I am not in favour of this import substitution. Although at that time I did approve a number of import substitution projects, this was simply to act as a primer to get the economy on the move again and to create job opportunities as quickly as possible.

I propagated the idea that it was time for the government to put all available resources into infrastructure and basic industries. But I did not have many supporters for this idea. In certain circles there was a belief that this was simply repeating what the Old Order had unsuccessfully attempted. But such a comparison was invalid. The Old Order failed because the means were not available, the country was not open, and there was insufficient political and social stability to promote major developments. There was not much time to think seriously about economics.

Under the New Order government conditions have changed entirely. The means are available, the market for a lot of commodities has been favourable, and the nation itself is geared towards development; consequently there is more community support.

BASIC INDUSTRIES AND INDUSTRIAL DEEPENING

In certain circles there was the view that downstream industries should be developed first because they create employment and contribute to so-called equitable distribution of development. This is indeed true, but those industries can be left to private enterprise provided the right incentives can be offered. This will allow the government to concentrate on the development of basic industries and infrastructure. Gradually the downstream sector can then be matched to the upstream sector in order to arrive at long-range strategies for industrial growth.

That was my way of thinking, but until I became Minister of Industry I was not able to get the message across. I proposed about 52 basic industries in which the government should take the initiative, because private entrepreneurs were not ready. The problem with basic industries, usually, is that a considerable amount of capital is needed, the gestation period can be quite long, the infrastructure has to be laid out, and the profit margins are generally low. I was able to convince the government that, once we had established a foundation with the aid of the rapidly growing oil revenues, industrial development would accelerate by itself. The concept was approved but I was not able in my term to finish the implementation of the whole program. All the same, many projects were completed including cement and fertiliser plants, the Asahan

aluminium smelter, paper and plywood mills and the nucleus of a steel and engineering industry.

I regret, however, that not enough funds were allocated for training of personnel, particularly in the engineering industry. There was a general conviction that existing plants would do this training job. Unfortunately, also, although I intended to leave the downstream sector to private enterprise, there were not enough long-term guidelines for the private sector; overlapping authority between government agencies has often caused erratic changes in rules, regulations and procedures. For example, in the case of the automotive industry, where standardisation could have been an important regulating factor, instead everything was left to market forces. Everyone tried to enter the game and there was such a proliferation of brands and types (72 brands and more than 150 types, at the time I became Minister) that under the circumstances it was impossible even to think of a national automotive industry as an ultimate aim. I gradually imposed limitations and promoted standardisation. When I left, the number of brands had more than halved, and the situation had become more conducive to making components for standardised equipment, and to building long-term policies. I mention the automotive industry in particular, because motor transport is crucial in Indonesia and certain sections of the industry are still quite labour intensive, which could very well accommodate the need for new employment opportunities.

In countries with a longer industrial history, basic industries usually develop from downstream activities upwards to secure supplies of raw and basic materials. The process grows naturally with the market. This growth pattern, following market forces, would not have been possible in a developing country like Indonesia. In the early days of the New Order, private enterprise was reluctant to enter the upstream sector because of the smaller profit margins and higher risks involved, as well as the huge capital requirements. Hence my suggestion that the government should take the lead. Nowadays private business has become a lot stronger and I think it is proper to allow it, and even to encourage, a greater initiative and participation.

It is very unfortunate that there is some friction between competing views on the need for 'high-tech' industries. High tech will certainly be needed at some stage in the future, and building the foundations now would not necessarily be unwise. The current programs may be a bit overstretched under the present situation, but one should not be

apprehensive *per se* towards high-tech or large projects, when their feasibility has been established. I understand the arguments of economists and the need for caution, but prudence can easily lead to vacillation, and major projects can get bogged down because of indecisiveness while others elsewhere have already started.

For instance, plans were in the pipeline for over ten years for an Olefin Centre in North Sumatra. When the plan was under negotiation it was very feasible; if it had been started right away it would have been profitable. But in the meantime, Saudi Arabia has developed huge plants, and it doesn't make sense now for us to invest in this sector. We are in a period of very rapid technological change and so we have to treat technology-related and technology-sensitive projects seriously.

IMPORT SUBSTITUTION VERSUS EXPORT PROMOTION

To anticipate a rapid shift from import substitution to export orientation does not seem very realistic to me. During the first three *Repelita*, there was strong emphasis on producing basic necessities, so all industries were focused on the domestic market and were very well protected. It would be inconceivable to expect that these products can be quickly redirected to export. One certainly should try to export as much as possible, but it will not be an overnight affair. An adjustment of currency exchange rates may help initially, but the positive effects of this will soon be eroded, without more long term follow-up steps.

An alternative way, in the current recession, of maintaining a reasonable balance of payments could be found by paying more attention to the spending side, instead of focusing entirely on revenues. It would certainly save a significant amount of foreign exchange if funds appropriations were more carefully scrutinised in terms of technology applied and foreign exchange needs, in order to achieve certain economic benefits. The counter-argument often heard is that the consequently increased local currency spending may eventually lead to more inflation.

Without rejecting this possibility, it is nevertheless still worthwhile to consider the trade-off in increased employment and use of local goods and services. Consider for instance the construction of a bridge somewhere in the interior of Sumatra or Kalimantan which, on current traffic volumes, could well be made from wood, naturally much cheaper

than one made of steel or concrete. It does not contribute as much as an expensive one in terms of development spending, but in terms of economic benefit it certainly yields the same effect; at the same time it will require less foreign exchange. In my opinion, too much emphasis is placed on the amount of development expenditure as a measure of growth, and not enough on the actual effective value, which naturally will lead to increasing pressures on revenues. There is enormous scope for the development of infrastructure, not just highways and big bridges in the cities, but also in rural areas, including small dams and irrigation all over the country. These can employ appropriate technology, using labour-intensive construction methods and local material, and equipment produced by local industry, or even small-scale industries. Government spending can create more effective development in this manner, and I feel we can balance the monetary equation and provide employment much faster than by focusing solely on exports, considering that we are not yet entirely ready for this redirection.

Moreover, although many industries have already been developed, marketing and distribution remain major bottlenecks. Domestic transport is still very expensive. There is a need for some reallocating of industries to ensure that transport becomes more effective and efficient. Investment in improved internal transport will promote industrial development and create jobs, and help compensate for the decline in oil earnings.

There is need for a more comprehensive perception of trade and marketing. We are still influenced by a view of trade which was born in times when goods were in short supply, and quite a lot of petty trade and brokerage developed. The view that seems to have resulted is one of trade as a simple exercise of buying and selling. Trade in a modern sense is to me a more complicated affair. There is the need to have correct and timely information and the ability for quick dissemination. One should be able to follow the changing patterns of consumer demand and to react accordingly. Our trading houses - if they may be called so - are poorly equipped and are hardly traders in my definition. My feeling is that trade is one of the weakest sectors of the economy. We still have not mastered the 'science of trade'.

INDONESIA AS A 'NIC'?

In a country like Indonesia, with so many islands, plentiful natural resources and such a large population, it is not as easy to develop a clear, aggressive policy as in Japan, Taiwan or Korea. I don't see, at the moment, how we can follow their pattern, and I don't think that simply copying their model would be right for Indonesia. We need, first of all, to increase our own domestic purchasing power, and that requires, among other things, improved efficiency in agriculture and more public works. This will create buying capacity which is needed for domestic industry to develop and be exposed gradually to competition from abroad.

Korea and Taiwan adopted their policies because there were not many other options. They had to apply whatever was possible to support their policies, even sacrificing domestic interests in favour of exports. For Indonesia, however, there are many options, including the development of public works with real social effective value, and increased efficiency in agriculture. This will expand the domestic market, and enable exports to grow in a more natural way. Then there are non-economic factors which make their policies difficult for Indonesia to imitate. The geography of Indonesia, for example, makes stringent control of the coastline impossible. Also, Indonesia has a lot of foreign production centres nearby, almost in its backyard. Secondly - and this is very often overlooked - compared with other developing nations, the Indonesian people have been exposed over a much longer period of time to a large number of outside influences. Indonesia has always been a crossroad of trade and cultures and a blend of numerous ethnic backgrounds. With this exposure, policies which are easily imposed on societies like Korea, or even India, may not be so easy to implement in Indonesia.

THE DEVELOPMENT OF ASAHAN

I have been closely involved with the development of Asahan; its purpose is to harness the hydroelectrical potential of the Asahan River in North Sumatra, in order to develop products, such as aluminium metal, initially for export and eventually for domestic industries. This primary aluminium production is only the beginning, to be followed by intermediate, downstream and other related industries. It is now time to

think about developing a bauxite refinery to produce alumina from local bauxite as input for the smelter. Bintang Island in the Riau Archipelago has large deposits, although it has already been mined for quite a while. Also, West Kalimantan has huge deposits still untapped. Plans are in the pipeline for an alumina plant on Bintang Island. The island of Bintang may not be the most ideal location for a number of reasons, but a decision has been taken by the government in favour of the island.

Despite the less than ideal location, however, Bintang may still be feasible, as more and more smelters are being built in the Middle East, South and Southeast Asia which at present have only Australia to rely on for their input. India is now coming into the picture too. In the long run this situation will not be sustainable; a large number of smelters will certainly require a broader supply base. It would not be inconceivable that more smelters will be built in Southeast Asia to serve the large Japanese market, now totally devoid of its own smelting capacity, or even Europe.

Thus, there is a good opportunity for the Bintang Alumina Refinery to become viable as an additional source for alumina, and there is scope for sharing the market properly without out-competing each other. The same concept may apply to carbon products needed by the smelters. Strategically, Asahan and subsequent developments related to aluminium should prove the merits of an industrial development policy based on viable natural resources and basic commodities, provided they are selected correctly, with a long-term view. So far this concept seems already to be working in the oil and gas, timber products, aluminium and textiles sectors.

With regard to the selection of North Sumatra for the application of this concept, considerations were not limited to available natural resources, but were also based on socio-economic factors, such as a reasonably well developed infrastructure, adequate educational facilities, and a fairly high general level of socio-economic achievement in the region, all increasing its potential to become the second industrial region in Indonesia after Java. In this process Asahan and the Lhok Seumawe gas and fertiliser complex have become additional prime movers, next to the estates which for decades have been the single locomotive for the region's prosperity.

THE ROLE OF STATE ENTERPRISES

I am in favour of a greater role for private enterprise, but not only for alleviating our present revenue problems. As has been said, the government had to take the initiative in the initial stages because of the absence of strong private enterprises at that particular period of time. Unfortunately most state enterprises have not been very well planned, nor well managed either. After all, their management has mostly been drawn from civil servants, with views and attitudes strongly influenced by bureaucratic experience and not really geared to business; consequently the majority of state enterprises are not very efficiently run. I therefore see privatisation primarily as a means of increasing efficiency and productivity within government-owned enterprises. This may eventually help to create some new revenues for the government, but the main objective should be to increase efficiency rather than to dispose of unprofitable enterprises. I would favour an effort to transfer state enterprises into joint ventures with private or even foreign enterprises, or at least to have some state enterprises operated by private domestic or foreign management teams or entities, until a sufficient number of capable Indonesian managers has been developed. Therefore more important than 'whether you privatise or not', is the question 'what is meant by privatisation' and 'how to privatise'.

Certain perceptions have to be reviewed and modified in order to give privatisation a fair chance of success. For instance there are deep-seated differences of opinion towards the interpretation of Article 33 of the Constitution, as related to large land holdings, which will have a bearing on privatisation of government-owned estates and foreign participation. Whilst there is a bias in favour of small holdings vis-a-vis large commercially operated estates, the question is often raised, whether owning land is still an overriding objective among rural people, or whether benefits can be secured from working on land, without necessarily owning it.

Although land ownership within rural society is indeed still a strong focal point, I have the impression that, for a growing section of this society, primary objectives are becoming spread over a large array of basic needs such as stable income, education, health services, housing, and so on. Perhaps the ownership of land is now less dominant vis-a-vis the benefits of a secure job and earnings of modern estate work. I believe

rural dwellers would be better served and more content with a good job in an estate which pays a proper wage, and that land ownership may not be so predominant any more. Of course the government should outline clearly to estates their socio-economic obligations, and see to it that these obligations are fulfilled. This policy should not prejudice the government's current small-holding programs, as the two concepts can be applied according to the suitability of an area, and in some instances even side by side, without interference to each other's domain.

The issue therefore is not simply to ask whether privatisation is the right course to follow, but to analyse and evaluate what is involved as a consequence of privatisation. I believe a variety of means should be adopted. The smaller companies of no strategic value could be sold off, probably at discounted prices. For other sectors the capital market could be utilised. *If there is some interest in Asahan from the private sector, I would personally welcome their involvement.*

There may be a number of state enterprises which have to be kept entirely in government hands for political or strategic reasons. For example, PERTAMINA, because of its strategic importance, particularly in terms of revenue, should be left to the government. There may be a number of such cases; the selection should be based on overall national development considerations.

TECHNOLOGY TRANSFER AND 'HIGH-TECH' INDUSTRIES

To build a national engineering industry, a prerequisite is the existence of national industrial standards and adequate training facilities; both are not yet fully developed. There is clearly enormous potential for building rather than importing machinery. For example, road building, even with labour-intensive methods, still needs the road roller. Likewise small irrigation dams built by labour-intensive methods still need a couple of concrete mixers, and one or two simple earthmovers. It is better to develop standards for local manufacture than to import sophisticated but very expensive equipment, which will decrease instead of increase labour involvement. Foreign exchange can be saved in favour of a domestic engineering industry. Appropriate standards could enhance local production.

From simple equipment for public works, the housing industry, and small-scale industries, to rubber manufacturing plants, palm-oil extracting plants and sugar factories, the basis is there for an engineering industry. For example, with about 50 sugar plants now in operation, and assuming their economic lifetime to be 20 years, in terms of workload we have to produce at least the equivalent of two sugar plants every year, which is a good basis for some engineering industries to develop. Add to that the palm-oil and cooking-oil industries, soap plants, and small rolling mills for roofing material and so on, and one already has a basis for a solid domestic engineering industry. From these beginnings, with well-trained people, it would not be difficult to move up into more sophisticated engineering operations, including advanced technology products.

For a country with 170 million people, there is not only a need for advanced technology - simple conventional technology and engineering skills at a lower level are equally important. Although we are moving in the direction of advanced technology, the development of more conventional technology is still a necessity. Take the case of power development. In Java we now have a technically very advanced power grid, covering the entire island. This has been a costly affair which at present certainly could not be duplicated on the other islands. For sparsely populated areas we need to develop localised systems, including micro-hydro and mini-hydro, which also provide a good basis for local manufacturing, especially if a high rate of standardisation can be employed. The People's Republic of China, for instance, developed about 70% of their electric power through mini-systems for rural use. Only the big cities and industrial areas are connected to a grid. Their apparently valid argument is that the smaller plants do not need to be imported. It is cheaper to build these locally, although probably not to the same level of quality as an imported one.

Some projects have to be imported entirely. The most important point here is proper assessment of technology and the right timing - firm decisions at the right time. A good example is the previously quoted Olefin Project, planned for North Sumatra at a time when the market was still favourably inclined. There was a reasonable investment offer, which may not have been the best one, but, at least from appearances, could be implemented quickly on the basis of sound feasibility. As has been said, negotiations dragged on for years to get a better deal, resulting only in a

total cancellation of the project. There are times when quick decisions should be taken, even with a measure of calculated risk.

We should now assess investments not only in terms of size of capital, but also in terms of returns, tangible as well as intangible. We need also to go for quality of investment - industries which can introduce new working methods, better quality products, and efficient use of the available material and resources. Although finance remains a problem, basically the biggest problem is management. As long as we do not have sufficient training facilities for labour and for management, it is very difficult to develop a sound industrial structure. Hopefully we will overcome this problem within not too long a time, but at present the only way, although not the ideal one, to introduce the required skills and discipline is through foreign investment. Therefore it may not be the time now to stress sensitive issues such as ownership and the role of foreign experts.

Of course we would like to have knowledge and certain positions transferred. But it is not just a matter of training, or putting it all in extensive manuals. Assuming foreign experts are sincerely willing to train, there is still the question of whether our workers can absorb the know-how fast enough and really master it. It seems to me that the absorptive capacity of our young professionals is still quite limited. Therefore if localisation is pushed too hard, you may lose the experts and our people will still not have learned the job. This is particularly so because technology is changing so rapidly. One example is horticulture - it is not like the old days, when plants grew easily in very fertile land and everything went smoothly. Nowadays, you have to master new knowledge which comes up almost on a weekly basis, and produce better quality products. The Japanese and Koreans have aggressively developed nationwide training programs and information systems. This is lacking in Indonesia. We need to put more emphasis on education, information and the role of the youth. These are three very important departments, but so far I do not have the impression that problems have really been tackled in these areas.

This also relates to the question of foreign cooperation through the private sector. Such cooperation need not necessarily mean direct investment; it can include licence arrangements, technical assistance contracts, or profit sharing. I hope that BKPM will be able to develop a

number of different modes of cooperation and not simply rely on the straightforward method of direct investment.

THE ROLE OF JAPAN

I still believe Japan can play an important role in helping the countries in this part of the world to get off the ground and to become really equal partners. Japan has the potential, it has the advantage of proximity, and there is a large measure of complementarity between Japan and Indonesia. There is, however, still a problem, and it exists on both sides. Maybe only time and closer relations will solve the problem. For the receiving Asian countries, especially those who were occupied by the Japanese during the war, there are still traumas.

These fears have been kept alive, unconsciously, by the brisk and aggressive business attitudes of the present day Japanese. I have tried to explain this to my Japanese friends many times, but apparently it is still not well understood, because the same attitude seems to prevail in their own environment, a similar ruthless, competitive way of life. People are fearful of the Japanese because of their relentless way of pursuing their interests. Of course, everybody is perfectly entitled to take care of his own interests, but there are many ways of doing this. It seems to me that there is still an undercurrent of archaic fear in the Japanese mind, bred over centuries of threat. Japan, with a very industrious and intelligent population, but which still harbours a kind of siege mentality, has to be aware of its prominent position now in the world, a prominence which brings with it responsibilities, if it is to be maintained. It has to be able to carry these responsibilities and to get rid of its prejudices. In academic and political circles I already see signs of **change**, in particular in the former. But in the private sector, a lot of adjustment still has to be made before the advantages of cooperation are really shared by all concerned.

With regard to Indonesia's industrial policy, the Japanese system of industrial policy guidelines would probably have more merit than the free-for-all western model. In principle, I would not be apprehensive about adopting something like a MITI (Ministry of International Trade and Industry), which plays a very active role in Japan's economic development. However, it would require time to build up the staff needed to operate such an institution. The system and the personnel of MITI were

developed over a long period of time before it became the prominent body it is now, staffed with able bureaucrats, well trained for specific objectives.

PRIBUMI BUSINESS

How do you overcome ethnic 'imbalances' in business? This is a point which we have not yet been able to resolve. One way is to invest in the members of the indigenous society so that they can conduct business on a more equal level; this was the idea behind the setting-up of subsidised mini-industrial estates during my tenure as Minister. These estates have, however, not been able to reach their objectives because they are not allowed budget resources, but have had to rely on bank financing, which has certainly been detrimental to their success.

The problem of ethnic imbalances has its roots in Indonesia's colonial history. Colonial policies have created imbalances not only in terms of business but socially as well. During my term, I tried to develop policies through a combination of regulatory guidance in certain sectors of business and preferential treatment to indigenous business, without denying a fair chance to the non-indigenous society; but since my departure, much has again been left entirely to market forces.

Preference to indigenous business should not be given in terms of credit-finance, but more in terms of provision of assets and opportunities; this indeed will involve subsidies, which I prefer to call investment in society. The concept of investing in the society, more specifically the indigenous sector of the society, could be extended, as an example, to big shopping centres, which are built by non-indigenous Indonesians. Establishing these centres should not be discouraged, but the government should buy, say, one-third at the commercial price and turn it over to indigenous Indonesian traders to be used at discounted rents. This will create the ability within the indigenous sector to compete with non-indigenous groups on a more equal footing without undue political pressure. Initiatives of the non-indigenous groups should not be curbed, but the benefits should be made accessible also to indigenous business groups, and this will require certain policies and subsidies. Unfortunately, 'subsidy' carries nowadays rather a negative connotation in policy circles. The question is whether this kind of support is a subsidy in the ordinary

sense or an investment in the future welfare of the society as a whole. Personally, I believe it is the latter.