Investment decisions and the puzzle of share price movements in capital markets: a case study

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NOTE

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PART 4. THE HISTORICAL DEVELOPMENT OF INFORMATION AND CORPORATE REPORTING PRACTICES

CHAPTER NINE

HISTORICAL DEVELOPMENT OF THE CAPITAL MARKET IN INDONESIA

The capital market is a market place where securities issued by companies or other institutions are bought and sold. Principally, the capital market is made up of two markets. Firstly, the new issues or primary market brings together companies and other institutions wishing to raise money through the issue of new securities and individuals or institutions seeking to invest their money. After a particular period, the securities which have previously been issued are bought and sold on the capital market. The two markets complement each other because the primary market encourages the individuals or institutions to invest their money into productive companies and the secondary market enables the investors to convert their investment into cash at short notice or at any given time to reallocate their money to securities which will best meet their needs.

An active and efficient market helps to ensure that funds are available not only to established companies but also to smaller companies which are usually private companies. These private companies were encouraged to expand their business to become publicly held companies. In this case, the stock exchange commission plays an important role in providing facilities for the maintenance of a fair and fully informed capital market. Moreover, the members of the capital market act as agents for their clients in securities transactions, advise the clients on portfolios, other investments, capital raising, take overs and other interesting issues in conjunction with the provision of a wide range of services. These mechanisms are generally recognised in every capital market.
9.1. THE EMERGENCE OF THE CAPITAL MARKET IN INDONESIA

The capital market in Indonesia emerged when the Dutch colonial government established the Vereeniging voor den Effecten Handel (the Association for the trading of stock) which began running a securities exchange in Jakarta on 14 December 1912. Under the Dutch colonial government the securities traded in this market were mostly government bonds and the shares of Dutch companies in plantations. Not long after it was established, the stock exchange was closed (in 1914). After a decade of recess, in 1925 the stock market was established in two other cities, Surabaya and Semarang. However, the outbreak of World War II stopped the exchange activities in 1940.

After Indonesian independence, the government of Indonesia incorporated the stock market in Jakarta in 1952 by an Act of the President (Decree No. 15). By this Act the operation of the stock exchange was assigned to the Association for Money and Securities or Pusat Perdagangan Uang dan Efek (PPUE) whereas Bank Indonesia acted as the advisory body. The conflict between Indonesia and the Nederiands over west New Guinea (now Irian Jaya), followed by the nationalisation of Dutch companies in 1958, affected most public companies and prevented many investors from trading in the market. The high levels of inflation in 1965 (more than 600), the lack of savings and the negative growth of domestic products and the deterioration of infrastructure, caused the stock exchange market and its activities to close down.

In 1969 a new government was elected and General Suharto was appointed as acting president. After about four years of being acting president, He become the president in the country. A new era of development was ushered in by the government. Its task was the restoration of economic stability and the initiation of a systematic economic development program. The new government pursued a totally different approach in governing the country. Its first priority was directed to the development of economics. The economy became its main concern rather than the political aspect. The nationalistic approach and massive government intervention of the past, as practiced by previous governments, were by and large
abandoned. The new government had a strong faith in the role of the private sector and a more liberal economic system. This included a willingness to develop the country with the aid of foreign capital and foreign investment which were prohibited by the previous government. However, by the early 1970s, critics began to argue that the foreign investment policy had benefited only a small number of people. Kuntjoro Jakti (1981), for instance, analysed the impact of economic development during the period 1966 - 1978. He argued that the benefit of economic development during the New Order had been unevenly distributed. The fast growing economy with an open door policy, caused inequalities between non-pribumi (Chinese people) and pribumi (indigenous people).

These criticisms grew in intensity and turned into severe political pressure on the government, culminating in early 1974 with the outbreak of a violent demonstration against foreign investment. In order to dampen criticism against the foreign investment policy, on 24 January, 1974 the council for National Stabilisation, led by president Suharto, made a major change in investment policy. This new policy was targeted at increasing the economic role of indigenous Indonesians. The council decided that all new foreign investments had to form a joint-venture with Indonesian partners, and after ten years of operation the foreign owned companies were required to transfer their majority shares (at least 51 %), to indigenous Indonesian nationals.

To provide some guarantee that the shares would really benefit the pribumi, the government expected the foreign owned companies to transfer their equities through public offerings in the capital market. For that purpose the government reopened the Indonesian capital market, with the public offering plan, in 1976.

9.2 THE GUARDIAN OF SMALL INVESTORS

Under Presidential Decree No.52, 1976, the government reorganised the securities market by establishing three institutions which were responsible for
promoting development of the capital market. These institutions were the Capital Market Advisory Council, the Capital Market Executive Agency and PT Danareksa as a national investment trust.

The Advisory Council was a high-power commission whose membership consisted of several cabinet ministers i.e. the Minister of Finance, the Deputy Chairman of the National Planning Agency, the Minister of Trade, the Minister/Cabinet Secretary, the Governor of the Central Bank and the Chairman of the Investment Coordinating Board. The Council acts as a policy making body that advises the Minister of Finance with regard to the development of the capital market.

The Capital Market Executive Agency (the BAPEPAM) is a special agency under the Ministry of Finance and was assigned to regulate the market and to operate the capital market under government policy. In its capacity as a regulator, the BAPEPAM establishes rules and enforces securities market regulations, reviews prospectus and other documents, and/or withholds approvals of public offerings. The BAPEPAM is also responsible for monitoring listed companies, as well as other professionals who render service in the capital market. As an operator of exchange, the BAPEPAM oversees securities transactions and facilitates exchange activities as well as promoting their development.

PT Danareksa was established with its main objective to maintain the interest of small pribumi investors in the capital market. It was empowered to play multiple functions in the capital market. Firstly, Danareksa was an underwriting company with a preemptive right to buy on its own account up to 50% of any securities offered on the market. Secondly, it was the only firm in the country that had authorisation to manage a mutual fund. In its capacity as an underwriting firm, Danareksa plays an important role in the initial public offerings (IPOs) of all listed companies. According to Sereh (1990), from Danareksa's stand point, such roles serve two purposes: (a) it guarantees that the listed companies are extremely healthy and merit
becoming a listed companies. In this context Danareksa plays the role of quasi regulator (emphasis added) under the merit regulation system. PT Danareksa uses its underwriting power to screen a company as to whether or not it should be allowed to be offered to the public. If PT Danareksa finds that a company does not satisfy its criteria, it simply refuses to underwrite that company, and thus shuts out market access for that company, (b) it ensures that the price of the offer is favourably low so that when it exercises its right to buy 50% of the securities it does not pay for those securities at an excessive price.

In 1988, P.T. Danareksa was authorised to manage a mutual fund. Prior to 1988, the company acted only as an intermediary in the interest of small investors. The company bought shares in the market, converted them into Danareksa's certificates with a small nominal value, and then sold them to the public, which could them choose either to convert the certificates back into the original shares or hold the certificates as a customer of PT Danareksa.

The targets of certificates were small pribumi investors. One investor could legally only buy a maximum one hundred units of a certain type of certificate. In order to reach as many small investors as possible, PT Danareksa utilised state bank networks as its agents so that the certificates could be distributed throughout the country. Two main features of the certificates were that, first, PT Danareksa promised to repurchase them at any time at a price based on the current value of the portfolio, but not less than the nominal value of the certificates, without any transaction costs. Secondly, PT Danareksa guaranteed to pay dividends on the certificates at not less than the interest rate on state bank time deposits of 12 months maturity.

As a guardian of small investors, PT Danareksa was very concerned with potential losses of small investors in dealing with the stock market. Dickie (1981) stated that if investors lost money on securities transactions, the goal of the exchange to distribute income to small investors was frustrated, and might create political ramifications that the government wanted to avoid. To prevent this condition, PT Danareksa was actively involved in stabilising prices in the secondary market by buying or selling shares when necessary. In its role, PT Danareksa would allow price fluctuations within a 4 percent daily range. This role has become a common feature
of securities transactions in the capital market. In fact, because of PT Danareksa's threat to intervene and its several actual interventions, the price of listed shares in the capital market never fluctuated outside the norm, as was expected.

9.3. TAX INCENTIVES FOR THE CAPITAL MARKET ACTIVITIES

Besides, the Presidential Decree of 1976, the government also addressed some policies related to tax incentives i.e. Minister of Finance Decree No. 1677 and 1678, in order to encourage companies to go public. Based on the Minister of Finance Decree, No. Kep-1677/MK/II/12/1976, on the Revaluation of Fixed Assets upon the sale of shares through the capital market, there are three kinds of tax incentives: a) the differences between book value and acceptable revaluation of fixed assets was exempted from company tax, b) any capitalisation resulting from revaluation was exempted from stamp duty levied on paid-in capital; and c) if the shares owned by existing shareholders underwent an increase in value as a result of revaluation, they were also exempted from capital gains tax. Further, the Minister of Finance Decree No. Kep-1678/MK/II/12/1976 on Tax Relief to Companies Selling their Shares through the Capital Market, and an Elucidation of the Decision Concerning such Tax Relief, stated that if a company sold 30 percent of its equity, the tax rate was reduced from a standard 45 to 35 percent. The company became subject to only a 25 percent tax rate if it sold 51 percent of its shares to the public.

As mentioned in the previous sections, after several years of preparation, in August 1977, the government reopened the capital market of Indonesia in Jakarta. However, by the end of 1978 no new company had gone public. The first listed company in 1977 was PT Semen Cibinong, an affiliate of Kaiser Cement of California. The company went public by selling out 10 percent of its outstanding shares through the market. The second company that went public (in 1979) was PT. Century Textile, an affiliate of Toray Japanese Textile. Based on this condition, it can be argued that the tax incentives provided by the government could not stimulate the companies. The companies were still reluctant to come on to the market.
In 1979 the government took further steps to promote the capital market by issuing the Minister of Finance Decree No 112/KMK.04/1979, which dealt with the improvement of granting tax relief to limited liability companies which sold their shares through the capital market, and the Minister of Finance Decree No.313/KMK.011/1979, concerning permission to public institutions to buy shares in the capital market and permission to foreign company listed in the capital market. By the Decrees of 1979, tax relief was granted even for companies that listed a minimum of 20 percent of their shares for public offer. By 1984, 22 more companies had listed their shares on the capital market. The total capitalisation based on the offering price was slightly less than Rp 132 billion, or about US $ 100 million at the prevailing exchange rate.

However, after 1984, no companies went public. The last company that went public was PT Prodenta Indonesia, which offered shares in October 1984. Among these 24 listed companies, 16 were foreign or joint venture companies and the rest were domestic companies. The proportion of shares sold to the public according to BAPEPAM (1985), ranged between 10 and 35 percent for foreign companies and between 15 and 46 percent for domestic companies. Dickie (1981) argued that the main reason for foreign companies going public was to satisfy the government request to divest part of their equities for domestic consumption. Even though this request irritated many foreign investors, many companies did so in order to keep a good business atmosphere and a smooth relationship with the government.

### 9.4. THE BEGINNING OF LIBERALISATION IN THE CAPITAL MARKET

There was a long period of stagnation, between 1984 and 1989, until a further liberalisation policy was adopted in 1987 and 1988. The deregulation packages issued by the government in 1987 enhanced the role of supporting institutions and the members of the capital market in order to move the securities market from direct government control toward a market determination. By issuing the decree of the Minister of Finance no. 1055/1989, the government permitted foreign interests to acquire up to 49 percent of the paid up capital of the listed companies. This meant that if the listed companies had been majority owned by foreign interests, as in the case of joint venture companies, foreign investors could not buy any of their
listed securities. This policy was made to conform to the previous regulation that allowed foreign investors to hold only minority interests in companies that had operated in Indonesia for ten years. Apparently, this policy had a limited effect on the development of the capital market in this country. There was no incentive for foreign interests to acquire up to 49 percent of paid in capital for other listed companies, since 16 of the 24 listed companies were foreign joint venture companies and were already majority owned by foreign interests.

The Decree of the Minister of Finance No. 860/KMK.01/1987 dated 23 December 1987, on Capital Market Supporting Institutions, provided some incentives to institutions who were willing to be underwriters. Entry into these businesses was opened and the licensing requirements for these institutions were eased. The objective of this new regulation was to create a transparent licensing procedure and to remove restrictions on market access. Commercial banks, non-bank financial institutions and other national finance companies, such as securities companies were permitted to seek an underwriting license. There are thirteen non-bank financial companies that have existed in Indonesia since the early 1970s. These companies had the opportunity to become underwriters.

According to the Decree, in order to obtain an underwriting license, a company had to apply to the Minister of Finance and fulfil several relatively easy requirements such as: (a) availability of at least one professional staff member who was an expert in the underwriting business. However, there are no standardised criteria of who can be classified as an expert. A certificate of an underwriting short course, and proof of experience working in financial services might satisfy this requirement. (b) The application document needs to be accompanied by: the charter of the company, the organisational structure, a copy of the business permit, the latest audited financial statement and the tax identification number. The Minister grants a license after hearing the opinion of the chairman of BAPEPAM. Once the license is granted it is valid for all underwriting activities and for an indefinite period without renewal requirements. However, the Minister retains the right to revoke such license in the case of any serious violation of the securities law or in the interest of the public.
Compared to previous regulations the new requirements are indeed less restrictive. Under previous regulations a permit was granted by the Minister of Finance, but only after a recommendation from BAPEPAM and Bank Indonesia (The Central Bank). Commercial banks, even though they might have received a license as underwriters, still need a special permit from BAPEPAM any time they want to perform underwriting functions. This special permit must to be approved by BAPEPAM after considering the recommendations of Bank Indonesia.

Another effort was made in 1987 by the government to develop more active securities markets in Indonesia; this related to the procedures of listing in the OTC market. According to the Decree of the Minister of Finance No. 862/KMK.01/1987, on Procedures of Listing and Trading Securities in the Over the Counter (OTC) Market, the OTC market is managed by the brokerage association and intended to facilitate the listing of smaller, less established companies which may not qualify to list their securities in the regular market on the Jakarta Stock Exchange. The listing requirements in this market are far more flexible than those in the regular market.

On 27 October 1988, in order to achieve more active capital markets in the financial sector, the government, via the Board of Bank Indonesia issued a decision of the Board of Bank Indonesia No. 21/51/KEP/Dir which related to financial reforms. This reform is well-known as the policy package of October 1988 (Pakto 1988). Three broad policy issues in this decision are: (1) the permitting of new entrants into banking and other financial services, relaxing branch restrictions for banks and non-bank financial institutions, allowing state-owned enterprises to put their financial assets in private banks, and lowering the reserve requirements for the banking system, and (2) the imposition of legal lending limits on banks. The legal limit rule sets a maximum ceiling to which banks or non-bank financial institutions can extend credit to a single borrower or a group of borrowers. The maximum loan that can be extended to a single borrower under the new law is up to 20 percent of the lender's equity. To a group of borrowers the limit is 50 percent of the lender's equity.
The legal limits rule is actually a regulation enacted for prudent lending reasons. It prevents lending institutions from over-exposure to a single borrower or group of companies which may create an unreasonable concentration of risk. In addition, the law also prevents banking affiliates of big corporations from excessive internal dealing. Therefore, the use of public funds by banking institutions has become more transparent and diversified. Furthermore, this law may force many big companies, especially groups of companies, that may experience difficulty in raising sufficient capital from lending institutions, to seek other sources of finance, particularly from the capital market.

Moreover, on 27 October 1988 the government also issued a government regulation, namely, Government Regulation (Peraturan Pemerintah) No.13/1988, on Tax on Interest of Time Deposits, Certificate Deposits and Other Savings. In the previous regulations, since 1984 the government imposed a different tax treatment on dividend income and interest income. Dividend income was subjected to a 15 percent withholding tax, while interest income was subjected to a tax exemption. This condition, rationally, made the investment in the capital market more attractive than those of savings deposits. Based on this regulation, a different tax treatment has been eliminated. Either dividend or interest income are subject to income tax.

9.5. FURTHER LIBERALISATION IN THE CAPITAL MARKET

On 20 December 1988, as part of the capital market's liberalisation, the government issued Presidential Decree No. 60/1988, on the Capital Market. The Decree formally terminated the controlling role of PT Danareksa. The preemptive right to buy at least 50 percent of any new offerings in old systems was eliminated. Even though the decree preserved the right of PT Danareksa to have priority in buying the issued shares, the company could no longer dictate the market. Under the new regulation, PT Danareksa's functions were limited as a securities firm or mutual fund. PT Danareksa has to work in a very competitive environment with more than 50 other securities houses in the capital market. In addition, the government also issued Presidential Decree No. 61/1988, on Finance Companies, which opened the way for the formation of new securities companies, including foreign joint venture securities firms.
This decree was amended by the decree of the Minister of Finance No. 1251/KMK.013/1988, on Joint Venture Securities Companies, that permitted foreign investors to hold up to 85 percent initial share ownership and the decree of the Minister of Finance No. 1252/KMK.013/1988, on the Procedures of the establishment of the Securities Exchange and the decree of the Minister of Finance No. 1253/KMK.013/1988, on Trading Procedure on the Jakarta Stock Exchange which was intended to permit the listed company to sell additional shares to a maximum total paid up capital, without having to follow an initial offer into the public process again.

On 25 March 1989 the government amended the Decree of the Minister of Finance No. 860/1987 by decree of the Minister of Finance No.281/1989. In this decree, the new ruling prohibited commercial banks from acting directly as underwriters. However, they were still permitted to participate in the underwriting business by establishing a separate subsidiary as a securities company. The reason for this new ruling, apparently, was that the government realised that without effective supervision from the government such an arrangement could jeopardise the prudent nature of the banking system. In addition to amendment decree 860/1987, the government also issued a decree of the Minister of Finance no. 1055/KMK.013/1989 on 16 September 1989, on Buying Listed Shares by Foreign Investors, due to the government realised that the old scheme did not achieve the goal of encouraging demand for securities by foreign investors. In decree 1055/1989 the government provided a new scheme that permitted foreign investors to buy securities directly at the IPO stage, not only in the secondary market. In addition, they were also permitted to buy up to 49 percent of any listed securities regardless of the ownership status of the company. The only restriction that existed after this decree was that foreign investors were still prohibited from buying shares in listed national banks. This prohibition was largely due to the provision of the Banking Act of 1967. Amendments also existed in the Decree of the Minister of Finance No.1251/1988 that permitted foreign investors to hold up to 85 percent of initial shares ownership. On 18 November 1989 the government issued the decree of the Minister of Finance No.1256/KMK.00/1989, on the Rule regarding Securities Companies. In this Decree the brokerage companies were given the right to seek licenses for underwriting.
9.6. ANOTHER STRATEGY USED TO DEVELOP THE CAPITAL MARKET

Appointment of new management at BAPEPAM based on the Presidential Decree No. 60/1988, at the end of 1988 also had a significant impact of the development of the capital market in Indonesia. The new chairman of BAPEPAM pursued a totally different approach in developing the capital market. An intensive campaign to educate investors regarding investment in capital markets and to convince privately held companies of the merits of going public was launched by the Chairman, who appeared at some seminars, organised press interviews, and published articles regarding the capital market. He even appeared, on 3 February 1990 at the conference of Muslim Scholars (Nahdatul Ulama) as a speaker on the benefits of the stock market. During 1989 and early 1990, according to Marzuki Usman (1990) more than a hundred capital market seminars were held in Jakarta and other big cities in Indonesia.

Since the change of regulations in 1988, BAPEPAM no longer screened on merit those companies wishing to be listed. Its function, with regard to offers to the public, was limited to a guarantee of full disclosure principles in presenting the financial report of the company. As long as the criteria of full disclosure was satisfied, the listing permit would be issued by BAPEPAM. This applied even to companies which had losses on financial statements. The cases of PT Bank Indocement and PT Duta (see Appendix No.3 The Influence of Political Economic Policies on Listed Company: A Case Study on PT Indocement and Appendix No 4 The Influence of Political Economic Policies on Listed Company: A Case Study on PT Bank Duta), for instance, are evidence of such policies.

In July 1989 new companies began to enter the market. Two companies, PT ABDA, an insurance company, and PT Surya Gas, a producer of a variety of industrial and medical gases, offered securities on the capital market. Both companies successfully launched their shares at the IPO stage. PT ABDA initially offered 900,000 shares. Due to very strong demand in the secondary market, one month later, the company issued an additional 4.5 million shares. PT Surya Gas offered 3.7 million shares for the first time. Due to the strong demand for the
securities at the IPO stage, both companies were oversubscribed. However, no data is available on the degree of oversubscription for PT ABDA, while PT Surya Gas, based on the BAPEPAM report (1991), was oversubscribed by 49 percent.

The success of those companies and the intensive campaign of the capital market by the Chairman caused other companies to follow. From July to the end of the year, 37 new companies went public. By the end of 1989, the number of companies listed on the capital market was 61 and the market capitalisation was $2,254 (million). Demand for those securities at the IPO stage was very strong, and only two companies were under subscribed. From July 1989 to December 1990, 102 new companies utilised the capital market to raise their equity finance.

In the secondary market, PT ABDA and PT Surya Gas shares were considered very liquid. The average market turnover increased from 22 percent in 1989 to 47 percent in 1990. The daily trading volume increased from 389,000 shares in 1989 to 2,900,000 shares by 1990, and the market's value increased from US$2.2 million to $15 million per day during the same period. For further discussion see Appendix No.12. Daily Composite Stock Price Index. The most impressive development was the price valuation of securities during these two years. From early 1989 to June 1990, as indicated in Appendix No.10, the price of securities in the market rose relatively constantly. The composite price index started at 298 in early 1989 and by April 1990 had reached 639.

In terms of price earnings ratio (PER), by the end of 1989 the PER reached 41.5. At this PER is relatively high among the markets of South East Asean nations. According to (IFC) Emerging Stock Market Factbook (1990), this PER was lower only than those on the Tokyo Stock Exchange and the Taipei Stock Exchange, which at the same time carried a PER of 51.9 and 51.2 respectively. This PER was 2.2 times higher than the average PER on overall world stock markets and almost 300 percent higher than on the New York Stock Exchange.
9.7. SEPARATION OF THE DUAL FUNCTIONS OF BAPEPAM

Although there was a fast growing market during 1989-1990, however, there were also several market abuses that happened during this period. The overheating of the economy also put strong pressure on the government to take quick action to provide a new legal infrastructure in order to protect the interests of investors and the general public. Apart from the problem concerning an adequate regulatory system in the capital market and the overheating of the economy in that period, the government also believed that, in order to achieve an efficient capital market, the function of BAPEPAM had to be separated. The double function of BAPEPAM, both as regulator and as operator of the capital market, could no longer be maintained. Arya (1990) argued that, if the capital market was expected to be efficient, BAPEPAM firstly had to function as a Stock Exchange Commission (SEC), as in the USA. He argued further that, by considering the development of the capital market up to 1990, it was time to transfer its management functions to the private sector, while BAPEPAM itself could be better used exclusively as a supervisory and regulatory body. In addition, as the market continued to become more advanced, and efficient it required a more sophisticated set of regulations, so that the protection of the investor and the general public as well as the credibility of the market itself could be enhanced.

On 10 November 1990 the government under Presidential Decree No. 53/1990: on the Capital Market and Minister of Finance Decree on 4 December 1990, No. 1548/KMK.013/1990: on the Capital Market, issued the decrees in order to provide a new institutional structure for capital market development, and a new set of regulations governing the Indonesian Securities market. These decrees have become the new basic law of Indonesian securities markets and became effective on 2 January 1991.

After more than a year of consolidation, on 16 April 1992 the operation of BAPEPAM was transferred to PT Bursa Efek Jakarta. The company, namely the Jakarta Stock Exchange (JSX), is responsible for operating the capital market. According to Deed No. 27 on 4 December 1991, the Exchange was established as a limited liability company, incorporating
221 Securities Trading companies as its shareholders. The status of the Exchange as a legal entity was validated by the Decree of Minister of Justice No. C2-8146 HT.01001 dated 26 December 1991, and has been formally announced in the Amendment of State Gazette No. 25 dated 27 March 1992. On 18 March 1992 the Exchange formally obtained its proprietary operating license from the Decree of the Minister of Finance No. 323/KMK.010/1992.

After its separation, the government via BAPEPAM, continued accelerating the development of the capital market in Indonesia by improving the market regulations. Until 24 September 1992, BAPEPAM had issued 37 rules, accompanied by 27 forms and 3 circular letters consisting of technical instructions related to exchanges and trading procedures, securities companies, clearing, settlement and depository institutions, custodians, securities administration agencies and individual licensing requirements. All these regulations have been compiled in the Securities Market Regulations 1992. With such regulations, protection of investors against various forms of manipulation hopefully can be maintained. Since this time, the problem concerning “full disclosure” requirements has become important.

Progress in the development of the Indonesian capital market continued during 1993. The company listing by the end of 1993 was 172, as indicated in Appendix No. 9: Listed Companies and the Market Capitalization. According to Bacelius Ruru (1994) the new issue shares increase, reflecting renewed demand and rising prices on the Exchanges. The right issue of listed companies became a major source of financing, as issuers became familiar with new operational rules and procedures. Underwriters demonstrated their ability to place large issues in the international market, such as the case of the $297 million offer of common shares by the Barito Pacific Timber company.

9.8. THE CONTINUING ENFORCEMENT PROGRAM

As mentioned in previous sections, since the beginning of the 1990s, there were instances of public disorder during public offers that tended to make the market inefficient. Considering this, BAPEPAM, upon consultation with market professionals, regulated the
allotment procedures. Moreover, since that period BAPEPAM has tightened enforcement measures. The licenses of 12 security companies according to BAPEPAM were revoked and 12 issuers (listed companies) were fined for violation of disclosure rules. BAPEPAM cooperated with the police in the investigation and prosecution of a major fraud case involving counterfeit securities that had happened at the beginning of 1993. However, although there is some market abuse, the performance of the exchange over the course of 1993 according to the Board of Directors of the Exchange still exceeded all expectation due to the economic conditions. Wide ranging deregulation has created a more diversified economy with significant growth in manufacturing, construction and services, while a relaxation of the tight money policy has further encouraged the expansion of private investment. This in turn has created a greater demand for investment financing for which many companies have turned to the stock market. Accordingly, the number of securities listed on the JSX increased by 56.5% in 1993. The Board also reported that the role of foreign investment remains crucial to the growth of the JSX.

9.9. SUMMARY

This chapter lays down a brief history of the nature of the capital market in Indonesia. In its history, the role of capital market was classified into three period as follows: the period before some policy reforms, the period during the policy reforms (1980s to beginning of 1990) and the period after the policy reforms were implemented. The main finding of this study are:

1). Before the policy reforms were implemented, the development of capital market was mostly influenced by the internal factors such as the role of government in making the guardian of small investors via PT Danareksa, the role of the government in filtering the company to be listed in the market by making higher requirements for the company to be listed in the market. This conditions cause slowing progress in the development of capital market in Indonesia. Although there were some inducements policies such as tax incentive, this such inducements could not attract the companies to be listed in the capital market. On the other
hand, the role of external factors such as the oil boom and the world economic recession, have a negative impact on the development of capital market in Indonesia.

2). During the policy reforms, especially when the government diminishing the role of PT Danareksa and loosing the requirements in the market, the capital market growth significantly. In the late 1980s there was a tremendous increase of companies listed in the market and caused the market capitalisation of companies shares increase significantly.

3). It is also indicated that during the policy reforms were implemented, the role of BAPEPAM in motivating companies and investors, has made significant impact on the development of capital market. An intensive campaign by the Chairman in the late 1980s affected investors attitude in the market. They began to consider capital market as an alternative financing in their investment decision. This condition has caused along que of investors in the IPO stage and in turn caused an excessive demand of shares. The existance of an excessive demand for almost all companies shares during the intial public offering caused the price of shares in secondary market increased significantly.

4). After a massive policy reforms were implemented, further liberalisation policy which was undertaken by the government lead to the separation function of BAPEPAM from its controlling function. In this period BAPEPAM onlyy responsible for the controlling function of capital market activities whereas the Jakarta Stock Exchange(JSX) become responsible for the operating function.

5). Besides a positive effect of the bullish market, there was alo a negative effect emerged during the development of capital market in Indonesia. The lack of regulations concerning the role of capital market activities and its weaknesses have created some market abusement in the market. The intentional of market abusement, in turn, caused bearish activities in the market. By 1994 the capital market in Indonesia still in the stage of recovering from the bad dream of the bearish market.
6). In order to minimize the market abuse that existed during the liberalization policies and normalize the market activities, the law enforcement program was implemented and intensive regulation was made.
 CHAPTER TEN

THE DEVELOPMENT OF ACCOUNTING INFORMATION IN INDONESIA

The FASB (1978) stated that financial reporting was generally recognised as not being an end in itself but rather was intended to provide information that was useful in making business and economic decisions. This statement indicates that the role of financial reporting is important for external users in making their business and economic decisions. In order to understand the role of corporate reporting in a country, there is a need to study the role of the Accounting Association, the Stock Exchange Commission and other regulatory bodies in which the information was generated and provided for the users in that country.

In a developing country like Indonesia, the role of corporate reporting practices is laid down by the Indonesian Accounting Association or Ikatan Akuntan Indonesia (IAI) and the Stock Exchange Commission (BAPEPAM). Accordingly, this section is concerned with the development of corporate reporting practices, the capital market in Indonesia and other issues such as the development of accounting associations and accounting education and also the development of general accounting principles and special accounting principles under a joint agreement between the association and other departments such as the Central Bank (Bank Indonesia) and the Stock Exchange Commission (BAPEPAM).

10.1 THE EMERGENCE OF ACCOUNTING PRACTICES IN INDONESIA

Accounting practices in Indonesia emerged during Dutch Colonialism in the 1600s, that is the periods in which the Dutch East India Company governed and exercised all rights of sovereignty over Indonesia. Abdoelkadir (1982) argued that the first recorded accounting regulation was issued in 1642 by the Dutch Governor General. The regulation governed the administration of cash receipts, receivable and the budget garrisons and ship dockage in Batavia and Surabaya. From the seventeenth century till almost the end of the nineteenth century, bookkeeping and accounting practices followed the Dutch pattern and there was
no significant development until the Dutch established Vereeniging voor den Effecten Handel (The Association for the Trading of Stock) which ran a securities exchange in 1912.

It has long been recognised that development of the capital market or securities exchange can be associated with the development of the accounting profession in a country. Since the securities exchange was founded in Batavia by the Dutch government, the development of accounting was considered important, at least for Dutch purposes. Accordingly, in 1915, bookkeeping was introduced into Indonesian High Schools and Special Schools in trade and commerce; however, it was limited only to the upper-class Indonesians. Until the onset of the Second World War, the accounting profession was the private domain of the Dutch people. Briston (1978) argued that it was not surprising that up to the beginning of the Second World War, only five Indonesians succeeded in qualifying as registered accountants in Indonesia.

During the Japanese occupation, between 1942 and 1945, according to Abdulkadir (1982), Indonesians had the opportunity of entering the field of accountancy out of a necessity to replace Dutch accountants. Under Japanese occupation, the Japanese conducted various training programs for civil servants. Upon successful completion of the respective courses of study, the successful students were able to serve as assistants, inspectors, tax auditors assistants, assistant accountants and bookkeepers; however such positions were treated as "juniors" by the Japanese.

After the Japanese occupation, the influence of the Dutch system on education and practices continued in Indonesia. The Japanese occupation had only small influence on the perception of some Indonesians as to the importance of accounting practices in business activities. After Indonesian independence, the Dutch companies continued to exist in Indonesia. Some of the Dutch accountants returned to Indonesia to continue their practices as public or internal accountants as a consequence of the Hague Treaty of 1949, between Indonesia and Netherlands. This condition was lasted until nationalisation of Dutch enterprises in 1958.
10.2. THE DEVELOPMENT OF ACCOUNTING EDUCATION

The development of business and professional organisations after 1950 had a significant impact on the development of education in Indonesia. In 1953, the University of Indonesia (UI) became the first tertiary institution to offer a masters program in accounting under the Dutch system. Prior to this, those who wished to acquire a professional accounting qualification had to go to the Netherlands. In 1957 four Indonesians graduated from the Netherlands. These were: Prof Dr Abutari, Dr Teng Soen Tjang, Dr Tie Poo Tjiang and Drs Tang Eng Oen.

Corresponding with the development of education in Indonesia, in 1954 the government issued Law No.34/1954 relating to the use of the title "akuntan" or accountant. Under this law, the title of accountant could be used only by those who had a masters degree in accounting from a state university or from other accredited institutions or had passed an examination administered by an "Expert Committee", appointed by the Ministry Education and Culture. The law required those accountants to register with the Directorate of State Accountants of the Ministry of Finance upon graduation from the accredited institutions or passing the Expert Committee examination.

In this period most business activities were still oriented to Dutch accounting practices and only a few others used other accounting practices such as the Chinese, Indian, Arabic and Japanese bookkeeping systems. Those practices existed because there were some merchants from other countries who brought their own accounting systems to the trading and operating of their companies in Indonesia.

In the field of education, in 1957 the Ministry of Finance also established a school to train accountants to work for the government as government accountants. The school was originally called Sekolah Tinggi Ilmu Keuangan (STIKN), and then its name was changed some years later to the Institute Ilmu Keuangan (IIK) and finally again to Sekolah Tinggi Akuntan Negara (STAN). Up to the 1970s, accountants who graduated from public universities and from
Sekolah Tinggi Akuntan Negara mostly became government accountants. Accountants who worked 3 years for governments, public companies or state universities were eligible to be public accountants.

Considering the historical development of accounting education in Indonesia, for about two decades of development, the Indonesian universities were in a stage of "dualism". The Indonesian universities adopted the Dutch accounting system and also the American system in their curricula. This dualism still existed until the Ministry of Education and Culture formed the Consortium of Economic Sciences (CES) in 1977. The CES issued a ruling which directed the universities to follow a uniform curriculum in preparing students for a masters degree in accounting. The System then was switched to the American accounting system.

10.3 THE EMERGENCE OF AN ACCOUNTING ASSOCIATION

Before the Indonesian Accounting Association (IAI) was established on 23 December 1957 Sumardjo together with some other accountants who graduated from the Netherlands and the University of Indonesia had some meetings to establish the Indonesian Accounting Association. At the first meeting on 17 October 1957, they proposed objective of IAI as follows: 1) to help accomplish the Law No. 34 /1954, including the compilation of labor laws, ethical rules etc. 2) to ensure adherence to the law, 3) to assist in upgrading the quality of accounting education, and 4) to hold meetings and discussions among members on theoretical and practical aspect of accounting. At the second meeting on 5 December 1957, the following matters were discussed:

1. The possibility of foreigners being accepted as member of IAI
2. The collection of fees
3. The number of office bearers and the duration of their office
4. The organisation of IAI conferences
5. The education of assistant accountants
6. Legal matters
7. The number of meetings to be held annually

8. The restriction of unqualified people professing to be accountants

The officials of the IAI were appointed at the second meeting; at the third meeting, they were required to prepare a regulation concerning the organisation of the IAI. From a series of fortnightly meetings, a first draft of articles was issued on 11 February 1958 and was approved on 15 May 1958 by the Ministry of Justice. The new objectives were laid down as follows:

1. The setting up of a discipline for study on which the profession should be based.
2. The preparation of a curriculum for the attainment of this specified discipline.
3. The adoption of standards on the qualification of candidates for membership and the procedure for the formal acceptance of members.
4. The adoption of standards to govern the relationship of accountants with their clients and with the public in general.
5. The establishment of an organisation to look after the professional development of members and the fulfilment of their responsibilities to the public.

Since Act No. 103 came into being, which relates to accounting certification and practicing accountants, Indonesia began to increase its accounting education by inviting some lecturers from the USA, such as Prof. Devine, Professor of Accounting in the University of California (Berkeley), and also provided some grants to people, especially lecturers from government universities who wish to continue their studies in the USA. This condition has had a significant impact on the development of accounting in this country.

The development of the economy after 1965, that is, a new era in the development of the economy in Indonesia, provided advantages for some investors outside the country for investing their money in Indonesia. This condition created the development of business
activities and influenced the development of accounting and reporting practices in Indonesia. The need for accounting principles has also been considered important by the government, especially when it reorganised the capital market in Indonesia in 1976. Since 1976, the organisation of the capital market has not come under the Association for Money and Securities Trading (PPUE) but under the Capital Market Agency (BAPEPAM).

10.4. THE DEVELOPMENT OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

In August 1972, the authorised body of the stock exchange market, BAPEPAM, commissioned a development of standards for accounting practices in Indonesia and established a Committee of Accounting Principles and Auditing Standards. The Committee adopted Paul Grady's Generally Accepted Accounting Principles (GAAP), with slight modification as Indonesian Accounting Principles or Prinsip Akuntansi Indonesia (PAI) and Standard of Auditing Practice (SAP) No.33, as Indonesian Standard Auditing Practice or Norma Pemeriksaan Akuntan (NPA).

At the third congress of the Indonesian Accounting Association (IAI) held on 2 December 1973, the Generally Accepted Accounting Principles for Indonesia (hereafter called PAI) and the Generally Accepted Auditing Standards (NPA), were approved by the General Council of the Society. From that time on those standards were used as a guide for the members and practicing accountants.

The issue of many regulations, such as the Minister of Finance decree No. 108/KMK.07/1979, on 27 March 1979 concerning the benefits for using audited reports for tax purposes, the issue of the decision concerning the annual reports competition hosted by BAPEPAM and IAI, promoted the role of accountants in this country. The need for promoting the role of accountants is considered important by the Society due to the lack of companies using audited reports for external users.
On the other hand, the continuing development of accounting and reporting practice in Indonesia have been acknowledge by the Society. At the fourth congress of the Indonesian Accounting Association (IAI) in October 1982, this need was highlighted by the Association in the form of some basic accounting principles. These were:

1. Accounting for foreign currency transactions and translations
2. Accounting for interest expenses during construction
3. Accounting for research and development costs
4. Accounting for expenditure which is carried forward to subsequent accounting periods.
5. Accounting for emission costs.
6. Accounting for construction contracts and acquisition of assets.
7. Accounting for leasing companies.
8. Accounting for income tax.
9. Accounting for extractive industries.
10. Other accounting problems as mentioned in IAS.
11. Accounting for pension funds.
12. Accounting for inflation.
13. Others such as accounting for insurance companies, developers etc.

The fifth congress of accounting associations in August 1986 reported the progress of the association which was mainly concerned with the results of previous congresses which related to development of accounting principles. These results were the issue of a revised edition of general accounting principles (PAI) 1984, proposed Statement no.1 which related to accounting for foreign currencies and proposed Statement no.2 which related to accounting for interest capital during construction. The Association also issued Interpretation of Accounting Principles No. 1, concerning effective date of implementation of PAI 1984, Basic Financial Reports, Subordinate Liabilities and Deferral Charges for exchange rate devaluation.

In organisational matters, on 1 April 1985 the IAI resurrected two previous committees viz the Committee of Accounting Principles, and the Committee on Standards of Auditing. On 6 June 1984, members of the committee of Accounting Principles came from different parties which were concerned with accounting principles standards. These were accountants from Government Departments, the Capital Market Agency, the Tax Department, the Central Bank, the Universities and the Public Accountant. On 1 April 1985 as members of the Accounting Principles Committee, those who became members of the Committee of Auditing Standards also came from different parties. In addition, in organisational matters, on 1 December 1984, the IAI established the Committee on Ethical Codes. This committee was mainly responsible for the formulation and interpretation of an ethical standard for the members of the IAI. Furthermore, in 1986, the IAI established two other sections beside Public Accountant section ie. the Accountant Education Section was established on 25 April 1986 and the Accountant Management Section on 13 May 1986.

Efforts to develop accounting by the Association, had been extended by joint cooperation with other Departments, for instance, with the Coordinating Accounting Development Agency which was established on 27 February 1985 which related to the development of accounting educations. On 16 July 1987, an agreement was reached between the Association and the Directorate General of Cooperation concerning development of Special Accounting Standards for special non profit activities (cooperation businesses), developed Statement No.1 and 3

In 1987 the agreement with other departments was also extended by the Association. The agreement between the Association and PT Asuransi Jasa Indonesia, the leading
insurance company in Indonesia, developed the Statement No. 4 concerning Special Accounting Standards for insurance companies. Last, but not least, an agreement was also developed with PT PERTAMINA, the government petroleum company. This agreement developed Statement No. 5 concerning Special Accounting Standards for oil and gas companies.

In this period, the development of accounting and reporting was also high-lighted by the Minister of Finance and The Capital Market Executive Board. In the absence of such development, the development of accounting and reporting would be promoted by the Ministers and the Boards. In 1987 the Minister of Finance issued decree no.859 / KMK. 01/ 1987, in which companies which issued their shares on the capital market were asked to submit their annual report each and every year. The development of corporate reporting was also strengthened by the decree of the Capital Market Executive Board. By decree no.24 PM/1987, schedule Five, it was required that listed companies had to follow a procedure of reporting which was consistent with Indonesian Accounting Principles and the disclosure requirements of the Capital Market Executive Board. Since its foundation, the development of accounting in Indonesia has shown much progress. However, during this period problems concerning the professionalism of accountants has become the main topic of every seminar.

By the end of 1989, one of the main activities of the IAI was hosting a Congress for the members. The Congress discussed all matters which related to professional care and organisational matters. In order to stimulate the development of the accounting profession, the IAI undertook a policy in which all matters relating to professional matters were to be discussed at the Convention, and all organisational matters were to be discussed at the Congress. The Congress, a National Accounting Convention, was held in Surabaya from 14 to 16 December 1989.

In the sixth congress, accounting education and formulation of a better standard was strengthened and extended. Since 21 September 1990, intensive accounting education has been hosted by the Association. Moreover, in this period the proposed statement and the
accounting interpretation from the Committee of Accounting Principles has been approved by the Association and were published as follows:

<table>
<thead>
<tr>
<th>No.</th>
<th>Title and Description</th>
<th>Published on</th>
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<tbody>
<tr>
<td>(1)</td>
<td>Statement No. 1: Accounting for Foreign Currencies</td>
<td>5 February 1988</td>
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<td>(2)</td>
<td>Statement No. 2: Accounting for Interest Capital During Construction</td>
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<td>(3)</td>
<td>Statement No. 3: Special Standards of Accounting for a Business Corporation</td>
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<td>(4)</td>
<td>Interpretation No. 1: Description of Effective Enactment of Indonesian Accounting Principles 1984, Financial Reports, Subordinate Liabilities, Differed Charges of an Exchange Rate Devaluation</td>
<td>25 February 1986</td>
</tr>
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<td>(5)</td>
<td>Interpretation No. 2: the Description of Exchange Rates Variations Due to Devaluation</td>
<td>10 February 1987</td>
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<td>(6)</td>
<td>Interpretation No. 3: Accounting Description for Fixed Assets Revaluation</td>
<td>18 January 1988</td>
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<td>(7)</td>
<td>Interpretation No. 4: the Description of Statement of Accounting Financial Reports Changes</td>
<td>March, 1989</td>
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<td>(8)</td>
<td>Interpretation No. 5: Accounting Description Concerning Past Correction and Extraordinary Items</td>
<td>1 June, 1989</td>
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<td>(9)</td>
<td>Interpretation No. 6: Accounting Description for Authorised Capital Cost or Expenses</td>
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<td>(10)</td>
<td>Interpretation No. 7: Description of Effective Enactment Statement No. 3: Special Standards of Accounting for Cooperation Business</td>
<td>1 January 1990</td>
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</tbody>
</table>

In Committee Auditing Standards, the Committee has published some Supplements, Special References, and Interpretations for Auditing Standards 1987/1988. These are:
In the period 1990 -1994, most efforts were directed at reviewing all accounting and auditing standards. A new Statement of Auditing was approved by the Association. The updating of standards was done in order to answer the need for a standard auditing that covered all matters in business practices. The new standard auditing for accountants, by permission of AICPA, was adopted from the AICPA Professional Standards. The standards cover: Statement of Auditing Standards, Statement of Attestation Standards and Statement of Accounting and Review Services and Auditing Guidance for Special Industry. These standards and statements are set out as follows:

<table>
<thead>
<tr>
<th>No.</th>
<th>Section</th>
<th>Title</th>
<th>PSA/PSAT/PSAR</th>
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<td>1</td>
<td>SA</td>
<td>Auditing Standards</td>
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<td>SA</td>
<td><strong>Section 100</strong> Statement of Introduction-Auditing Standard</td>
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<td>110</td>
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<td>Independent Auditor Functions and Responsibilities</td>
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<td>The Relationship Between the Auditing Standards and Quality Control Standards</td>
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SA Section 200 General Standards

201 Features of the Auditing Standards

210 Training and Skill of the Independent Auditor

220 Independence

230 Accuracy in Job Implementation

SA Section 300 Standards Field Work

310 The Relationship Between Audit Sample and Audit Planning

311 Planning and Supervision

312 Audit Risks and Materiality in the Audit Implementation

313 Substantive Examination Before Balance Sheet Date

314 Risk Determining and Internal Control of PDE Characteristics and Considerations

315 Communication Between the Former Auditor and the Next Auditor

316 Auditor's Responsibilities to Detect and Report Mistakes and Fraud

317 Breaking the Law by The Client

319 The Consideration of Internal Control Structure in Audits on Financial Reports

320 Assignment of Audit Letters

322 Audit Consideration of Internal Audit Function in Audit of Financial Reports

323 Audit Assignment for the First Year

325 Problem Communication Concerned with Internal Control Structure which is Found in Audit

326 Audit Evidence
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<th>Chapter</th>
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<td>Inventory</td>
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<td>332</td>
<td>Long Term Investment</td>
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<td>333</td>
<td>Client Representation</td>
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<td>Person with he/she Special Relationship</td>
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<td>The Uses of Special Services</td>
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<td>Auditing a Judgment on the Going Concern Concept</td>
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<td>380</td>
<td>Audit Committee Communication</td>
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<td>390</td>
<td>Consideration on Procedures not done after Auditor Report Date</td>
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<td><strong>SA Section 400</strong> First, Second and Third Reporting Standards</td>
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<td>Compliance with General Accounting Principles</td>
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<td>Fairness in Generally Accepted Accounting Principles</td>
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<td>420</td>
<td>Consistency in Generally Accepted Accounting Principles</td>
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<td>Full Disclosure in Financial Reports</td>
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544 Nonconformity with Generally Accepted Accounting Principles SPA No. 45
550 Other Information in Audited Financial Reports SPA No. 44
551 Other Supplemental Information which is Reported by Auditor SPA No. 36
552 Auditor Report on Summary Financial Reports and Other Financial Data SPA No. 53
558 Additional Information that Must Be Reported SPA No. 50
560 Subsequent Events SPA No. 46
561 Next-Fact-Finding After Auditor Report SPA No. 47

SA Section 600 Other Type of Report

622 Special Description on Elements in Financial Report SPA No. 51
623 Special Reports SPA No. 41
625 Audit Reports concerning the Implementation of Accounting Principles SPA No. 42
634 Letters for External Parties Such as Underwriters or Others SPA No. 54

SA Section 700 Special Topics

710 Special Consideration on Audits for Small Business SPA No. 58

SAT Attestation Standard

100 Attestation Standard PAST No. 02
200 Financial Forecast and Estimation PSAT No. 04
300 Proforma Financial Information Reporting PSAT No. 03
400 Interim Financial Information PSAT No. 01
On the other hand, the Committee of Accounting Principles also revised and updated all accounting principles in 1984 and replaced the name Accounting Principles with that of Financial Accounting Standards. By 1994, the Association had approved Financial Accounting Standards that covered: the Conceptual Framework for Accounting and Reporting Practices, 25 Statements of Financial Accounting Standards and 9 Statements of Financial Accounting Standards for Special Industries. Those standards and statements are set out as follows:

**PSAK: Conceptual Framework for Financial Reporting**

**PSAK No.**
1. Disclosure of Accounting Policies
2. Cash Flow Statement
3. Interim Financial Statement
4. Consolidated Financial Statements
5. Segmentation of Information for Financial Reporting
6. Accounting and reporting for Companies in progress
7. Information reflecting special interests
8. Contingency and Events After the Balance Sheet Date
9. Presentation of Current Assets and Liabilities
10. Accounting for Foreign Currencies
11. Presentation of financial reporting in foreign translation
12. Reporting financial information by joint cooperation and assets
13. Accounting for Investments
14. Accounting for Inventories
15. Accounting for Investments in Associated Companies
This chapter describes a brief history of the development of accounting information and reporting practices in Indonesia. Such development was discussed into some parts as follows:

1) Before the late of 1970s, accounting and reporting practices in Indonesia were based on Dutch Accounting System (DAS) due to long period of colonialism (since 1600s up to 1945). Even up to late 1970s, the influence of Dutch Accounting Systems (DAS) could be found in some companies in Indonesia.
2). During the Dutch colonialism only few of Indonesians have chance going to school. Accordingly only few of Indonesian become accountants and most of them graduated from Nederlands Universities. This condition also influenced accounting and reporting practices up to mid 1970s.

3). The short periods of occupation by Japan, it couldn't change the existing system. Japan occupation caused the Indonesian had possibility to study accounting in order to help Japan to records all sovereignty in this country.

4). After having some accountants graduated from United States, the Dutch Accounting System was gradually replaced. The period of 1960 to 1970 is the periods of dualism in accounting and reporting practices in this country. Some companies in Indonesia, especially the ones that came from nationalisation of Dutch companies still used Dutch Accounting Systems but the others tend to use American Accounting System. In 1977, based on Minister Education Decisions, the learning process of Dutch Accounting System was not thought anymore in Indonesia universities. The system should be replaced by American Accounting Systems (AAS). Accordingly, by the end of 1970s most accounting activities in Indonesia have already used the American Accounting Systems (AAS).

5). The development of accounting and reporting practices can also be associated with the development of capital market. The first effort to develop accounting and reporting practices merge in 1972, when the Capital Market Agency (now BAPEPAM) reopened the capital market in Indonesia. The significant development of capital market during the late of 1980s and the intentional market abusement in the market caused BAPEPAM and the Indonesia Accounting Association (IAI) spure development of accounting and reporting practices in Indonesia. The development of accounting and reporting practices then culminated in 1994, when the Association (IAI) adopted the International Accounting Standard (IAS) by AICPA permission.
CHAPTER ELEVEN

THE ROLE OF THE STOCK EXCHANGE COMMISSION AND

THE CAPITAL MARKET AGENCIES

In the previous Chapters, the role of the capital market in mobilising funds for investment and also the role of accounting associations in providing a standard for accounting and reporting practices was examined. The main purpose of this chapter is to discuss the role of the Stock Exchange Commission (the SEC) or BAPEPAM in regulating the activities of the capital market and the capital market agencies that support the activities of the market.

The need for discussion of the SEC was supported by previous researchers due to the SEC being one of the mandatory regulators in shaping accounting and reporting practices in the country. However, the need for further discussion concerning the role of capital market agencies such as the accountants, underwriters, and lawyers is also considered important in this study, because they make the market more efficient. Generally, as supporting agents in the activities of the capital market, they must conform to the role of the SEC (BAPEPAM) and keep the activities of the capital market in such condition that it becomes an alternative financing place for investment decisions.

11.1. THE ROLE OF THE CAPITAL MARKET SUPERVISORY AGENCY (BAPEPAM)

As has been indicated, before the enactment of President Decree No. 53/1990, the Capital Market Supervisory Agency (BAPEPAM) has a dual function, as a regulator and operator of the capital market in Indonesia. However, since the enactment of this decree, BAPEPAM's functions have been redefined so that it is now the only supervisory agency for the market, the investors and the general public. To exercise this function, BAPEPAM has been equipped with a very broad power. The Presidential Decree states that the powers of BAPEPAM are to monitor and regulate the market so that securities can be issued and traded regularly, fairly and efficiently.
In addition, BAPEPAM also has some other responsibilities such as providing and meeting the provisions stated in the State Policy Guidelines, that is, to obtain funds for national economic development by adhering to the self-sufficiency principle; developing the capital market in such a way that investors and other interested parties are protected. Further, BAPEPAM should encourage public participation in mobilising funds through ownership of company securities, so as to create and encourage the participation of private businessmen in making use of the capital market and creating and maintaining sound practices, fair and efficient, in the capital market for all parties as mentioned in the Presidential Decree No.53/1990.

In order to maintain those functions, BAPEPAM has been equipped with a series of authorities or specific tasks which can be classified into two categories viz planning and control functions. Under the planning function, the tasks of BAPEPAM are to provide rules concerning operational instructions on all aspects of the capital market, and guidance to members or agencies involved in capital market activities, to set various requirements applicable to any person or institution who participates in the market and also to establish accounting standards together with the Indonesian Accounting Association. In the control functions, the task of BAPEPAM is to conduct supervision of all self-regulatory organisations (SROs) and to act as an appellate agency for administrative actions taken by the SROs against their members. The law requires these SROs establish their own rules and regulations to govern and police their members. In order to protect the interest of the public, all rules of these private organisations, including any changes thereto, must be approved by BAPEPAM.

Moreover, the task of BAPEPAM is to conduct investigations into the offices, bookkeeping or records of any public company or of any person who has obtained permission to be a member of the capital market. Within its power, BAPEPAM has the right to inquire into the securities related affairs of any person and request any securities related information from any person.

With regard to enforcing regulations, Presidential Decree No. 53/1990 authorises the government regulatory agencies, the Minister of Finance and BAPEPAM to impose
administrative sanctions and monetary fines to enforce the securities law. This includes suspending or revoking the licenses, approvals or registrations of any securities market participants and suspending or cancelling the transactions of any listed securities. The law authorises BAPEPAM to impose a monetary fine for violation of the reporting requirements.

BAPEPAM reported that during the enforcement activities, 1 April 1991 to 31 March 1992 and 1 April 1992 to 31 March 1993, there were 11 and 21 listed companies, respectively, which were fined for lateness in submitting either their annual financial statements and mid-year reports, or their reports on important events. The total amount of fines during that periods were Rp 328 million and Rp 537.8 million. During the period 1/4/91-31/3/92, the companies that were fined were:

<table>
<thead>
<tr>
<th>No.</th>
<th>Name of Company</th>
<th>Amount</th>
<th>Delay of Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PT Argo Pantes</td>
<td>Rp. 60,000,000.00</td>
<td>60 days</td>
</tr>
<tr>
<td>2</td>
<td>PT Inter Delta</td>
<td>Rp. 24,000,000.00</td>
<td>24 days</td>
</tr>
<tr>
<td>3</td>
<td>PT Prima Alloy Steel</td>
<td>Rp. 60,000,000.00</td>
<td>60 days</td>
</tr>
<tr>
<td>4</td>
<td>PT Igar Jaya</td>
<td>Rp. 60,000,000.00</td>
<td>60 days</td>
</tr>
<tr>
<td>5</td>
<td>PT Binas Finance</td>
<td>Rp. 34,000,000.00</td>
<td>34 days</td>
</tr>
<tr>
<td>6</td>
<td>PT Astrijati Industri Rotan Ind</td>
<td>Rp. 19,000,000.00</td>
<td>19 days</td>
</tr>
<tr>
<td>7</td>
<td>PT Teotronic Permai</td>
<td>Rp. 19,000,000.00</td>
<td>19 days</td>
</tr>
<tr>
<td>8</td>
<td>PT Dharmala Ind.</td>
<td>Rp. 38,000,000.00</td>
<td>38 days</td>
</tr>
<tr>
<td>9</td>
<td>PT Bank Duta</td>
<td>Rp. 4,000,000.00</td>
<td>4 days</td>
</tr>
<tr>
<td>10</td>
<td>PT Pudjiati &amp; Son</td>
<td>Rp. 5,000,000.00</td>
<td>5 days</td>
</tr>
<tr>
<td>11</td>
<td>PT Bank Tabungan Negara</td>
<td>Rp. 5,000,000.00</td>
<td>5 days</td>
</tr>
</tbody>
</table>

During the period 1/4/92-31/3/93 these companies were:

<table>
<thead>
<tr>
<th>No.</th>
<th>Name of Company</th>
<th>Amount</th>
<th>Delay (Days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PT Argo Pantes</td>
<td>Rp. 60,000,000.00</td>
<td>60 days</td>
</tr>
<tr>
<td>2</td>
<td>PT Dharmala Land</td>
<td>Rp. 38,000,000.00</td>
<td>38 days</td>
</tr>
<tr>
<td>3</td>
<td>PT Teotronic Permai</td>
<td>Rp. 19,000,000.00</td>
<td>19 days</td>
</tr>
<tr>
<td>4</td>
<td>PT Astrijati Ind.</td>
<td>Rp. 19,000,000.00</td>
<td>19 days</td>
</tr>
<tr>
<td>5</td>
<td>PT Binas Finance</td>
<td>Rp. 34,000,000.00</td>
<td>34 days</td>
</tr>
<tr>
<td>6</td>
<td>PT BTN</td>
<td>Rp. 5,000,000.00</td>
<td>5 days</td>
</tr>
<tr>
<td>7</td>
<td>PT Pudjiati &amp; Sons</td>
<td>Rp. 5,000,000.00</td>
<td>5 days</td>
</tr>
<tr>
<td>8</td>
<td>PT Bank Duta</td>
<td>Rp. 4,000,000.00</td>
<td>4 days</td>
</tr>
<tr>
<td>9</td>
<td>PT Igar Jaya</td>
<td>Rp. 60,000,000.00</td>
<td>60 days</td>
</tr>
<tr>
<td>10</td>
<td>PT Inter Delta</td>
<td>Rp. 24,000,000.00</td>
<td>24 days</td>
</tr>
<tr>
<td>11</td>
<td>PT Prima Alloy Steel</td>
<td>Rp. 60,000,000.00</td>
<td>60 days</td>
</tr>
<tr>
<td>12</td>
<td>PT USP</td>
<td>Rp. 59,940,000.00</td>
<td>220 days</td>
</tr>
<tr>
<td>13</td>
<td>PT Jas Marga</td>
<td>Rp. 38,000,000.00</td>
<td>38 days</td>
</tr>
<tr>
<td>14</td>
<td>PT Bank Bukopin</td>
<td>Rp. 1,000,000.00</td>
<td>1 day</td>
</tr>
<tr>
<td>15</td>
<td>PT BTN</td>
<td>Rp. 25,000,000.00</td>
<td>25 days</td>
</tr>
<tr>
<td>16</td>
<td>PT Indocitra Finance</td>
<td>Rp. 59,950,000.00</td>
<td>90 days</td>
</tr>
<tr>
<td>17</td>
<td>PT BII</td>
<td>Rp. 14,000,000.00</td>
<td>14 days</td>
</tr>
<tr>
<td>18</td>
<td>PT Bakrie Brothers</td>
<td>Rp. 1,000,000.00</td>
<td>1 day</td>
</tr>
<tr>
<td>19</td>
<td>Clipan Finance</td>
<td>Rp. 7,000,000.00</td>
<td>7 day</td>
</tr>
<tr>
<td>20</td>
<td>PT BPD Jatim</td>
<td>Rp. 1,000,000.00</td>
<td>1 day</td>
</tr>
<tr>
<td>21</td>
<td>PT BPD Jateng</td>
<td>Rp. 3,000,000.00</td>
<td>3 days</td>
</tr>
</tbody>
</table>
Beside these fines, during those periods the BAPEPAM also handed some cases. According to BAPEPAM reports on law enforcement activities, there were six cases in 1992 and ten cases in 1993. Those six cases in 1992 were:

1. Investors vs Brokers
   a. Ms. Leyla (investor) and PT. BHS Bank (broker). This dispute concerned the failure of PT BHS Bank to deliver the Indonesian portion of its shares bought by the investors. This dispute was settled after the delivery of these shares by PT. BHS Bank.
   b. Mr. Abdul Munir Nasution (investor) and PT. Dhanamas Buana Wirasta (broker). This dispute concerns the failure of PT Dhanamas to deliver shares purchased by Mr. Abdul in accordance with the existing rules.

2. Broker vs Broker
   a. PT. Mitra Tatadhana (buying broker) and PT. Gunung Sewu (selling broker). This dispute concerns an error in the transfer of money for the purchase of one-hundred lots of Bank Duta shares.
   b. PT. Dharmala (buying broker) and PT Dhanamas (selling broker). This dispute concerned three-hundred shares of PT. Astra which were declared lost. The dispute was settled through replacement of the shares by PT. Dhanamas.
   c. PT. Buana Mas (buying broker) and PT BHS (selling broker). This dispute concerns three-hundred shares of Trias Sentoso which were declared lost by PT. Buana Mas on behalf of its client, Nurhadi.

3. Custodians vs Brokers
   Standard Chartered (custodians of Banque Internationale Luxemburg Sub A/C Asia Emerging Fund); PT. Deemte (buying broker); PT. Dana Tunggal (selling broker). The dispute concerns dividends declared of one-hundred thousand shares of PT.
United Tractors to an individual, who sold these shares to Banque Internationale Luxemburg Sub A/C Asia Emerging Fund, represented by Standard Chartered as custodian.

4. Custodians and Issuer (listed company)

This dispute concerns ten-thousand shares of PT. Astra International that, registered at PT. Astra International (issuer) under a foreign investor’s name, where Citibank acts as custodian.

5. Custodian vs Securities Administration Agency

This dispute concerns the registration of eleven thousand five-hundred shares of PT. HM Sampurna by PT. Sirca (securities agency) at the request of Citibank as custodian. PT Sirca initially refused the registration of these shares due to incomplete documentation required. The dispute was settled by completing such document.

6. Violation by Capital Market Supporting Professionals

1. Drs Hadi Pontan (a public accountant) was sanctioned with the prohibition of engaging in activities in the capital market due to the case of PT Bank Duta (the listed company). For further discussion see Appendix No.4 The Influence of Political Economic Policies on Listed Company: A Case Study on PT Bank Duta.

2. Drs Murni Anwar (a public accountant) was suspended from conducting any activities in the capital market for one year, effective 26 August 1991 to 26 August 1992.

Those ten cases in 1993 were:

1. The Listed Company vs the Shareholders

The dispute concerns debits and credits between PT. Prapatan Hotel (listed company) and BM. Diah (shareholder) occurred when B.M. Diah was one of the member of directors and
the biggest shareholder in PT. Prapatan Hotel. In court, PT. Prapatan Hotel charged B.M. Diah with demanding 5,611,369 shares of B.M. Diah as a guarantee. This case is still in progress in the Jakarta Pusat State Court up to 1993.

2. PT. Prapatan Hotel (listed company) vs. the Jakarta Stock Exchange (JSX)

PT. Hotel Prapatan charged PT. Bursa Efek Jakarta (JSX) with violating the law. JSX had approved the sale of 5,611,369 B.M. Diah shares to other parties at the time the guarantee was required by the court. The dispute finally ended through agreement and the charge was dropped.

3. PT. Minindo Perkasa Semesta (listed company) vs. PT. Deemte Arthadharma (underwriter)

As the issuer, PT. Minindo appointed PT. Deemte as underwriter. In the underwriting agreement, PT. Deemte was to guarantee full commitment. When Minindo shares were not fully subscribed, PT. Deemte did not fulfil its obligation. The dispute was settled. PT Dharmala Inti Utama takes all PT. Minindo shares and the name of PT Deemte was changed to PT. Dharmindo Adhiduta.

4. The JSX vs PT. Binaarta Parama (broker)

On 28 January 1993, the Board of JSX imposed a sanction on Binaartha Parama in the form of a prohibition from trading on the JSX, because the company disavowed its obligation to pay compensation caused by a false shares transaction of PT. Semen Gresik that its sold by its representatives to PT. Jasabanda Garta and PT. Srikandi. PT. Binaartha Parama objected to this decision and appealed to BAPEPAM. On the basis for further review, BAPEPAM concluded that the JSX's decision was right. Therefore BAPEPAM reinforced the decision. The JSX imposed sanction on PT. Binaarta Parama in the form of prohibition from trading on the JSX because PT Binaarta was not willing to pay compensation for trading counterfeit shares of PT. Bank Duta and PT. Semen Gresik that were sold by the PT Binaarta (broker-dealer). After the appeal, PT. Binanartha Parama fulfilled the requirements of the JSX by paying compensation so that the company was permitted to trade on the stock exchange
5. The Shareholders vs the Listed Company

Sumadipradja & Taher, Mr Fajar Setiawan Clients, were the Shareholders of PT.Panin (listed company). Mr Fajar (representatives) was late in registering Sumadipradja and Taher shares. PT Panin (listed company) was not willing to issue bonus shares to Mr Fajar because he was not registered on the list of shareholders entitled to receive them.

6. PT Wira Unggul Securitas (Securities Agency) vs. brokers that suffered a loan.

The Central Jakarta court decided that PT.Wira would proportionally pay compensation to the brokers who suffered a loss. The evidences (shares and money) confiscated by the office of the Counsel for the prosecution were to be returned to the brokers involved.

7. Investors vs. Brokers

Lukman Hartono and Herlina Salim (investors) were accused of executing false share transactions, from 10 to 19 March 1993, in stocks of PT. HM. Sampoerna, PT. INCO, PT. Indah Kiat, PT. Semen Gresik, PT.Inti Indorayon Utama involving 1,181,900 shares. The total amount of loss caused was about four trillion rupiahs. Buying Broker-Dealers who paid the amount of money had the right to obtain original shares from the Selling Broker-Dealers because the transactions were considered valid and could not be suspended. To handle this case, the Chairman of BAPEPAM issued an Instruction Letter No. 11/PM/1993 regarding the Formation of the Jakarta Stock Exchange Coordination Team for False Shares. The Team, consisted of officials from BAPEPAM, JSX, Police Headquarters, and the Supreme Court. The law suit was filed at the Central Jakarta Court of First Sentence, and the case was prosecuted 'in absentia'.

For further discussion see Appendix No. 6: The Effect of Counterfeit Shares on Market Activities.

8. Rig Tender Indonesia (RTI) Case.

In January 1993, RTI acquired stocks of PT. Mustika Pelita Abadi and CH. Off-shore Ltd (listed companies), without prior announcement on approval from public shareholders and,
in addition, these acquisitions were not reported to BAPEPAM. These decisions were contrary to the procedures and provisions of the capital market rules. Therefore, BAPEPAM instructed the company to:

a). obtain approval from independent shareholders.

b). assign an independent party to review and give an opinion regarding the fairness of the stock prices acquired.

c). announce the acquisitions in at least one Indonesian newspaper.

9. PT Dharmindo (Broker) vs the JSX/BAPEPAM

On 3 June 1993 BAPEPAM received an appeal from PT. Dharmindo Adiduta (broker) regarding its objections to the decision made by JSX to reject the relisting of its shares on the JSX. After a thorough examination, BAPEPAM concluded that JSX had rejected the request without showing reasons pertaining to the violation of any existing listing rules. Therefore, BAPEPAM cancelled the decision and asked the JSX to relist the shares of PT Dharmindo Adiduta.

10. The JSX and PT. Mashill (Broker-dealer) vs Mr Lukito (Investors)

In October 1993, BAPEPAM gave testimony, before the Central Jakarta Court of First Sentence, in relation to a civil case between Mr Lukito versus PT.Mashill Jaya securities and JSX. Mr Lukito accused PT. Mashill together with JSX with having submitted un-true reports to the Chairman of BAPEPAM by saying that there was a family relationship between Mr Lukito and Mr Lukman H and Ms Herlina Salim, the suspected persons who executed false share transactions in the JSX in March 1993.

In contrast to the authority of the US Stock Exchange Commission, up to 1994, BAPEPAM is not equipped with the authority to bring a civil suit against the violator of any securities law. As Section 21A of the Securities Exchange Act of 1934, the US law, the SEC has authorisation to bring a civil action against any person who violates the securities law. In this action the SEC may require the court to impose a civil penalty to be paid by the guilty person. Cox et al. (1991) states that most civil actions are settled out of court, not litigated. If a
certain case is settled, this generally means that the defendant has agreed to pay a fine assessed by the SEC without either admitting or denying the underlying violation of the securities law. One of the reasons leading to this high rate of settlement is that the defendant avoids the high cost of litigation and prevents unwanted publicity.

In the absence of such authority, BAPEPAM may find difficulty in enforcing the law. Despite BAPEPAM having a broad authority to impose various administrative sanctions however, there are still many types of violation of securities regulations that may be too trivial to justify an administrative sanction. Without the authorities to impose civil penalties many minor offences of securities law will go unpunished. This may erode the credibility of BAPEPAM as an effective regulatory agency. In addition, the lack of such authority may also reduce BAPEPAM's ability to develop a proper securities law.

Notwithstanding the deficiency that has just been discussed, in general BAPEPAM's authority is broad. The main issue in the foreseeable future is how BAPEPAM is able to exercise its broad power to achieve the objectives of the law. Considering the limited resources of BAPEPAM, including underpaid staff and lack of staff training and experiences, and also the complexities of the environment in which BAPEPAM operates, it appears that BAPEPAM will need a long period of time to establish itself as an effective agency to implement the mandate of the law.

11.2 THE ORGANISATIONAL STRUCTURE OF BAPEPAM

Having reviewed its authority, it is time to assess how BAPEPAM is structured in order to achieve its objectives. As an agency under the Ministry of Finance, BAPEPAM and its deputy are appointed by the President with a recommendation from the Minister of Finance and are responsible to the Minister. The Minister of Finance is the ultimate authority that sets the policy of capital market development and BAPEPAM is the agent that executes that policy. Because BAPEPAM is not yet effective despite the law, many important decisions, at the moment, are still retained by the Minister of Finance. For instance, the Minister reserves the
right of issuing licenses for securities exchange, clearing agencies and investment funds. Licensing for other capital market institutions, securities companies including underwriters, broker-dealers, investment managers and advisers as well as licensing for individuals who participate in the market, has been transferred to BAPEPAM. The Minister also acts as an appellate institution for BAPEPAM decisions.

In practical terms, however, BAPEPAM has been the most important government agency to oversee the market and influence the direction of future market developments. Despite the policy making decisions being within the authority of the Minister of Finance, the Minister, by and large, is reliant on the recommendations of BAPEPAM as the basis for his policy decisions. Presidential Decree 53/1990 states that BAPEPAM has the authority to make recommendation to the Minister of Finance on all aspects of the capital market, including on the granting and revoking of licenses for those institutions whose licenses are still within the authority of the Minister.

![Organisational Structure of BAPEPAM](#)
The staff of BAPEPAM is organized into bureaus and functioning groups. At its headquarters, BAPEPAM's structural organisation consists of a chairman, a secretariat, several bureaus and capital market functioning groups. According to the law, BAPEPAM may have a regional office where the securities exchange exists. The chairman, with the assistance of his deputy, is responsible for the overall operations of the agency. The secretary generally serves the internal needs of BAPEPAM. Some of the functional responsibilities of BAPEPAM are delegated to the bureaus. Based on these functions there are five bureaus in BAPEPAM - the Bureau for Legal affairs and Enforcement, the Bureau for Enforcement and Research, the Bureau for Securities Transactions and Institutions, and the Bureau for Corporate Finance I and II.

The Bureau for Legal Affairs and Enforcement is responsible for legal activities and enforcing securities regulations. The Bureau for Enforcement and Research has the responsibility of supervising investment management and advisory activities of securities companies, investment funds and investment advisers. This bureau also has the task of performing capital market research. Supervision of securities exchanges, CSD institutions, securities companies, and underwriters and broker dealers representatives are the main responsibilities of the Bureau for Securities Transactions and Institutions. Two divisions, sharing the same name, the Bureau for Corporate Finance I and II, are responsible for supervising public companies and administering the securities law's disclosure requirements. The Bureaus for Corporate Finance I and II are also responsible for the improvement of accounting standards within the industries. The difference between the two bureaus is that the first covers firms that "are engaged in the service industry (except investment funds)", while the second bureau covers firms that "are engaged in the production industry". The capital market functioning group is not clearly defined. The decree states that this group is responsible for assisting the bureau in forming their respective duties.

Similar to the body of the law itself, which has been adopted in the main from US securities regulations, the organisational structure of BAPEPAM also resembles the US SEC. Notwithstanding several differences, such as the fact that the SEC is an independent agency whose commissioners are appointed by the President for five year terms while BAPEPAM is
the subordinate of the Ministry of Finance, the arrangement of the BAPEPAM to a large decree has been modelled on the SEC. The intriguing question is how far the successful role of the SEC in supervising the US securities markets can be mimicked by BAPEPAM in supervising the Indonesian capital market.

Observing the structure of the BAPEPAM, one great concern that emerges is that the issue of enhancing accounting standards has not received the highest priority for a few years. This is reflected in BAPEPAM's organisational structure, where the task of improving accounting standards is split between two bureaus (the Bureau for Corporate Finance I and II). Putting the office of accounting standards at a lower level of the organisation and splitting it into two different divisions may create less effective results, firstly, since the bureaus are also responsible for other functions, the job to improve accountancy standards will receive only ancillary attention, and secondly, because the functions lay in different offices, it requires constant coordination which may not always be effective.

Within the SEC, for instance, the office of the chief accountant is a separate entity and stands at the same level as other offices and divisions. Therefore, the office's attention is well focused and job coordination is easily accomplished. One additional advantage of such an arrangement is that by specialisation in enhancing the accounting standards, the office can augment its professional capacity from experience, and ascend the learning curve.

The accounting standards is one of the most important issues that needs to be addressed in order to strengthen the Indonesian capital market. The Indonesian Accounting Standards which was mostly adopted from the US Generally Accepted Accounting Principles, is still far from satisfactory. Some public accountants, for instance, are still not reluctant to participate in tailor-made operations. The case of Bank Duta indicated earlier is a vivid example in this context. Considering this weakness, BAPEPAM's role in enhancing accounting standards is crucially needed. Thus, reorganisation of the structure by creating a special bureau for accounting standards improvement and enforcement, which is responsible directly to the Chairman of BAPEPAM, is suggested in this study.
11.3 BAPEPAM AND THE ROLE OF DUE DILIGENCE

The process of checking and verifying information contained in a statement to be realised to the public prior to the registration of that statement is one of the most important functions of BAPEPAM. It has to reviewing the registration documents of listed companies in order to verify that all relevant and important information about the company is properly disclosed. Additionally, such review is to ensure that the information released to the public is easy to understand. In this context the Minister of Finance issued decree No. 1548/1990, requires that: BAPEPAM shall take into account the adequacy and objectivity of the information contained in the registration statement and other considerations it deems necessary for the protection of investors.

To implement this regulatory requirement BAPEPAM has issued three rules regarding the form and content of the registration statement, the prospectus and the summary prospectus. These rules set guidelines for listed companies with regarding to the information needed to be released to the public in the case of public offerings. BAPEPAM also uses these guidelines as a basis for reviewing the registration documents. However, BAPEPAM reviews only the completeness of the registration statement and the clarity (formal materiality) of the information therein. Indeed, BAPEPAM cannot verify the substantive accuracy of information released to the public.

If all information and supporting documents are satisfying the statutory guidelines and there is no reason for BAPEPAM to believe that the information is in-accurate, the registration statement will be declared effective. Since the system is mainly reliant on mandatory full disclosure by the issuer, both the issuer itself and all market supporting professionals, eg. accountants, appraisers, legal attorneys and underwriter(s) are responsible for the accuracy of the information contained in the registration statements. The responsibility of the listed company is unconditional while the responsibility of market professionals is limited to the information they provide.
To stress the limits of BAPEPAM's function in this regard, the law clearly prohibits BAPEPAM from approving or rejecting or otherwise expressing its views on the merits of investing in certain securities. Despite BAPEPAM's having the authority to issue a stop order or to prevent the effectiveness of a registration statement, if BAPEPAM finds the information contained in the registration statement to be false, erroneous or misleading, in general the review procedure conducted by it does not guarantee that the information released to the public is accurate. Realising such a scenario, the law compels companies to notify the public on the limit of BAPEPAM's responsibility. Accordingly, on the front cover of each prospectus the following statement must be printed in large capital letters. "THESE SECURITIES HAVE NOT BEEN APPROVED BY BAPEPAM, NOR HAS BAPEPAM PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS ILLEGAL".

11.4 THE ROLE OF CAPITAL MARKET SUPPORTING AGENCIES

In order to support BAPEPAM's effort in regulating capital market activities, any related parties, such as the Listed Companies, Public Accountants, Underwriters, Legal Consultants, Notaries, and others have their responsibility of ensuring that they comply with any regulations and sound practices that should be exist in every capital market. In this study, the role of those parties, especially accountants, underwriters, and notaries and legal consultants are considered important in making efficient the activities of the capital market.

11.4.1 The Public Accountant

The public accountant is a party that responsible for the legitimacy of financial reports according to generally accepted accounting principles and BAPEPAM regulations. The accounting principles are defined as the Indonesian Accounting Principles issued by the Indonesian Accountants Society. In order to legitimate the financial report, the public accountant does an audit based on auditing standards which have also been issued by the Society. Those standards, namely the Financial Accounting Standards for the generally accepted accounting principles and Statement
of Auditing Standards covers some related standards (for auditing used by the Society), ie. Statement of Attestation Standard and Statement of Accounting and Review Services and Auditing Guidance for Special Industry, for auditing standards used by the society.

According to the Auditing Standards, a public accountant is not required to do a full audit or detailed audit. However, he or she is permitted to do an audit through professional sampling methods. Thus, it should be noted that the financial report may not be true in its presentation. Therefore, a public accountant has to state that the financial report and its related accounts are presented "fairly". The true and fair view of a financial report should be understood by the users of that financial report. If there is a mistake or some of the information is contrary to the audit opinion, the public accountant may not be responsible, depending on whether or not he/she followed the auditing standards. Last, but not least, people should realise that the final responsibility for financial reports will be in the hands of the providers, that is, the Emitten (the Listed Companies).

Related to the responsibility of accountants in auditing reports, there are some market abuses in historical development of the capital market in Indonesia, such as PT. Bank Duta case. Based on those conditions, to supervise and improve the professionalism of public accountants in the capital market, item 1 article 123 of the Decree of the Minister of Finance number: 1548/KMK.013/1990, reads: "Any Capital Market Supporting Professionals must register with the Chairman of BAPEPAM prior to being engaged in the capital market activities". As a follow up, effective May 5, 1992, BAPEPAM received registrations of members of the Society, who wished to operate in the capital market. As of 1992/1993, 79 Public Accounting Offices (KAP) and 118 Partners have obtained a Letter of Evidence of Registration (STTD) in the capital market from the Chairman of BAPEPAM. With the implementation of this regulation, all issuers, institutions or capital market supporting professionals required to submit a financial report to BAPEPAM must use one of the registered public accounting offices.
With the issuance of the STTD, the duty of BAPEPAM to supervise and provide guidance to these Public Accounting Offices becomes relatively simple. Any Public Accounting Office that has obtained the STTD from the Chairman of BAPEPAM is expected to improve its professionalism by participating in courses and seminars in the accounting and auditing fields, locally as well as internationally.

11.4.2 The Underwriter.

The underwriter is a party having a key role in any share listing in the capital market. This role can be outlined as follows:

a). To assist the company in preparing registration statements and other documents.
b). To provide advice in finance such as quantity and type of shares which will be issued, the type of markets they are going to enter, the issue date, the appointment of professional supporting agencies, etc.
c). To guarantee for the issued shares of the companies.
d). To evaluate company conditions concerning finance, management, marketing, production.
e). To determine the share prices in initial public offerings.
f). To determine whether there is a buyer in OTC market.

Based on these functions, the success of the issue of shares depends on the experience of underwriters in promoting the company to the public. Besides, the underwriter is required to possess high integrity such that all of the data and information given to the investors are correct and unambiguous. Thus, the underwriter should be responsible for any error which may occur during the submission of company prospectuses and which causes some loss to the investors.

In practice, there are two types of commitments ie. full commitment underwriting, and best effort underwriting. In full commitment underwriting, the
underwriter will take full responsibility, any risk as a result of public offering, by giving a guarantee to the Emitten (the Listed Company) that all of the shares are guaranteed to be sold at a price. In the case where the shares are not sold, at the IPO stage, at certain price, the underwriter is responsible for buying the rest of those shares. In some cases, the underwriter gains a profit, being the difference between the price at the IPO stage and the commitment price between the company and the underwriter.

In the Indonesian capital market regulations, this condition is modified for some reasons. The underwriter is not allowed to buy any shares before the IPO stages and then offer those shares at the IPO stages at different prices; the underwriter, based on the Indonesian regulations is responsible for buying the shares after the IPO stages. This model can hopefully provide a fair market price for investors at the IPO stage. A slight modification of this model, the underwriter can buy the rest of the listed shares after the IPO stages at certain prices, according to the agreement between the company and the underwriter, with lower prices than at the IPO stage.

In best efforts underwriting, the underwriter acts solely as an agent for the company. The underwriter does not give any guarantee to buy the remaining unsold shares, but will try his best to sell all the shares. Therefore, the unsold shares, if any, will then be returned to the company. The underwriter will pay the company only for the sold shares. Under this model, there may be another commitment, namely, all or none offering. In this model the offer may be cancelled if all of the shares are unsold. The company can use this model at last resort if it strongly feels that the offer is not economically viable. A slight modification also exist in this kind of commitment. The maximum and minimum offering require that the company only sell the shares if the minimum requirements can be achieved. If the minimum constraint has been reached, the underwriter will continue the offer. In other words, the buyers' request will then be fulfilled only if this minimum number has been reached.
11.4.3. The Notary and Legal Consultant

Notaries and legal consultants are also required in the issue of shares for listed companies in the capital market. In this role, a notary is responsible in preparing any agreement needed by those parties involved in the capital market. In some cases, legal consultants are also needed in capital market activities. The purpose of this is to provide a legal opinion about any matter that is related to the company’s condition. The legal consultant must give an opinion regarding the following matters:

a) The basic regulations.

b) The legal license for the company

c) The legal proof/facts of the company’s assets

d) Any commitment with other parties

e) Any legal cases related to the company or the management staff.

11.5. SUMMARY

This chapter laid down a brief history of capital market agencies, the BAPEPAM and the supporting agencies, during the periods of 1980s to 1990s. It was indicated that before the enactment of Presidential Decree No. 53/1990, BAPEPAM had a dual functions, as a regulator and as operator of capital market activities. This part summarized those functions based on its historical perspective.

1). Before 1990, as indicated in Chapter 9, the role of BAPEPAM was intended to motivate and attract the companies and investors dealing in the market. Some inducements, intensive campaigned by the Chairman, diminishing the role of PT Danareksa and also loosing some listed requirements were the strategis used by the BAPEPAM to develop capital market in Indonesia.
2). After 1990, when the market was considered to become a dynamic's market, there were some market abusesments which tend to be more intense,. In order to prevent the investors from such market abusesments, as mentioned in Chapter 9, BAPEPAM firstly, separated the operating function from the controlling function. The operating function was delegated to the Jakarta Stock Exchange (JSX), and the intensive care related to the regulation was handled by the BAPEPAM.

3). Moreover, since BAPEPAM intensified the law enforcement programs some listed companies were fined due to late reporting to the BAPEPAM. Some brokers, underwriters, and also accountants were sanctioned by prohibition of engaging in capital market activities.

4). In order to protect the interest of investors, especially for the small or individual investors, and also in order to achieve more efficient market in this country, some regulations were made. However, by the end of 1994 the new capital market regulations was not yet finalized. The regulations were still in progress and are expected to be issued by the end of 1995.
It is generally recognised that information disclosed in financial statements prepared in developing countries is relatively less reliable than information contained in financial statements prepared in economically developed countries. This lack of reliability has been explained by some researchers as being related to the use of information in the capital market. Moreover, as indicated in the previous chapter, information provided by corporate reporting practices, in the public domain, is considered too late for investors and there is also a need for more information of a non-financial in nature for making investment decisions in the capital market.

In the context of investment decisions, several authors and researchers eg. Kripke (1980), Chang, Most and Brain (1983) have commented on the role of investors in selecting a portfolio of equity securities, bonds and other investments for individuals, for firms or institutions. They found that there are differences in selecting the portfolio equities due to the differences in the perceived importance of information. Moreover, investors always look for specific information in order to make an abnormal profit and to avoid non zero abnormal profits and losses. Also they argued that investors tend to use some strategies to overcome those problems. In previous chapter it was recognised that the role of personal factors, and the cognitive style of investors were considered important, but due to the area of this study being mainly related to external factors, that is, impersonal factors, the problem of personal factors is not analysed in this study. A further look at the personal factors for the future research, which will be related to the process of information and how that information is utilised by investors, is suggested in this study.
By considering those previous research studies, this chapter attempts to answer those issues by analysing some factors that are considered to have influenced investors in investment decisions. Accordingly, the discussion in this chapter is divided into four sections. The first discusses the impact of political economic policies on socio-economic factors; the second discusses the impact of political economic policies on socio-political factors; the third canvasses the impact of political and socio-economic factors on the development of the capital market in Indonesia; and the last discusses the impact of political economic policies on investment decisions and share price movements in the capital market.

12.1. THE IMPACT OF POLITICAL ECONOMIC POLICIES ON SOCIO-ECONOMIC FACTORS

As mentioned earlier, after Indonesia gained its independence, the government faced great difficulties concerning the economic and the socio-political climate in the country. This section discusses the impact of political economic policies on socio-economic factors. Those factors are gross domestic product, income distribution and poverty, which are main economic indicators in macroeconomic studies. The next part of this study discusses the impact of political economic policies on socio-political factors and the impact of political economic policies on investment decisions and in-turn on share price movements.

12.1.1. The Impact of Political Economic Policies on Gross Domestic Product (GDP)

In the First five-year Development Plan (Repelita I), 1969-1974, government policies were introduced to help the country recover from long period of economic stagnation between 1945 and 1965. Towards the end of this period, high budget deficits had led to spiralling rates of hyper-inflation, exports covered only a fraction of imports and the country's infrastructure had deteriorated severely as a result of continuous neglect. Moreover, a complex and shifting system of regulations and controls hampered economic development in the country.
The turn-around period started in 1966 when the new government under General Suharto took power. A wide range of economic policies was introduced and directed to stabilisation and rehabilitation of political socio economic conditions. The policies included substantial liberalisation of controls and regulations, particularly those governing foreign exchange and prices. Furthermore, effective steps were taken to reduce inflation to manageable proportions. In order to encourage new economic development, substantial incentives were introduced in 1968 and 1969 to stimulate foreign and domestic private investment. As a result, economic growth increased substantially, especially due to the production of food crops, as indicated in Table 12.1.1.1. On the other hand, economic growth in the 1970s was greatly facilitated by the development of the oil sector, in particular through the world-wide increases of oil prices in 1974 and 1979 as indicated in Table 7.2.1

The high rate of growth was accompanied by substantial changes in the structure of production. The most noticeable development, based on BPS calculated data as indicated in Table 12.1.1.1, is the marked decline in the share of agriculture during 1971 to 1980.

Table 12.1.1.1

<table>
<thead>
<tr>
<th>Industrial Origin</th>
<th>1971 Value</th>
<th>%</th>
<th>1975 Value</th>
<th>%</th>
<th>1980 Value</th>
<th>%</th>
<th>Annual Rate of Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>2,441</td>
<td>44.0</td>
<td>2,811</td>
<td>36.8</td>
<td>3,425</td>
<td>30.7</td>
<td>3.8</td>
</tr>
<tr>
<td>Mining</td>
<td>551</td>
<td>9.9</td>
<td>828</td>
<td>10.9</td>
<td>1,035</td>
<td>9.3</td>
<td>7.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>490</td>
<td>8.8</td>
<td>848</td>
<td>11.1</td>
<td>1,705</td>
<td>15.3</td>
<td>15.2</td>
</tr>
<tr>
<td>Electricity, Gas, Water</td>
<td>25</td>
<td>0.4</td>
<td>41</td>
<td>0.5</td>
<td>78</td>
<td>0.7</td>
<td>13.5</td>
</tr>
<tr>
<td>Construction</td>
<td>171</td>
<td>3.0</td>
<td>365</td>
<td>4.8</td>
<td>839</td>
<td>5.7</td>
<td>15.8</td>
</tr>
<tr>
<td>Commerce, Hotels Etc</td>
<td>924</td>
<td>16.7</td>
<td>1,294</td>
<td>17.0</td>
<td>1,852</td>
<td>16.6</td>
<td>8.0</td>
</tr>
<tr>
<td>Transports, Communication</td>
<td>210</td>
<td>3.8</td>
<td>303</td>
<td>4.0</td>
<td>609</td>
<td>5.4</td>
<td>12.6</td>
</tr>
<tr>
<td>Other Service</td>
<td>733</td>
<td>13.2</td>
<td>1,141</td>
<td>14.9</td>
<td>1,827</td>
<td>16.4</td>
<td>10.7</td>
</tr>
<tr>
<td>Gross Domestic Product</td>
<td>5,545</td>
<td>100</td>
<td>7,631</td>
<td>100</td>
<td>11,169</td>
<td>100</td>
<td>8.1</td>
</tr>
</tbody>
</table>

Source: BPS various issues
In spite of a highly respectable growth of close to 3.8 percent per year, its share of GDP had dropped to 29.5 percent in 1980 compared to 43.5 percent in 1971. Most other sectors increased their share of GDP. It is striking that, in real terms, the share of mining, including oil production, was not much higher in 1980 than in 1971. In current prices however, the share of mining had increased more than three fold, from 8.1 percent in 1971 to 26.3 percent in 1980, though by 1983 it had declined to 18.7 percent. The increase up to 1980 was largely due to price increases rather than to changes in volume.

Table 12.1.1.2
Resources and Uses, Savings and External Position of Indonesia in Percentages of GDP

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Resources:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- GDP</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>8.1</td>
</tr>
<tr>
<td>- Import (M)</td>
<td>17.0</td>
<td>22.1</td>
<td>23.8</td>
<td>18.0</td>
</tr>
<tr>
<td>- Total</td>
<td>177.0</td>
<td>122.1</td>
<td>123.8</td>
<td>9.9</td>
</tr>
<tr>
<td>Uses:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Private Consumption</td>
<td>77.6</td>
<td>60.5</td>
<td>60.1</td>
<td>9.1</td>
</tr>
<tr>
<td>- Public Consumption</td>
<td>9.3</td>
<td>10.3</td>
<td>10.5</td>
<td>12.5</td>
</tr>
<tr>
<td>- Gross Domestic Investment</td>
<td>15.8</td>
<td>20.9</td>
<td>25.9</td>
<td>14.2</td>
</tr>
<tr>
<td>- Export (E)</td>
<td>14.4</td>
<td>30.4</td>
<td>27.4</td>
<td>6.9</td>
</tr>
<tr>
<td>- Total</td>
<td>117.1</td>
<td>122.1</td>
<td>123.8</td>
<td>9.9</td>
</tr>
<tr>
<td>Saving and External Position</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Domestic Savings</td>
<td>13.2</td>
<td>29.2</td>
<td>29.4</td>
<td>22.0</td>
</tr>
<tr>
<td>- Foreign Exchange Earnings (F)</td>
<td>-1.9</td>
<td>-4.5</td>
<td>-5.8</td>
<td>-26.4</td>
</tr>
<tr>
<td>- Total (National Savings)</td>
<td>11.3</td>
<td>24.7</td>
<td>23.6</td>
<td>21.2</td>
</tr>
<tr>
<td>Current Account Deficit Balance</td>
<td>4.5</td>
<td>-3.8</td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td>- ( M - E - F )</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: BPS various issues

The strong performance of the Indonesian economy during the 1970s was associated with rapid increases in private and public consumption, overall investment, domestic savings and foreign exchange earnings. In particular, the oil sector contributed to substantial increases in government revenues and foreign exchange earnings. Based on calculated BPS data, as indicated in Table 12.1.1.2, the increased gross investment to 21.2 percent of GDP in 1980, reflected the strongly improved
resources position as a result of oil resources, foreign investment and high levels of foreign aid. Domestic savings increased even faster and amounted to 29 percent in 1980. Although in real terms consumption increased rapidly, i.e. private consumption at a rate of 9.1 percent and government consumption at 12.5 percent per year, in current prices the share of consumption of GDP declined. As investment increased more rapidly than GDP, the incremental capital-output ratio increased from around 2.2 in the early 1970s to 3.2 around 1980. Thus a development path emerged requiring more and more investment to sustain a unit of output growth.

Table 12.1.1.3
Growth Economic Growth of Industrial; Countries and Developing Countries and Asean 1979-1986

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>1. Japan</td>
<td>5.3</td>
<td>4.3</td>
<td>3.7</td>
<td>3.1</td>
<td>3.3</td>
<td>5.0</td>
<td>4.8</td>
<td>2.5</td>
</tr>
<tr>
<td>2. United States</td>
<td>2.5</td>
<td>0.2</td>
<td>1.9</td>
<td>2.5</td>
<td>3.6</td>
<td>5.8</td>
<td>3.4</td>
<td>2.8</td>
</tr>
<tr>
<td>3. West Germany</td>
<td>3.9</td>
<td>1.5</td>
<td>-</td>
<td>1.0</td>
<td>1.9</td>
<td>3.3</td>
<td>1.9</td>
<td>2.3</td>
</tr>
<tr>
<td>4. England</td>
<td>2.7</td>
<td>2.5</td>
<td>1.1</td>
<td>1.5</td>
<td>3.2</td>
<td>5.2</td>
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<tr>
<td>5. France</td>
<td>3.2</td>
<td>1.6</td>
<td>1.2</td>
<td>2.5</td>
<td>0.7</td>
<td>1.4</td>
<td>1.6</td>
<td>2.1</td>
</tr>
<tr>
<td>6. Italy</td>
<td>4.9</td>
<td>3.9</td>
<td>1.1</td>
<td>0.2</td>
<td>1.1</td>
<td>3.2</td>
<td>2.9</td>
<td>2.9</td>
</tr>
<tr>
<td>7. Canada</td>
<td>3.9</td>
<td>1.5</td>
<td>3.7</td>
<td>3.2</td>
<td>3.2</td>
<td>6.3</td>
<td>4.6</td>
<td>3.2</td>
</tr>
</tbody>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Africa</td>
<td>3.3</td>
<td>3.6</td>
<td>2.0</td>
<td>1.2</td>
<td>1.3</td>
<td>0.8</td>
<td>3.7</td>
<td>2.1</td>
</tr>
<tr>
<td>2. Asia</td>
<td>4.5</td>
<td>5.5</td>
<td>5.8</td>
<td>5.2</td>
<td>7.6</td>
<td>7.5</td>
<td>6.5</td>
<td>6.4</td>
</tr>
<tr>
<td>3. Latin American</td>
<td>6.1</td>
<td>6.0</td>
<td>0.2</td>
<td>1.1</td>
<td>1.9</td>
<td>4.3</td>
<td>2.4</td>
<td>4.1</td>
</tr>
<tr>
<td>4. Europe</td>
<td>3.8</td>
<td>0.1</td>
<td>-</td>
<td>1.1</td>
<td>1.9</td>
<td>4.3</td>
<td>2.4</td>
<td>4.1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Malaysia</td>
<td>9.3</td>
<td>7.6</td>
<td>5.7</td>
<td>5.2</td>
<td>5.9</td>
<td>4.7</td>
<td>3.9</td>
<td>1.2</td>
</tr>
<tr>
<td>2. Philippines</td>
<td>6.9</td>
<td>4.4</td>
<td>5.6</td>
<td>1.7</td>
<td>1.3</td>
<td>3.5</td>
<td>7.9</td>
<td>2.0</td>
</tr>
<tr>
<td>3. Singapore</td>
<td>9.1</td>
<td>10.3</td>
<td>9.9</td>
<td>9.3</td>
<td>5.4</td>
<td>7.9</td>
<td>8.2</td>
<td>1.7</td>
</tr>
<tr>
<td>4. Thailand</td>
<td>6.1</td>
<td>8.6</td>
<td>8.4</td>
<td>5.7</td>
<td>6.0</td>
<td>8.4</td>
<td>3.0</td>
<td>1.0</td>
</tr>
<tr>
<td>5. Brunei</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>6. Indonesia</td>
<td>6.3</td>
<td>9.9</td>
<td>7.9</td>
<td>8.4</td>
<td>4.2</td>
<td>6.0</td>
<td>5.2</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Source: BAPEPAM various issues

Table 12.1.1.4
Comparison of Growth Performance between ASEAN Countries and South Korea in 1982

Please see print copy for image

World Bank (1984)
During the 1980s, Indonesia experienced a sustained rapid rate of growth compare to other countries. As indicated in Table 12.1.1.3, between 1979 and 1986 the Gross Domestic Product (GDP) increased at an average of 6.1 percent per year above the rates recorded in most other developing countries during the same period. As a result, per capita GDP had increased to US $ 580 by 1982. According to World Bank report (1984), as indicated in Table 12.1.1.4 within this figure Indonesia was for the first time classified in the group of lower middle-income countries.

In comparison with the economic development of 1980 to 1989 which was initialised by world recession and the fall of export prices in oil and gas, economic development in Indonesia since 1989 has indicated an up swing. At that time many economists predicted that 1989 was the starting point of an economic boom, which was what happened in 1970, when the Gross Domestic Product growth reach 7 percent per annum on average. The reasons for this were that oil and gas prices increased over those of the previous years. There was also a structural adjustment change to strategy development, which was oriented to oil and gas production, into a diversification of products other than oil and gas. This strategy was set up in the late 1980s in order to continue the program of macro economic stability, high growth and equity.

Since the regulation was introduced by the government in 1983 and continued until 1988, economic development in this country increased. As indicated in Table 12.1.1.5 in 1989, the Gross Domestic Product in this country was 7.5 percent, that is, 38 percent higher than the average growth in the period 1986-1988. The robust economic growth in 1989 caused the government to consider that the economy was over heating. The rapid growth of GDP will create an increase in consumption and will then increase the inflation rate. In other words, the national goal of stability could not be maintained. Accordingly, in 1990, the government began to slow down this growth, by addressing some monetary policies such as converted money supply, especially from public companies, into certificates of the Central Bank and releasing liquidity preferences for the bank. These policies caused economic growth in 1990 to
Investment Decisions and the Puzzle of Share Price Movements

become 7.2 percent, or 4 percent less than 1989. This growth is still considered higher than the economic boom in 1970. Accordingly the cooling down of the economic overheating in 1991/1992 was considered to be necessary.

Table 12.1.1.5
Gross Domestic Product and Inflation Rates

<table>
<thead>
<tr>
<th>Period</th>
<th>GDP 1)</th>
<th>Inflation Rate 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973 - 1982</td>
<td>7.5</td>
<td>18.2</td>
</tr>
<tr>
<td>1983 - 1985</td>
<td>6.0</td>
<td>9.0</td>
</tr>
<tr>
<td>1986 - 1988</td>
<td>5.4</td>
<td>8.6</td>
</tr>
<tr>
<td>1989</td>
<td>7.5</td>
<td>6.5</td>
</tr>
<tr>
<td>1990</td>
<td>7.2</td>
<td>7.4</td>
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<tr>
<td>1991</td>
<td>6.9</td>
<td>7.6</td>
</tr>
<tr>
<td>1992</td>
<td>6.4</td>
<td>7.5</td>
</tr>
<tr>
<td>1993</td>
<td>6.5</td>
<td>10.2</td>
</tr>
</tbody>
</table>

Source: 1) BPS; 2) IMF

In 1993, Indonesia completed its rapid cooling down of the 1990 overheating. The macro economic developments in 1993/1994, which largely reflected tax, monetary and exchange rate policies, could respond to the economic changes, either internally or externally changing into stable economic growth and reduced poverty. The World Bank noticed the achievement of economic performance over 25 years. In its report, the World Bank (1994) stated that Indonesia's economic performance over the past 25 years had been one of the best in developing countries. Average economic growth exceeded 6 percent and the inflation rate was less than 10 percent and the incidence of absolute poverty was reduced from 60 percent of the population to about 14 percent.

2.1.2. Balance of Payments

As mentioned in the previous section, in the 1970s Indonesia's external resources position was heavily influenced by the oil sector. Based on BPS data on the current account of the balance of payments, the share of oil and gas of total exports increased from 39 percent in 1971 to 75 percent in 1980. In spite of the dominance of
oil and gas in the increased export earnings, the export of some other products, especially coffee, palm oil and timber also increased substantially during the 1970s, due to the international economic boom in this period.

During 1975/1976 the balance of payments was characterised by an increasing resource surplus of the trade balance. By 1980/1981, the current account turned surplus came to 6.512 billion rupiahs. Price effects played a major role in improving Indonesia's balance of payments position in the 1970s. Based on the Central Bureau of Statistics (1981) data, the terms of trade index had augmented from 54 in 1971 to 216 in 1980 based on constant prices in 1975. Obviously, the increase in the terms of trade index was largely due to the increase in oil prices.

The tremendous increase in foreign exchange earnings also brought problems. One of the effects, according to Rosendale (1981), was that it led to an expansion of the domestic money supply and consequently to higher rates of inflation. The increase in the money supply was fuelled by a massive expansion of bank credit and by a growing domestic deficit in the government's budget. High rates of domestic inflation led to declining real income in the non oil traded-goods sector, including that of growers of agricultural export commodities, as well as labor-intensive export and import competing industries.

In order to reverse this trend a major devaluation of the rupiah was carried out in 1978, fixing its value at Rp 625 against the US $ from a previous rate of Rp 415. This devaluation had a favourable effect on export prices. As indicated in the previous chapter (Table 7.2.1), in 1980 the index of non-oil export prices was more than twice as high as the price index for import commodities. During the early years of the 1980s, the terms of trade stabilised, with import prices and export prices increasing at comparable rates.
An important aspect of the balance of payments situation relates to debt servicing. According to the World Bank Report (1984), in 1980 the foreign debt burden was about US$ 15 billion, or 58 percent of the country's exports and 20 percent of its GDP. Public debt servicing was less than US$ 2 billion, or 8 percent of total exports. As a consequence of the balance of payments problems which arose in subsequent years, Indonesia's external debt and debt servicing obligations increased, but was considered as remaining within manageable levels.

During the first few years of the 1980s the Indonesian economy was severely hit by a number of adverse developments. First of all, the international oil market suffered a serious depression. According to OPEC agreements in response to this depression, Indonesia had to cut back its production of oil from a production of 1.6 million barrels per day in 1981 to 1.3 million in 1982. This was followed in 1983 by a reduction in the price of oil from US$ 34 to US$ 29 per barrel. Further substantial oil price decreases occurred in 1986 with prices averaging at about US$ 15. Furthermore, Indonesia was affected by the general deterioration of the world economy which resulted in both declining prices and volume of Indonesia's traditional primary export commodities. As a result of these developments a complete stagnation of economic growth occurred in 1982. During the whole period 1980 to 1984 the average annual growth rate of GDP declined to 4.2 percent per year as indicated in Table 12.1.1.5

It should be noted that, by 1984, the share of agriculture in GDP had declined to only 24 percent. As a consequence of lower oil production and oil price levels, the share of mining also decreased. The recession also resulted in a dramatic turnaround in net foreign exchange earnings. In 1981/1982 the current account suffered a deficit of almost US$ 3 billion as compared to a US$ 2 billion surplus in the two previous years. In 1982/1983 the current account deteriorated further, experiencing a deficit of about US$ 7 billion, which amounted to 38 percent of the value of exports in that year. In addition, the government's budget was seriously affected as total revenues stagnated in 1982/1983, while oil revenues actually fell.
With the prospect of still worsening conditions, the government decided to take a number of fundamental measures to tackle the situation. These included reducing public expenditure, especially public investment, reducing government subsidies on food and oil products, devaluation of the rupiah by 28 percent in March 1983, from Rp 700 to Rp 970 against the US dollar, rescheduling the implementation of a number of large investment projects, deregulation of the banking system in order to generate more domestic savings, and a number of tax reforms to raise government revenue.

In combination with a slow recovery of the international economy, these measures had an immediate favourable impact. Exports started increasing again, especially of non-oil products, and imports were successfully curtailed. As indicated in the BPS report (1985), the balance of payments improved considerably. The trade balance turned positive again in the years after 1983/1984, while the deficit in the current account could be contained at US$ 2 billion in the years 1984/1985 and 1985/1986. Moreover, international reserves decreased from a low US$ 3.1 billion in March 1983 to US$ 2 billion by April 1984.

Internally, the effect of rephrasing public sector projects resulted in a 17 percent decline in real terms in public investment in 1983/1984 compared to 1982/1983, while government revenues increased above expectations, especially for non-oil revenues. The share of oil revenues, however, continued to record a steady decline. On the expenditure side substantial savings were achieved on various subsidies. With regard to the budgetary deficit, it can be calculated that in 1983/1984 the foreign surplus fell sharply to only 0.4 percent of GDP, while the domestic deficit fell only slightly to some 6.3 percent of GDP. As a consequence, the overall budget deficit rose to around 6 percent of GDP compared to only 3.5 percent in 1980/1981. Due to further oil price decreases in 1986 from US$ 28 to an average of US$ 15 per barrel, oil revenues were reduced to 45 percent of total government revenue in 1986/87. Therefore, major reductions were foreseen in the development budget for the coming years. In response to the poor economic outlook, the rupiah was devaluated
Investment Decisions and the Puzzle of Share Price Movements

once more in September 1986 from Rp 1.130 to Rp 1.640 for the US dollar, in order to increase the rupiah's value of foreign exchange revenues and to improve the international competitiveness of non-oil commodities.

The prospects and targets for economic development during the second half of the 1980s were laid down in Repelita IV. The major goals of economic development in this Five-Year Plan were agricultural development in order to retain self-sufficiency in food and to provide raw materials for industrial processing, and the development of heavy and light machinery industry to generate growth potential in the longer term. In addition, a number of social objectives would remain important, including the development of lagging regions and meeting basic needs for the poor. Major efforts were also made to improve the transport and communication infrastructure. With regard to foreign trade, priority was given to the promotion of non-oil/LNG exports and to import substitutions.

Since the Fifth Five Year Plan, the non oil export growth has became the key factor in Indonesia's economic performance over the Sixth Five Year Plan. As mentioned in the World Bank Report (1994), in 1983/84-1985/86, the development budget represented 10-12% of Gross Domestic Product (GDP). The adjustment to the drop in oil prices led to a fall in the development budget to an average of 8.5% of GDP in 1989/90-1993/94 (excluding development expenditure for reserves). The development budget is projected to decline somewhat further, to an average of 8.1% of GDP during the Sixth Five Year Plan. At the same time, the development impact of this budget has improved substantially. The share of the development budget spent on general government services, public enterprises and subsidies has declined substantially, while the shares spent on education, health and infrastructure have risen.

The non oil exports are programmed to grow 16.8% p.a. in dollar terms during the Sixth Five Year Plan. Although fairly rapid, this growth rate is somewhat less than the 17.9% p.a. average rate during the Fifth Five Year Plan. In contrast, the oil and
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gas exports are likely to stagnate during the Sixth Five Year Plan. Real oil exports are likely to decline as a result of rising domestic consumption and declining reserves. As a result, Indonesia is projected by the World Bank (1994) to become a net oil importer by the end of the century.

12.1.3 Income Distribution and Poverty

How widely the benefits of economic growth spread in Indonesia is, to an important extent, reflected by changes in income distribution and poverty. But before turning to the distribution of income, the income per capita will briefly be examined. As has been discussed in the previous section, since the regulation was introduced by the government in 1983 and continued until 1988, economic development progressed. However, based on the report made by the World Bank in 1990, the Gross National Product (GNP) of Indonesia decelerated in income per capita. The income per capita in 1988 decreased compared to US $ 542.97 in 1983. In 1988, the income per capita was US $ 484.24 lower than in 1983.

Table 12.1.3.1

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<td>1980</td>
<td>67,510.6</td>
<td>45,445.7</td>
<td>146,361.7</td>
<td>310,502.8</td>
<td>626.9</td>
<td>495.29</td>
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<td>1981</td>
<td>72,862.3</td>
<td>58,127.7</td>
<td>149,677.3</td>
<td>358,350.1</td>
<td>631.7</td>
<td>614.80</td>
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<td>1982</td>
<td>73,555.1</td>
<td>62,475.7</td>
<td>152,988.2</td>
<td>408,369.5</td>
<td>661.6</td>
<td>617.28</td>
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<td>1983</td>
<td>77,622.8</td>
<td>77,622.8</td>
<td>156,372.2</td>
<td>496,397.7</td>
<td>914.2</td>
<td>542.97</td>
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<td>1984</td>
<td>83,037.4</td>
<td>88,885.1</td>
<td>159,831.1</td>
<td>562,375.5</td>
<td>1,031.4</td>
<td>545.97</td>
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<td>1985</td>
<td>85,091.9</td>
<td>96,996.8</td>
<td>163,104.6</td>
<td>594,690.8</td>
<td>1,117.0</td>
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<td>1986</td>
<td>90,080.5</td>
<td>102,682.6</td>
<td>166,488.6</td>
<td>616,754.5</td>
<td>1,293.6</td>
<td>477.03</td>
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<td>1987</td>
<td>94,517.8</td>
<td>124,816.9</td>
<td>170,178.5</td>
<td>733,465.9</td>
<td>1,549.3</td>
<td>444.93</td>
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<tr>
<td>1988</td>
<td>99,981.4</td>
<td>142,104.8</td>
<td>173,799.2</td>
<td>817,637.8</td>
<td>1,688.5</td>
<td>484.24</td>
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<tr>
<td>1989</td>
<td>107,435.6</td>
<td>167,184.7</td>
<td>177,362.5</td>
<td>942,615.8</td>
<td>1,772.5</td>
<td>531.80</td>
</tr>
<tr>
<td>1990</td>
<td>115,110.0</td>
<td>196,919.3</td>
<td>179,520.6</td>
<td>1,105,320.7</td>
<td>1,845.1</td>
<td>594.07</td>
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<td>1991</td>
<td>122,705.0</td>
<td>227,162.8</td>
<td>181,671.4</td>
<td>1,250,404.9</td>
<td>1,951.6</td>
<td>640.71</td>
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</tbody>
</table>

Source: Central Bureau Statistic

From the other side, , in come per capita was calculated from the Gross Domestic Product (GDP). The GDP of Indonesia, based on the report made by the World Bank in 1990, decelerated in income per capita. In 1988, income per capita was
US $ 440.20 percent lower than in 1983. The Governor of the Central Bank of Indonesia argued that the decreased income per capita in 1988 was a result of the decrease in domestic currency (rupiahs) exchange rates and an increase in population. Furthermore, he stated that, even though per capita income was decreasing, in fact the Indonesian economy was growing, which could be seen from Indonesian society in general. Based on the Indonesian Central Bureau of Statistics, the decrease in income per capita can be seen in dollar terms as indicated in Table 12.1.3.1.

From Table 12.1.3.1, it can be concluded that the income per capita in Indonesia during the period 1986 to 1988 decreased, and from 1989 to 1991, the income per capita increased in dollar terms. In 1991 the income per capita was US$ 640.71. However, this figure was very low compared to the other Asean countries such as Malaysia and the Philippines. Table 12.1.3.2 shows the income per capita in Indonesia compared to other countries.

<table>
<thead>
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<th>Table, 12.1.3.2</th>
<th>Income per capita among countries</th>
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<tr>
<td>Indoneisa</td>
<td>430</td>
</tr>
<tr>
<td>The Philippines</td>
<td>690</td>
</tr>
<tr>
<td>Thailand</td>
<td>670</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1,620</td>
</tr>
<tr>
<td>Singapore</td>
<td>4,430</td>
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</tbody>
</table>


Moreover, the presidential speech on August 16, 1993, gave more descriptions concerning the income per capita in Indonesia. The president stated that the income per capita was still below the Asean countries such as the Philippines and Malaysia. The income per capita for the Philippines and Malaysia in 1993 was US$ 835 and US$ 2,965 respectively. By the end of the Sixth Five year Plan, in the year 2000 the income per capita of Indonesia is estimated to be more than $ 1,000. The president stated that this condition could only be achieved if economic growth was 6.2 % p.a.
Further analysis concerning the income per capita indicates that the distribution of income, between the rural and urban areas, and also between the rich and poor during the 1970s was unequal. It shows in the World Bank report (1984) that the resource-rich outer islands had grown more rapidly in terms of Gross Domestic Product (GDP) per capita than Java, even when excluding the contribution of the oil sector. As a consequence, regional inequalities in GDP widened during the 1970s to the disadvantage of Java. However, the figure also reveals that living standards, as reflected by per capita consumption, were much less unequal. The World Bank (1984) attributed the lower inequality of consumption largely to taxation and to the redistribution of government spending.

Major trends in aggregate levels of living can be discerned from household survey data on monthly per capita expenditure. Such data are presented in the Central Bureau of Statistic (BPS) statistical yearbook (1982), and Huges and Islam (1981). As these figures are in nominal values, appropriate price indices have to be applied in order to derive changes in real levels of living depending on the choice of the price index. The World Bank (1979) found that, between 1970 and 1976, real consumption levels increased by a total of between 35 and 50 percent in the urban areas of Java, by between 24 and 32 percent in the urban areas of the Outer Islands, by between 11 and 19 percent in rural Java and by approximately 14 percent in the rural areas of the Outer Islands. These figures therefore suggest substantial improvements in the level of living, especially in urban areas. It is clear though that the derivation of changes in the real level of living is very sensitive to the choice of the price deflator.

Taking into account inflation, per capita expenditure in rural areas continued to increase by only about 2 percent per year in the period 1976 to 1978, while urban consumption increased at a much higher 6.5 percent per year during the same period. It would seem, however, that after 1978 a dramatic reversal occurred, at least in urban consumption. Urban consumption was 10 percent lower in 1980 than in 1978. On the other hand, rural consumption per capita apparently continued to grow unabated at a
gradual pace of some 2.5 percent per year between 1978 and 1980. The decline in urban consumption levels may be associated with attempts by the government to control nominal wages in the wake of the November 1978 devaluation to keep inflation under control. However, a decline in the growth in real consumption in the years 1978 to 1980 is not corroborated by other data. National accounts data reveal that the real private consumption growth in 1979 and 1980 at 14 percent per year far exceeded consumption growth for the period 1976 to 1978.

An analysis of interpersonal income distribution in Indonesia shows some distinct patterns. The major trends for the period 1970 to 1978 are increasing inequality in urban areas, particularly on Java, and declining inequality in the rural areas, largely as a result of declining inequality in the outer islands. After 1976, the BPS statistical yearbook (1982) shows a marked increase in inequality in 1978, as measured by the Gini coefficient and the percentage distribution of expenditure, in both the urban and rural areas of Indonesia. On the other hand, 1980 data, again show a reversal in the trend for both urban and rural areas, i.e. a move towards more equality. With regard to urban areas, income distribution is less unequal in 1980 compared to 1978, but still more unequal than in 1976. These data according to Booth and Sundrum (1981) indicate that "the fruits of the rapid economic growth that has taken place in urban Indonesia in the period since 1970 have been very unequally distributed among the urban population".

In addition to the investigation of patterns of relative levels of living, it is of major interest to examine absolute levels of poverty and the impact of economic growth on the incomes of the poor. Interest in the magnitude of absolute poverty has especially been raised in the context of basic needs satisfaction. The inability to satisfy basic needs such as food, clothing and shelter is largely the result of inadequate income; in turn, inadequate incomes can be associated with the lack of productive employment.
In a large and diverse country like Indonesia, regional imbalances in poverty and income according to Islam and Khan (1986) are likely to be substantial. This is confirmed by a study using provincial data. This study presents a grouping of provinces in terms of poverty as well as inequality. It turns out that seven provinces have both relatively low poverty and inequality. With the exception of Bali, these provinces are either located on Sumatra or on Kalimantan. At the other extreme there are seven provinces which have both high poverty and high inequality including all provinces of Sulawesi, Lampung, East Nusa Tenggara and Maluku. Jakarta is characterised by low poverty, but high inequality.

The analysis of trends in poverty has been conducted at a much more aggregated level. Data on poverty in Indonesia in the years 1970 to 1980 are presented in a World Bank report (1984). On the basis of household expenditure data and an assumed poverty line, this report found that poverty in Indonesia had substantially declined in the 1970s, as indicated in the World Bank report (1984). The most remarkable developments have been a very rapid reduction in poverty in urban areas, where the proportion of the population below the poverty line decreased from 51 percent in 1970 to only 20 percent in 1980. The reduction of poverty in rural areas was less dramatic, but still significant, from 59 percent of the population in 1970 to 45 percent in 1980. Moreover, the incidence of poverty is clearly much less serious on the Outer Islands than on Java.

Whether the reduction of poverty has been as dramatic as the figures indicate can be questioned. Questions have been raised on the data used, but also on how these improvements could have been achieved. With regard to rural areas, especially on Java, the developments in the agricultural sector are characterised by increasing land displacement of tenants and a reduction of labor inputs. In the previous section it was shown that the unfavourable trend in agricultural employment could, to a large extent, be compensated by employment growth in manufacturing and in the tertiary sector. It is questionable, however, whether these jobs are more productive. Recent
fragmentary data broadly indicate that real wages did not increase significantly during the 1970s (World Bank, 1983; and Papanek, 1981). The finding of stagnant real wages in combination with rising per capita consumption levels supports the view of deteriorating income distribution in Indonesia.

Other measures which can be used to assess changes in poverty are, for example, developments in real food consumption of the poor, and changes in food consumption as compared to total consumption. Real food consumption can be approximated to the rice equivalent of total expenditure on food. The BPS statistical yearbook (1982) and BPS Susenas (1976/1980) show that between 1970 and 1980 the rice equivalent of food consumption of the poorest 40 percent of the rural population largely stagnated. For urban areas it recorded a substantial increase up to 1976, but stagnated in the following years.

On the other hand, the BPS report also shows that the share of food in total consumption is slowly declining. Such a trend would suggest, in view of Engel's Law, a real increase in consumption. Obviously, the measurement and analysis of income distribution indicated that poverty remains an important area for further research. It remains undeniable, however, that a substantial proportion of the Indonesian population, i.e. 40 percent according to the World Bank Report (1984) has below poverty-line levels of income and is therefore unable to satisfy its basic needs.

During the 1980s, income distribution in this country was not much different than in the 1970s. Even though there is much progress to the income per capita, however, the problem of the inequality of income is still an issue in this country. Peter Timmer (1992), Professor in economic development studies at Harvard University, argued that efforts to increase the equality of income are becoming more difficult for a country like Indonesia, due to the decline of the agricultural role. Furthermore, he argued that redistribution of income through tax and subsidies is not a good way of solving the problem of inequality of income.
The need to structure adjustment for economic development back to the 1960s, is considered the best way to achieve equality of income, otherwise, the problem of inequality becomes crucial in the development of this country for the near future. Accordingly, in the Fifth and Sixth Five Year Plan, the government still considered that the main target of those plans was continuing stability, growth and equity. One of their programs was continuous reduction of poverty.

As indicated in the World Bank report (1994), the initial, the year of 1971 incidence of poverty was severe, especially in Java. During the 1970s, poverty declined in all regions, although the decline was faster outside Java. However, in the 1980s, the pattern was reversed. According to the World Bank report (1994) poverty in Java during 1980s fell by more than one-half (from 47% to 19%). Outside Java, the decline in poverty slowed. By 1990, the incidence of poverty in both Java and outside it was about the same level. However, according to the World Bank report (1994), this level was much lower than in most other developing countries. At the beginning of the Sixth Five Year Plan, the absolute incidence of poverty was reduced to about 14%.

12.2. THE IMPACT OF POLITICAL-ECONOMIC POLICIES ON SOCIO-POLITICAL FACTORS

Indonesian economic development, cannot be separated from the socio-political processes that exists in this country. As mentioned earlier, after Indonesia gained its independence, the government faced many difficulties concerning the economic and socio-political climate. Since the President Suharto was elected, the New Order became the ruling class in this country. In general, economic development is becoming better than before. Some people argue that the process of this development has been rooted in the political nature of this country. The basic assumption underlying this argument is that there is an association between the national warfare and the political system. They argued that Indonesian economic conditions declined in the past because the government did not adequately develop the political system in this country.
Based on this argument, the Indonesian government was aware that there were at least 4 (four) factors which had to be considered in developing a political strategy. Those factors were: (1) ecology (2) history (3) social structure and (4) value system and ideology. Besides considering those factors, the government also needed the participation of the society. Without any participation from society, those policies could not be well implemented by the people. Some regulation packages and other policies such as the political strategy which related to economics, finance, taxes and other areas that were introduced since the 1960s, were the political strategy of the New Order. Accordingly, it can be argued that all activities related to economic development are political in nature.

Understanding economic development without any consideration of the political system is a mistake. Political and socio-economic factors must be analysed very carefully in order to get a better understanding of the development of the economy in a country. Political factors become the basic consideration for any economic development and also in the development of social culture. Mark Saunders (1994), the president of Credit Lyonnais, for instance, argued that the issues related to the development of the stock market in Indonesia. He said that the Indonesian market could overtake the Thailand and Malaysian markets in the next few years if there was political stability in the country. Accordingly, this section will discuss the process and the political climate in this country.

12.2.1 The Political Process

Since the 1970s, after the era of Sukarno, the national development strategy by the New Order was directed to three areas, namely, growth, stability and equity. Although any one of this area could take priority, these three areas still remain the national objective of development. In order to better understand the political strategies that were implemented by the Indonesian government. It is necessary to consider some comments concerning these strategies. King, D. (1977) and Reve, David (1985), for instances, have argued that the pattern of Indonesian government, in organising some political organisations, since 1970s, is somewhat based on the root of corporatism.
Stepan (1978, p. 46) stated that corporatism is a particular set of policies and institutional arrangements for structuring representative interests. Where such arrangements predominate, the state often charters or even locates interest groups, attempts to regulate their number, and gives them the appearance of a quasi-representational monopoly along with special prerogatives. This argument was advocated by some others such as Cruch (1979) Mackie, J. (1986), Robinson (1988), Liddle (1987) and Maclntyre (1988).

Cruch (1979) has argued that the politics of the New Order were a combination of bureaucratic-patrimonialism and bureaucratic-polity. In this model the picture of government-business relations presented is still, to a large extent, valid at present despite the rise of some big conglomerates and the possible long term implications of this in the future. Mackie, J. (1986, p.17-18) also confirmed this kind of relationship. He stated that, for all the talk we have heard since the early years of the New Order about the close connections between wealthy Chinese - cukong, and powerful Indonesian generals, there is little evidence that any of them have been able to carry much weight in the general decision making processes that determine the broad outlines of national economic or social policy formulation (eg. exchange rate policies, budgetary allocations, industrial priorities, etc.): at most they can exert some influence over particular decisions about the allocation of contracts, licenses, credits and so on.

On the other hand, Robinson (1988) argued that the political policies under the New Order were similar to the model of neo Marxists, whereas the capitalists did not have significant influence in the processing of policies. Although there is some support from them, the policies still remain under the army and some selected people. This kind of authoritarianism is strengthened through consolidation between government units and some corporatist ideology. Last, but not least, some other researchers such as Liddle (1987) and Maclntyre (1988) argue that the formulation of policies in the New Order, in some cases, are also influenced by other factors such as public opinion,
producers, consumers and the national ideology Pancasila. Pancasila according to Liddle (1987) has become the main reference in the decision-making process of government policies.

Based on the description above, it can be concluded that, since the New Order became the ruling class in this country, it has implemented a variety of models in policy development but these policies depend on, and are related to, developments in national awareness. It is also concluded that, although there are some political issues that emerge in every period relating to those policies, the political climate in Indonesia is still considered stable after 25 years.

The 1980s, can be regarded as the turning-point in the development of the Indonesian political process. We now have a greater hope of democracy. The turning point was the introduction of the term "openness" by the government. It is easy to understand that, since the 1980s and the beginning of the 1990s, it seems that people are starting to have the courage to express their opinions.

In the early 1990s discussion about leadership was also an important part of the democratisation process in Indonesia. This discussion came to a climax just before the 1992 general election after the president announced the structure of "Kabinet Pembangunan VI" (Ministry Development Cabinet VI) for the period 1992-1997. Greater democracy appeared hopeful, due to the decreasing number of active military members in the Cabinet, and the increasing role of civil members, who tended to be technocrats.

However, many observers predicted that political developments after the 1992 election and after the president announced the cabinet, were still based on the authority of the government's power. The people's role is not great in determining its role in the political process. Observers said that this is caused by the growth, in government centers, of nepotism and the underlying traditional values that promote community and
consensus above individual opinion. Therefore, they argue that the political will tends towards state policies and it will holding the democratisation process in this country.

Therefore in order to understand the political prospects after the 1992 election, there is a need to know expression by the people about the Cabinet. Comments will come from people who have a good understanding of the new policies introduced by the government. Although there are some conflicts, there is some agreement and hope for the development of politics in this country.

Kwik Kian Gie (1994), the Chairman of the Dewan Pengurus Pusat (DPP) Parati Demokrasi Indonesia (PDI) Research and Development Center, argued that the structure and composition of the Cabinet is appropriate enough at the moment. Although there are many new persons who are relatively young, they are experienced in bureaucratisation. The regeneration process being taken by the government every five years desirable and indicates that our country is mature and capable. The process of regeneration every five years is positive, as long as the new persons are capable and competent. Furthermore, he stated that the technologists joining the Cabinet are not intending to replace the current economic policies, the current economist theory of RMS (Radius, Mooy and Sumarlin). However, such replacement is needed to for regeneration and a major function of Cabinet is to save as counsellors to the president.

In other words, the policy of Widjojo Nitisastro, has not been replaced by the policy of Habibie. In fact, the development concept of Widjojo is still being implemented. Widjojo is currently is a presidential adviser, he had a significant at the CGI (Consultative Group for Indonesia) meeting in 1993. Kweek elucidated on Habibie's drafted concept for development of science and technology, in which he considered the important development of human resources. This concept was also mentioned in the earlier policy by the economist Widjojo so it is not totally new in this country.
What Mr Kwiek said was also strengthened by H Alamsjah Ratuperwiranegara, the ex Minister of Religion and Welfare. Mr Alamsjah (1994) said that it is not true that technologists dominate the Cabinet. It is also not true that technologists replaced economists. The process of replacement is an ordinary matter. The technologist, who is Minister of Education and Culture is in accordance with the State Policies (Garis Garis Besar Haluan Negara). Furthermore, he stressed that Mr Suharto had not been dictated to by a certain person (BJ Habibie or Wijojo). All of them are the president's assistants. They can propose a program, but if the president doesn't agree with it, it will not be put in place and if the concept proposed is agreed to by the President, it becomes the President's concept. Furthermore, he argued that this was why this country was still behind other countries. This was because of the low level of hi-tech development and infrastructure. We have raw material which cannot be processed. The producers of products get better value than the producers of raw materials. The added value of the products belongs to importers of raw materials that exist in developed countries.

He also asked the people not to worry about hi-tech developments, because these accounted for less than 1 % of government budget. The people in developed countries needed to worry because if Indonesia has hi-tech, the market potential of such developed countries, could decrease in the near future as Indonesia's dependency on developed countries decreases. The Indonesians who criticize the hi-tech application policy are those who feel jealous of Habibie, but this is human nature. Criticisms from other countries of the policy of hi-tech applications is also considered logical by Alamsjah.

Dawam Rahardjo (1994), Professor of economics at the University of Muhamadiah, Jakarta, also said that there was no domination by technologists in this Cabinet. However, he saw that there was a decline in Wijojo's group and an increase in BJ Habibie's group although Habibie's group currently dominated the Cabinet, he believes that the leaders still come from the political side. Dawam also underlined the comment of Kwiek concerning the domination of technologist. He stated that Habibie's
concept is not clear enough so it could be difficult to be implemented. The technologist’s concept stresses the development of technology and science through the development of human resources under a state budget, so that there is a need to provide some protection by subsidies from the government. If this is so, according to this prominent economist, the concept of deregulation cannot be matched. In other words, the concept of Wijoyo cannot be replaced by the concept of Habibie.

He stated further that although many of Habibie’s ideals can be subjected to criticism. But some of Habibie’s ideals also requires our attention. For example, the idea of Habibie for the rapid development of hi-tech industry in the near future. However, as it would be a problem to implement this in the short-term, he stressed that this idea has to be long term plan. Our problem now is a matter of innovation, of transferring inputs of technology into production to be sold in the market. That is why economic consideration is very much needed. The development of technology should be accompanied by mature economic consideration. Critics of Habibie’s concepts from other countries are not correct when they say that Indonesia will have a big burden. In correspondence with Alamsjah, he also stated that if the concepts were not applied, we would always be dependent. I think, we should support Habibie’s willingness to be free from technological dependency. To relieve the burden, according to Dawam, the concept should be balanced with pragmatic development activities. Furthermore, these two concepts are in accordance with the main objective of state development that is to reduce the poverty.

Hadi Soesastro (1994), Director of the Executive Centre for Strategic and International Studies (CSIS), also argues that the policy taken by Cabinet, the techno-economic approach, tends to give priority to the development of technology rather than to solve economic problems. He argues that, at present, our society is not ready to have that kind of development. This kind of development will cost much. Accordingly, he argues, the only way is to invite foreign investment into this country.
On the other hand, Dipo Alam (1994), Chief of the Executive Officer ICMI, Assistant Minister of National Development Plan (Ketua Bappenas), argues that the techno-economic approach has already been discussed in developed countries such as the USA. This approach tries to associate investment with technological change. This problem was discussed in the Journal of Economic Literature in association with the development of economic literature i.e., Neo Schumpeterian and Post Keynesian. So this is not Habibie’s concepts. The essence of Habibie’s techno-economic concept, is the technological perspective of the quality of human resources as mentioned in the state development, Garis Garis Besar Haluan Negara (GBHN). So this is not identical with the existence of both the two existing projects, IIPTN and BPIS. Some people were suspicious that Habibie gave priority to those projects because they would absorb budget funds. On the other hand, we need a lot of funds to increase our welfare by creating quick yielding projects to reduce the social gap between rich and poor.

He also stated that the gap, actually, is not because of this concept but because of others, such as the policies and concepts of the economist i.e., Sumariin, that caused the people to tend to become large consumers of goods. At that time, the economists concepts introduced an open policy to investment in producing capital goods. However, in fact, the investment did not produce capital goods but consumer goods. Accordingly, critics to the technologist’s concepts to provide protection and subsidise on some projects is not relevant. Most countries use this policy. The newly developed countries, such as Japan, used this policy so that they could have competitive advantages over other older developed and newly developed countries.

Last, but not least, the prominent rural-economist, Mubyarto (1994), Professor of Economics at the University Gajah Mada and Assistant Minister of National development Plan (Ketua Bappenas) argues that the onset of technology in the Cabinet could not be associated with the era of techno-economics because of the process of regeneration. He is not arguing that the group of technologists has greater influence over the policies of government, but he asked that the issue of technologists...
or economists not be made too important. He argued, that the government was still committed to the state development plan (GBHN).

He stated further that the problem in this period of development (in PJPT II) was not the issue of technologists versus economists in the Cabinet but more a problem related to foreign loans. In the state development, the government indicated in PJPT II we should be less dependent on foreign loans. On the other hand, foreign countries do not consider whether people in the Cabinet are technologists or economists, but rather whether this country can pay the interest and the instalments, on foreign loans.

Related to his concern in development of rural areas, he stated that the dependency on centralised economic policy could foster regional dependencies and therefore dependency on foreign loans. To combat this Mubyarto suggest that every region must have its own development pattern, based on the people aspirations. as long as the basic pattern of development is not so different with the general pattern of national development.

After the general election in 1992, the political climate in Indonesia could be said to have remained in a stable condition. In order to understand the political process of the government, this study needs to discuss the political strategy used by the government in creating the political climate in this country. One of the strategies used, is related to the dual function of the military in this country. This issue has long been discussed among people in Indonesia.

Those in favour said that from the historical perspective, compared to some developed countries, the Indonesian military has played a meaningful and important role in the political strategy of this country. From the time of Indonesian independence the people believed that the military had an important role in this country. In 1959, when no new constitution existed under the parliament system, the military gave
impetus and support for the return of the basic constitutions that Indonesian already had. When the coup was instigated by communist party in 1965, the military again played an important role in stabilising conditions. On the other side, those against said that the dual function of the military should not be continued. They said that the dual function should only be maintained when Indonesia was in a bad political condition, and there was no need at present as conditions were stable. Others argued that the dual function should be maintained but the implementation had to be controlled, otherwise this dual function was not worth while. The dual function had to be directed to the existing constitution which was established in 1982. The constitution states that the military is not directed to dictate the government. Accordingly, the military had to become a pioneer in developing democracy-Pancasila and skilful in implementing and following the existing constitution in all activities.

The development of the political climate can also be associated with the awareness of the law by the people of Indonesia. During the period of the New Order, especially after the government become more open to the people, awareness of the law became an issue especially in the 1980s. This law issue was mainly associated with the implementation of Articles Nos. 27 and 33 of the Indonesian Constitution of 1945.

It is generally recognised that Indonesia is a state government under a Constitution. During its historical development, Indonesia has experienced constitutional change three times. Based on a Presidential decree on 5 July 1959, Indonesia returned to the first constitution, Undang Undang Dasar 1945 (UUD 1945). Also in the period of the New Order, this ruling class committed itself to keeping up the implementation of this constitution.

As the development of activities becomes more complex the limits of regulation becomes obvious, so in order to carry out these activities within the constitution, under amendment No.2 of UU D 1945, allows the use of other regulations
such as Dutch Law which has been used in the past as long as it is not of odds and which still correspond with the current constitution.

Although there are fundamental laws and regulations which can be used in dealing with some activities in this country, the need for more regulation and a more committed law has become an issue in the past few decades. First, there is a need for monopoly regulation, anti trust legislation, and also capital market regulation. In a seminar on 14 June 1991, at the University of Indonesia, for instance, Gregory Churchill, a Professor from States University, argued that "anti trust legislation needed to be compromised. A consensus is important. Support from other bodies and awareness of the law are needed". The need to augment capital market regulation was also addressed by the SEC since 1991, when the capital market became bearish. The SEC (BAPEPAM) argued that "the interest of investors, especially individuals, had to be maintained. Accordingly, there is a need for government to set up capital market regulations as soon as possible".

The second issue relates to the political system. Soemitro, the retired General, argued that it can be concluded that the Indonesian people have not had a normal life in political terms or democratic terms during the period of almost 50 years since Indonesian independence (Kompas, September 29, 1994). He stated further that "we feel like our life is in a state of emergency, due to the people always feeling threatened. It also should be realised that we do not yet have what the founder of this country wanted. Democracy in the form of Pancasila (Five Principles) has not yet been fully implemented, even by the New Order. This is a normative idea".

Another view comes from Frans Seda (1994), the former Minister of Communication. He argued that "one difficulty in developing Indonesia as a state based on law was the weakness of the Supreme Court in this country. The Supreme Court, currently, is not the highest level of justice and can not control the implementation of regulations via the bureaucratisation of the ruling class, due to its
functions being very limited. Therefore, democratisation under the State Ideology of Pancasila cannot yet be expected by the people in general". (Kompas, 27 August 1994)

12.2.2. The Emergence of the Private Sector and the Entrepreneur

As the agents of development in the economy of a country, the existence of entrepreneurs and a dynamic private sector are essential elements for the discussion of socio political factors in this study. Entrepreneurs are the backbone of the market economy. They are the initiators of technological innovation and commercial undertakings. These entrepreneurs always need more capital for business expansion and therefore become the primary supply source of securities to the market. Drake (1980) argued that the fast growth of the London Stock Exchange, was not separate from the history of capitalism in that country. The expansion of utility companies, such as railway, canal, dock, electricity and water companies which were initiated and managed by the private sector, had been the major sources of securities that were sold and traded on the London Stock Exchange. Modigliani and Perotti (1991) also argued that the advancement of early-developed countries such as England, were attributed to three interrelated factors: the creation of risky commercial ventures by merchants, technological innovation by entrepreneurs and the supply of capital with a broad redistribution of risk by the securities market.

Sudweeks and Grub (1988) argue that, even though a securities market can be created in semi-centrally planned economies like China, the development prospect is dim. This is due to several factors. Firstly, state involvement in the economy is extensive and little room is left for private activities. Secondly, in a socialist economy the state usually treats the private sector as ancillary to the public sector. The industrial policy and subsidised credit schemes that generally are available in such an economy create distortions making it hard for private firms to tap public funds. Finally, philosophically, the securities market is less compatible with a centrally-planned
economy. Sarnat (1992) argued that the former regime requires a free flow of capital based on private decisions. The latter demands the allocation of resources by central planners, which may not be parallel with the interests of the private sector. Moreover, central planning and excessive state interference would affect market outcomes, making rational investment difficult and unpredictable.

As indicated in previous chapters, since the mid 1960s, the New Order government has had strong faith in the role of the private sector and a more liberal economic system. Massive government intervention in the economy was perceived as the source of the problem that killed the initiative of private entrepreneurs in all sectors of the economy. In Indonesia, however, since the government relaxed control over business activities, the role of the private sector has been considered more important in business activities.

Tax facilities and credit priority at subsided interest rates were provided in order to spur the development of investment in Indonesia. However, this kind of policy is considered to benefit only the Chinese in Indonesia. The indigenous people are still behind the Chinese. They argue that they did not have opportunity to act as an agent of development in economic activities.

In 1974, the government made a major change to credit and investment policy. This policy targeted the increase of the economic role of the indigenous people in Indonesia. Moreover, most domestic investment during the 1970s was carried out by the state and the role of state owned enterprises in the economy became more dominant than previously.

The oil boom of the 1970s apparently has had far reaching effects on the Indonesian economy. In this period the main issue was not how to generate enough capital, but how to allocate abundant money to speed up economic development. The decline in oil prices and the recession in the world economy which started in the early
1980s also had a significant effect on the development of the private sector. The government then, relaxed control of the economy.

In 1983, the government undertook several adjustment policies to put the economy back in a sound position. These adjustment policies were extended by other government policies through out the 1990s. In 1988, the government introduced the regulation program, especially in the financial sector. Since that time the development of the economy has shown significant progress. The development of the private sector cause the GDP in 1989 to increase 38 percent over the average growth in the period 1986-1988. For instance, according to the Bank Indonesia reports (1994) the development of financial institutions increased from 7,428 in 1987 to 13,330 in 1993, with the outstanding credits rising from 63,606 billion rupiahs to 150,049 billion rupiahs in December 1993.

The robust economic growth in 1989, caused the government to consider the economy to be over heating. Accordingly, in 1990 the government began to slow down this growth by addressing some of the monetary policies. These policies have had a significant effect on the development of the private sector. In this period most companies experienced financial distress and attempted to get off-shore loans due the high interest rates in Indonesia. Some private banks provided loans with 23 percent interest rates, and some public banks provided loans at less than 23 percent per annum.

In 1993, Indonesia completed its rapid cool down of the 1990 overheating. However, the effect of those policies still cannot support the development of the private sector due to the interest rates being considered still high at that time. By 1994, bank interest rates varied between about 18 and 21 percent per annum.
12.4.3. The Emergence of Institutional Investors and the Middle Class.

The presence of a large middle class is also an essential factor in the development of a securities market in developing countries. The rich and upper-middle class are generally the largest source of savings within a society, which provides liquidity for the equity market. In countries where institutional investors are not well developed, the role of individual investors is crucial in enhancing market liquidity. In the early years of the development of the Malaysian Stock Exchange, according to Drake (1980) the upper-middle class in that country was the most important group of people to have stakes in corporate equities. Ultimately, however, institutional investors generally play more important roles in the market.

The presence of mutual and pension funds and insurance companies also provides vehicles for more individual investors, including small investors, to participate in the market. Therefore, government policies support the development of those institutional investors and encourage them to invest part of their portfolios in the capital market. However, Cox et al (1993) argue that in developed countries such as the USA, the role of institutional investors in securities markets becomes more and more important, while the role of individual investors continues to decline. In 1965, 84.1 percent of all equities were owned by individuals, but by 1989, institutional investors had captured approximately 45 percent of all outstanding U.S. equities.

In Indonesia, due to the data concerning the institutional and individual investors in the capital market not being recorded, the trend of institutional and individual investors cannot be traced properly. However, it can be estimated that in the period 1989 to 1990, the role of individual investors in the development of the capital market was more important than after this period. This period is considered to be the booming period in the development of the capital market in this country. After 1990, the role of individual investors slowed down.
As has been discussed in previous chapters, the development of the capital market is very dependent on the purchasing power of the people; and this can be measured in terms of income per capita. By referring to this statement, it can be argued that the income per capita of Indonesia cannot support the development of the capital market in this country. Looking at the World Bank report (1990), income per capita in Indonesia was not more than US$ 440.20 in 1988. However, due to the inequality of income distribution, the development of the capital market relied on the existence of the middle and upper classes of society and the institutions. The bad experience that the middle class had in the past, cause the development of the capital market to depend mainly on the upper classes of society and the institutions.

The slow down of individual investors participating in the market caused the government to consider that there was a need to better regulate the capital market in order to take care of the needs of both domestic and foreign investors. Even though the role of foreign investors in the capital market is not expected by the government due to its preferring direct rather than indirect investment, however, some policies are directed to motivate the foreign investors in Indonesia capital market. Appendix No.13 provides some indications that the role of foreign investors has become more important in this country, and the role of domestic investors are becoming less important.

12.2.4. Reluctance of Private Companies to Go Public.

It is generally accepted that socio political factors can be associated with the characteristics of a company. In a developing country, Indonesia for instance, during the 1970s companies were reluctant to go public due to several reasons. According to Dickie (1981), one of them was that there was a strong concern by private company owners (especially family controlled firms) with regards to the public ownership and control of their companies. Even though this concern was actually more emotional than rational, nevertheless, this attitude has been identified as one impediment to the development of securities markets in many less development countries (LDCs).
Shin (1989) reported, because companies were so reluctant to go public voluntarily, the Korean government decided to force certain corporations to go public via an executive order. The Going Public Encouragement Act (GPEA) 1972, empowered the Minister of Finance to issue designation orders to force selected companies (subject to several criteria) to go public. If the firm rejected such an order several punitive measures would be imposed.

Companies are also usually reluctant to disclose their books and business dealings to the public as required by securities regulations. This hesitancy is due to several factors. An inefficient tax law that allows a firm to pay tax arbitrarily (not according to its real income), for instance, may deter a firm from going public. Thus, private companies may face lower taxes than those which are public. Indeed, prior to 1984, it was highly questionable whether the Indonesian corporate community paid tax as it was supposed to. Prior to the enactment of the new tax law in 1984 (and even after that), there was a lot of talk in Indonesia which claimed that many firms managed three types of books: one for tax purposes, another for banking purposes and the third book (the real one) for share holder records. Profits in the first book were deflated to reduce the tax burden, while in the second book the profits were inflated to receive larger loans or to make the firm more credit-worthy. It was very difficult to verify such allegations. However, considering that tax collection in Indonesia is the lowest among ASEAN countries, this indicates that such practices really exist. In addition, because the tax administration was so inefficient, such practices could generally not be prosecuted. Dickie (1981) noted that in 1985, the Attorney General brought two Japanese firms to court because of tax evasion. Nevertheless, the tendency to resist going public is sustained as far as the companies can generate enough capital from sources other than the securities markets.

In Indonesia, in order to motivate private companies to go public, the government at the beginning provided some incentives to the listing companies by not
further investigating the profits as reported for tax purposes, and providing a credit for
the company that provided a proper annual report. For further inducements, the
government also allowed companies experiencing losses to go public. The companies
interested in going public did not have to worry about the three periods of profit as
required. There is an indication that, due to the differences between the interest rates
and the dividend yield being significant, some companies that went public were not
considered to be in conformity with the objective of the capital market. The capital
market was not becoming the alternative source of funds for investment, but was a
place for gambling.

12.3. THE IMPACT OF POLITICAL AND SOCIO-ECONOMY FACTORS ON INVESTMENT DECISIONS IN THE CAPITAL MARKET

As mentioned in Chapter Two, this study argues that the impact of political and socio-
economy factors on investment decisions causes share price movements in the capital market. Further, political economic policies are defined as policies that relate to the current and prominent ideology, and which are implemented in the form of political economic policies and social order. These policies are investment, monetary, tax policies and other governmental policies. Political and socio economic factors are those that can be associated to the needs of people for social welfare such as education, the labor force, employment, security, income distribution and poverty. These two main factors then, are associated with the economic indicators in this country.

This part discusses the impact of such factors on investment decisions by analysing the political economic policies and their association with economic indicators and the development of the capital market in Indonesia. The discussion is directed to the historical development of political economy policies that cause political and socio economic factors and their impact on the development of the capital market.
12.3.1. The impact of government policies on the development of the capital market before 1977.

As mentioned in previous Chapters, after Indonesia gained its independence on 17 August 1945, the government incorporated the stock market in Jakarta, under Act no. 13 of 1951. In 1952 this Act was amended by Act No. 15/1952. The main reason for the government wanting to develop the capital market was to overcome the crisis in economic and financial conditions in the country. It was deemed necessary to reopen the bourse for money and securities trading and to stipulate regulations concerning the bourse. However, efforts to develop a capital market by the government in this period apparently were not successful, due to bad internal and external factors that emerged during that period.

During this period there were many factors that contributed to the disorder and instability of the political climate in Indonesia. These included, conflicts between Indonesia and the Netherlands following nationalisation of Dutch companies and prohibition of Indonesian people trading Dutch shares in the capital market; rioting by DII and Permesta and other Moslem fundamentalist groups who sought to replace the State ideology, Pancasila, with a Moslem ideology; and also the deterioration of infrastructure eg. the inability of the House Representatives to establish the State's Codes and Acts and to resolve conflicts among the socio-political parties. These conditions caused the government to pay more attention to development of a cooperation and unity and also to the development of a self-sustaining economy as the first priority in the development of this country. Other developments such as the development of the political economy and the socio economy were considered unimportant and were abandoned.

Furthermore, a long economic recession, and the impact of World War II on the world economy, caused international trade among countries to worsen. In addition, the impact of more than three hundred years of colonialism by the Dutch and then
three years and six months by Japan, caused the government to refuse any foreign interference in the country. Accordingly, the government adopted a closed political economy and strongly controlled all segments of the economy. This caused the economy to never have a positive growth during the last two decades and the inflation rate reached 650 per cent. As a result of such political and socio-economic conditions in the country, there was no development or activities in the capital market of Indonesia.

12.3.2. The impact of government policies on development of the capital market during the period 1977-1987.

After about two decades without any activity, the government under Presidential Decree No. 52/1976 reorganised the capital market by establishing three institutions which were responsible for capital market development. Based on this decree, the need for development of the capital market was outlined as follows: in order to accelerate the process of the participation of society in acquiring companies' shares and also to achieve equality of income distribution and stimulate participation of society in financing national development, it was deemed necessary to develop the capital market.

From a historical perspective, the need for understanding the development of the capital market can be associated with the political climate in this period. The claims by the indigenous people concerning the unequal distribution of income from economic development also caused the government to consider necessary, the development of the capital market. PT. Danareksa, a national investment trust, acted as a guardian for small investors. Although there were some inducements in the field of taxes for listed companies in the capital market, by 1983 only a few companies were listed in the capital market in Indonesia. Apparently, such inducements did not motivate companies to be listed. There are a number of reasons for this. Firstly, companies still had doubts as to whether the tax policies would be long lasting or only temporary. Secondly, there
was no comparative advantage for companies. Apparently, based on these reasons, companies considered that there was no benefit in listing on the capital market.

From the government's side, it can be argued that firstly, the capital market was assumed not as an alternative financing for investment but only as a tool for income distribution. This assumption tends to be more political than economic. This argument can be supported by the historical data of economic development in this country. Favourable economic development during the 1970s to the mid 1980s is shown in Appendix No.2, The Development of Economic Policies in Indonesia and Its Impact on the Development of the Capital Market. Moreover, during the period 1970s to the mid 1980s, as shown in Table No.7.2.1, the government hardly depended on oil and gas revenues. Government revenues from the oil and gas sectors and foreign aid and loans were considered to be sufficient for financing the development program. In other words, the favourable economy that had been caused by the external factors had a negative impact on the development of the capital market, so that the only reason for the development of that market was the pressure from the indigenous people concerning the equal distribution of income from developing economy.

Secondly, as the capital market was not considered as the last resort for financing development programs in Indonesia, there was a need for the government to mobilise internal funds via monetary policies. The issuance of deregulation packages in June 1983, relating to monetary policies, caused the internal mobilisation of funds, accumulated by the bank and non financial institution to show significant progress as indicated in Table 7.5.2

From the view of capital market development, it can be argued that, besides the political factors, the government also provided some inducement to the development of the capital market in Indonesia from the beginning of the 1980s. However, due to the lack of regulation concerning the capital market activities, the government still restricted some activities by making some bureaucratisation in the
market. As a result, the capital market was not expected to be a source of financing before the end of 1980s.

Table No. 12.3.2.1
Tax ratio and GDP

<table>
<thead>
<tr>
<th>Budget Year</th>
<th>Revenue (Rp. Billion)</th>
<th>GDP non Oil and Gas</th>
<th>Tax Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984/1985</td>
<td>4,788.3</td>
<td>70,249.0</td>
<td>6.8</td>
</tr>
<tr>
<td>1985/1986</td>
<td>6,616.9</td>
<td>80,125.6</td>
<td>8.3</td>
</tr>
<tr>
<td>1986/1987</td>
<td>7,465.7</td>
<td>88,296.8</td>
<td>8.7</td>
</tr>
<tr>
<td>1987/1988</td>
<td>8,779.4</td>
<td>104,920.4</td>
<td>8.4</td>
</tr>
<tr>
<td>1988/1989</td>
<td>11,908.5</td>
<td>121,606.0</td>
<td>9.8</td>
</tr>
<tr>
<td>1989/1990</td>
<td>15,425.6</td>
<td>142,782.4</td>
<td>10.8</td>
</tr>
<tr>
<td>1990/1991</td>
<td>19,719.7</td>
<td>184,649.6</td>
<td>12.0</td>
</tr>
<tr>
<td>1991/1992</td>
<td>24,058.4</td>
<td>167,875.1</td>
<td>14.3</td>
</tr>
<tr>
<td>1992/1993</td>
<td>28,850.3</td>
<td>189,970.1</td>
<td>15.2</td>
</tr>
</tbody>
</table>

Source: Directorate General Tax

The drop in oil and gas prices from the beginning of the 1980s caused the government to direct the political economy into seeking alternative financing. Due to tax revenues being considered too low compared to other countries, tax revenue became the alternative form of financing for development. The structural adjustment in tax regulation in 1983 was expected to provide more incoming internal funds for development besides external funds from foreign loans. Table 12.3.2.1, indicates that government revenue from taxes was still lower than other countries. As indicated in this table, six years after the tax reform issued by the government, the Indonesian tax ratio was 10.8 percent. This tax ratio was still far below that of Thailand, Singapore and India, respectively 16.5 percent, 18.2 percent and 17.9 percent. Since 1990/1991, the tax ratio has increased although this is still below those countries.

The need for intensifying such revenue cause the government to issue in 1988 a similar tax policy related to the interest on deposits and income from trading shares. Before this, the diversified tax caused investors consider to put their money in deposits or saving accounts rather than trading in the capital market. After this period the government’s political economic policies were more seriously directed to development of the capital market and to further structural adjustment to the political
Investment Decisions and the Puzzle of Share Price Movements

economy through some basic changes in regulation of the financial and non financial sectors.

12.3.3. The impact of Government Policies on development of the capital market
during 1988 -1993

In October 1987 and December 1988, the government continued to issue, some regulations concerning the capital market. These political economic policies were accommodated by the companies. By 1991, three years after the issue of those regulation packages, the development of the capital market, as shown in the Appendix No.11 showed significant progress. This development was accelerated until 1993.

From socio economic indicators, the development of the capital market can be understood by analysing the income per capita. From 1990 the income per capita showed significant progress. Based on a price-wage ratio 1988, the income per capita increased from Rp 310,502.80 in 1988 to Rp 1,105,320.7 in 1990 and Rp 1,250,404.9 in 1991. The income per capita increased due to the positive effects of an increase in gross domestic product and on the other side, the negative impact of the increase in population. Statistical data supplied by a Bank Indonesia officer, Harinowo (1993), indicated that the increase in gross domestic product by about 5.6 % during the period 1989 to 1991, had been weakened by an increase in population of more than 2 percent (Personal Interview). Accordingly, the income per capita increased only about 3 percent during 11 years of development. In dollar terms, it can be argued that the income per capita during this period was still low compared to other countries. According to a presidential speech (1993), Malaysia had income per capita of about US$2,965 and the Philippines of US$ 835 respectively. The President also stated that the income per capita in Indonesia was still far below that of those countries.

Inflation and its monetary policies are also considered to have had a significant impact on the development of the capital market. It is generally accepted that the
higher the inflation, the more investors retain their money in capital assets rather than in the capital market. The political economy that was directed at stabilising inflation and maintaining the rate of growth which was implemented by the new government, did not apparently become a restriction for development of the capital market. In other words, the development of the capital market was supported by the government by keeping inflation low and economic growth stable. This low inflation and stable economic growth induced the development of the capital market.

As stated in previous sections, the inflation rate was more than double digit during the 1960s. In 1965, for instance, the inflation rate was 6.50% Since 1969/1970, the inflation rate, as exhibited in Table No. 12.2.1, decreased from 1969/1970 to 1975/1976, and after that was relatively stable by 1993. The benefit of this had caused the government, since 1976, to reorganise the capital market of Indonesia.

The positive effects of the policy reforms and securities regulation changes on the capital market were enormous. As indicated in the Appendix No 9, by 1988 the long period of market dormancy had come to an end. From this year the capital market in Indonesia began to display some dynamic activities. A positive trend which intensified in 1989 - 1993 existed as government controls were removed and foreign investors were permitted to carry out some activities in the capital market. Appendix No.10 indicated that the trading volume in 1988 increased almost three times compared to 1987, from 2.5 million shares to 7 million shares. In terms of market capitalisation, it increased from 112 billion rupiahs to 481.5 billion rupiahs. Market prices also increased very rapidly. During 1988, the composite price index as indicated in Appendix No.12, increased from 83.531 in January to 305.632 by the end of the year. This fast movement of the index was significant, compared to the index level before 1988. It has been noted that, since 1983, the index level of aggregate share prices is below one hundred.

As security prices increased due to strong demand, the existing listed companies responded by supplying some additional securities to the market by issuing
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stock dividends, bonus shares or additional shares listings. All these market activities indicated that the change of regulation, especially the liberalisation of the market from government control, had a positive response from the market participants. However, the positive effects of the relaxation of securities regulation in December 1987 is still considered limited.

Although there was a strong demand for securities and higher prices during 1987, there was little incentive for new companies to list in the capital market in 1988. This was due to at least three factors. Firstly, despite foreign investors having been permitted to participate in the market, their participation was still restricted. Foreign investors were allowed to buy only shares of listed companies that were minority-owned by foreign interests. Since only six (6) of twenty four (24) listed companies satisfied that requirement, foreign participation had no significant impact on the market transactions.

Secondly, since the tax treatment between bank deposits and securities investments was still in favour of the former, this condition also hindered the market's expansion in 1988. The tax exemption on interest for savings or deposits made the securities investment less attractive than savings or deposits in the bank. As has been indicated earlier, at the end of 1988 the government reversed this policy by imposing a withholding tax of 15 percent on deposit interest.

Thirdly, this study argues that the social/political factors i.e. the attitude of the corporate management, also became the greatest hindrance in preventing new firms from entering the IPOs in 1988. In this period, the corporate community was still in a "wait and see" posture. For the owners and management of privately-held companies, the increased activities of the stock market were perceived with great uncertainty. They questioned how long it would last and how serious the government was promoting the stock market. The government's policy, that the stock market was to play a role as mobiliser and allocator of capital, was critically assessed by the private sector. Would
the government allow large companies and many groups of companies (conglomerates) which were generally controlled by non-indigenous, to go public? What would be the political repercussions, if such companies went public and exposed their holdings as required by the securities regulation? With regard to the indigenous people and Chinese issues in the past, and the political issues that related to sensitivity of exposing corporate ownership to the Chinese, the owners of those companies became very cautious.

A further deregulation in October and December 1988 engendered greater confidence by the private sector in the seriousness of the government to develop the capital market. The policy that abolished completely the role of Danareksa and allowed the establishment of the private stock exchanges and new securities companies, and the imposition of withholding tax on banking deposits more clearly indicated the government's intentions. The implementation of legal lending limits sent a final clear message to big enterprises and group of companies that the government was really serious about the development of the securities market.

By early 1989 all necessary conditions for further development of the market had been laid down. The appointment of new management at BAPEPAM at the end of 1988 carried a special weight in helping the market to grow. The new flamboyant chairman of BAPEPAM launched an intensive campaign to educate investors regarding investment in stock markets and to convince privately-held companies of the merits of going public. The active promoting role of BAPEPAM encouraged all segments of society, especially the potential participants, the buyers and the sellers of the shares. Moreover, since the change of regulations in 1987, BAPEPAM no longer screened the issuers (the listed companies) on merit. Its function with regard to public offerings was limited to a guarantee of full disclosure.

On the other hand, the success of PT ABDA, PT. Surya Gas in offering their stock either at the IPO stage or on the secondary market, caused other companies to
follow these companies. This condition caused an excess of demand for shares during this period. This excess of demand can be described as follows. Firstly, every company that wanted to sell its shares on the market, by and large had to follow the procedures which took time. Secondly, there were excessive funds and idle money in society that could be transferred to other forms of investment due to the issue of new tax laws on interest on savings or deposits. The gradual participation of foreign investors on the JSX also encouraged domestic investors to participate actively in the market. As a result of these factors, prices increased rapidly. In this period, some investors/speculators made excessive capital gain. Naibaho (1989) in Business News November 20, reported that the capital gain made by speculators/investors from December 1988 to the end of 1989 was 379.34 per cent and the dividend earned was 2.36 percent. This condition attracted an even larger number of people and ultimately created a speculative bubble in the market.

The presence of the speculative bubble on the JSX during 1989-1990 was highly visible. The presence of such a speculative bubble encouraged new firms to enter the market because the bubble provided a very attractive opportunity for corporate owners to raise capital at very cheap costs. Indeed, during the third stage of development, most firms that went public experienced a high oversubscription and sold their securities at very favourable prices. Within less than two years the market grew from 24 listed firms to 122 in 1990.

Observing the frenzy of the securities transactions, and the fact that the listed firms sold their securities at very favourable prices, more and more privately held companies wanted to join the bandwagon and cash in non the market. The secondary market also became more liquid. The average market turnover in 1989 reached 22 percent, and advanced to 47 percent by 1990. The daily trading volume increased from 389 thousand shares in 1989 to 2.9 million shares by 1990. The most impressive development was the price valuation of securities during these two years. From early 1989 to June 1990 the price of securities on the JSX rose relatively constantly. The
Composite price index started at 298 in early 1989 and came to a peak in April 1990 when the index reached 639.

In terms of price earnings ratio (PER), IFC (1990) reported that by the end of 1989 it reached 41.5. At this PER, the price of equities on the JSX was among the highest in the world, only lower than those on the Tokyo and Taipei Stock Exchanges, which at the same time carried a PER of 51.9 and 51.2 respectively. This JSX price earning ratio was 2.2 times higher that the average PER in overall world stock markets and almost 300 percent higher than on the New York Stock Exchange.

As with any speculative bubble, it could not be sustained for an unlimited time. Sooner or later the bubble would deflate and the market would return to a rational profile. In the United States when the bubble burst it created a sudden crash in the market. The collapse of the US market in 1929 and the crash of October 1987 have been argued by some observers as demonstrating the normal consequence of the bursting of the bubble. The securities prices plunged in a very short period of time. The Wall Street Journal (1987) reported that on Black Monday October 27, 1987, the Dow Jones Industrial average dropped by over 500 points (23 percent) of its value.

In the case of the collapsing speculative bubble on the Tokyo Stock Exchange (TSE) during 1990-1991, the price decline was more severe but happened more slowly. IFC (1991) reported that the great bull market during 1988-1989 sent the Nikkei Index to nearly by 39,000 at the end of 1989 and made the price of securities on the TSE the hottest in the world, while the price earning ratio (PER) stood at 52, or almost four times greater that the average PER on the NYSE at the same time. Beginning in mid 1990 the market began the downward slide which continued until 1992. On April 14, 1992, the Wall Street Journal reported that the index had plunged by 22,000 points to 17,000, a decline of 56 percent from the peak.
The bubble on the Indonesian market did not burst suddenly. Instead, the price of securities declined slowly over a long period of time. After reaching a peak in April 1990, when the Composite Index stood at 639, the price began to decline in a pattern. By the end of the same year the Composite Index had dropped by 35 percent, to 417.7. A year later, at the end 1991 the Composite Index stood at 247, a decline by 61 percent from the peak level of April 1990. At this point, almost all gains achieved during the bubble period had evaporated. According to IFC (1992), at the end of 1991 the value of securities on the JSX were the lowest among all the emerging markets of Asia.

The boom and bust cycle that took place on the JSX created both positive and negative effects on further development of the securities market. On the positive side, it left a legacy where most Indonesians came to realise the existence of the stock market. The bullish market during 1988-1989 and the first half of 1990, had been the most effective educational tool in educating Indonesian investors on the advantages of the market.

In addition, the bullish market also left behind quite a number of listed companies and also other members of the capital market. As has been indicated earlier, by the end of 1990 more than 50 securities houses were in business. Within these companies a great number of highly talented persons had been assembled, which was advantageous for further market development. Furthermore, the corporate community was also becoming more aware of the advantage of raising equity capital through the market. Despite a price slump in mid 1990, the number of listed companies increased. By the end of 1991, 139 companies were listed on the JSX, and by the end of 1993, 172.

The government also obtained invaluable experience from the great bull market. It learned that its regulatory agency, BAPEPAM, could be overwhelmed by the very rapid growth of the market. Its previous limited experience, poor staff and overly
simplistic regulation caused the agency to play its role as the guardian of the market rather ineffectively. Although not widely prevalent, several market abuses had been found during the bull market. The most notorious was the Bank Duta case where three months after going public, it was revealed that the Bank Duta was actually in a very bad financial condition due to continuous losses. Tempo magazine on 15 September 1990, reported that the losses totaled US $400 million. This fact was not disclosed in the prospectus, which indicated that the formal prospectus and the registration requirements alone were not adequate unless legal liabilities against listed companies and market supporting professionals were also strictly enforced.

It was also reported that several manipulations took place in the market during this period. These included price manipulations and insider trading. These accusations were raised, for example, by Jopie H and Kwik Kian Gie (1991). However, the validity of such accusations were difficult to prove because there was neither hard evidence available nor formal actions taken by BAPEPAM against such practices. Nevertheless, these accusations indicated the need for a more sophisticated regulation and more professional BAPEPAM. These concerns have, by and large, now been addressed, at least at an institutional level, by the issuing of new securities regulations at the end of 1990.

On the other hand, the bearish market also had a significant impact on investors, especially individual and small investors, due to the potential losses that they had. This bearish market also left a very strong imprint in the mind of every individual investor. This condition was different for other investors such as institutional investors, who recognised these losses as company losses not as individual or corporate manager losses.

As a result, the speculative bubbles caused some investors to avoid the market. In other words, some investors may choose not to participate in the stock market in the future. However, this possibility is slim. Experience shows that the market
boom and bust cycle does not hinder the development of the securities market itself. Almost all stock exchanges around the world experience the boom and bust cycle. At some time the market, generally, becomes to active again with even more maturity and strength.

The new law in 1990 provided many institutional improvements within the market. This law also encouraged the development of private investment funds and financial institutions. The presence of such institutions will strengthen the market and provide individual investors with a better avenue for investing in the stock market. The law also authorises the privatisation of the JSX and assigns BAPEPAM to function merely as a regulatory agency.

12.4. THE IMPACT OF INVESTMENT DECISIONS ON SHARE PRICE MOVEMENTS

As indicated in previous chapters in general the investors' decisions can be understood through the information used by those investors. This information, provided to the public, mostly relates to the common information needs which can be divided into two types, macro and micro. At the macro level, the information is related to political/economic policies, which are provided in the public domain.

At the micro level, the common information needs of investors are related to the information on the performance of listed companies. This information mostly is provided by the standards of accounting and reporting practices. At this level, investors will utilise such information and actively to find specific information such as dividend yields and additional listings in order to get a non-zero abnormal return. At this micro level, investors attempt to involve in insider trading, that is looking for specific information, which is not provided in the public domain. This insider information creates rumours in the market. Due to the difficulty in exploring such information, this study argues that, if public information cannot be associated with share price movements, it can be indicated that the investors used unpublished information or they traded in the market due to the influence of psychological factors.
It is generally accepted that this information is utilised by investors simultaneously. The effect of every single piece of information cannot be traced in absolute term to its association with the investors' activities. Accordingly, this section discusses some major indicators or events that can be associated with market activity and the index prices movement as surrogates of investment decisions and share price movements respectively.

12.4.1 The Impact of Policies Reforms on Share Price Movements.

As has been discussed in previous chapters, during the 1970s and early 1980s, Indonesia had a substantial economic benefit from the two oil booms that took place then. After this period, the oil boom was replaced by the oil bust. The drop in oil prices began in 1982 and was followed by other external shocks such as the deterioration of the terms of trade of almost all of Indonesia’s primary export commodities. Furthermore, the realignment of international currencies, as indicated in the World Bank report (1986), put the Indonesian economy in danger due to the decrease in the financial ability of the Indonesian government to finance its development programs.

On the other hand, as indicated by Nota Keuangan 1982/1983, interest and debt payments increased significantly. For this reason, the government continued the political/economic policy reforms in order to maintain the momentum of economic development. As indicated in the previous chapter, that since 1983 policy reform was adopted by the government. During 1983 to the middle of 1990, there were fifteen packages of economic deregulation and policy reforms adopted by the government. These reforms consisted of the relaxation of government control on a broad range of economic activities, over financial sectors, international trade, investment procedures and many others such as exchange rate policies, and also deregulation of the securities market.

Reforms to the securities market were started in December 1987. The first reforms related to the relaxation of listing requirements, abolition of price control and
allowing foreign investors to participate in the market. In October 1988, the second set of reforms were introduced. These reforms related to imposing a 15% withholding tax on the interest of time deposit. Further reforms on the abolition of the dominant role of P.T. Danareksa over the market and permitting the listed companies' shares to be traded on the OTC market were issued in December 1988. Authorisation for the establishment of new financial institutions were issued in December 1988. In November 1989, a reform was also issued by the government, allowing securities companies to seek licensing as underwriters. Further deregulation of the capital market was then issued by the government in December 1990. These reforms related to the issue of the new law that lead the market into purely private management and BAPEPAM's role was changed to become only a supervisory agency.

The impact of policy reforms on share price movements was enormous. As indicated in Appendix No. 9-10 and 12, by 1988 the long period of stagnation had come to an end. From 1988 the Indonesian Capital Market began to display some dynamic activities. Trading volume in 1988 increased almost three times compared to 1987, from 2.5 million shares to 6.9 million shares. Stock market prices also increased very rapidly. During 1988, the composite price index increased from 83 in January to 305 by the end of the year. The increase in the composite price index were caused by the strong demand for shares in the market. On the other hand, there were no new companies in the market. As a result there was an excess of demand in this period. This excess caused the investors to buy shares at higher than normal prices.

Furthermore, as the securities prices increased due to the strong demand, the existing listed companies responded by supplying some additional securities to the market. This was generally in the form of stock dividends, bonus shares and additional listings. For further discussion, see Appendix No. 15: Company Listing and Dividend Payment 1985-1993. Trend of dividend payments of the companies that listed in 1978-1988 increased during the period of 1985-1988 due to the liberalization of the market from government control.
The further deregulation in October and December 1988, engendered a greater confidence by the private sector in the seriousness of the government to develop the capital market in Indonesia. The policy that abolished completely the role of Danareksa and allowed the establishment of private stock exchanges and new securities companies and the imposition of withholding tax on banking deposits, indicated the government's intentions. Moreover, the implementation of legal limits on the banks sent a final clear message to big companies that the government was really serious in developing the capital market. The appointment of new management to BAPEPAM at the end 1988 carried special weight in helping the market to grow. The active promoting role of the chairman of BAPEPAM and also the function of BAPEPAM in not screening the companies on a merit system, as PT. Danareksa did, attracted companies to list their shares on the capital market. In this period the only concern of BAPEPAM was the full disclosure requirement. As long as the full disclosure requirement have been satisfied a listing permit would be issued.

In July 1989 new firms began to enter the market. Two companies, PT ABDA, an insurance company and PT Surya Gas, a producer of a variety of industrial and medical gases, listed in the market. These two companies, in this period, had an over-subscription. According to BAPEPAM (1991) report, PT Surya's IPO was oversubscribed by 49 per cent. No data, in quantitative terms is available for PT ABDA, but they were oversubscribed.

The success of those offerings caused other companies to follow. From July to the end of the year, 32 new companies listed in the capital market, injecting a total of 374 million shares into the market, and making the total of listed companies 56 with 439 million shares. Among these 32 companies, based on the data on Business News (20 November 1989), only two companies were undersubscribed; all the others were oversubscribed, ranging from 2.5 percent to 10.826 percent.
Investment Decisions and the Puzzle of Share Price Movements

The high demand for shares in this period, can be studied from the viewpoint of participation by foreign investors. By 1989, participation by these investors was substantial. In addition, by the end of the 1989, 11 foreign-based funds came and joined the market. As a result of these two factors, very large funds were mobilised in the market and this pushed the prices up. As a result, excessive profits and abnormal returns were earned by some investors. This condition attracted and created a speculative bubble in the market.

From the market activities point of view, it can be seen that during eight months of 1990, fifty-eight (58) additional companies entered the market. This means that, on average, more than 7 companies entered the market every month. By the end of the year a total of 122 companies were listed in the market. Appendix No.9 shows the market capitalisation and the trading activities during this period. Based on this data, the increase in trading activities was followed by an increase in the price index ratio and also the price earning ratio. At this time, according to the IFC (1990), the PER was among the highest in the world, lower only than those on the Tokyo and Taipei Stock Exchanges, which in the same period carried a PER of 51.9 and 51.2 respectively. The JSX price earning ratio was 2.2 times higher than the average PER on the overall stock market and almost 3 times higher than that of the NY Stock Exchange.

12.4.2 The Impact of the Speculative Bubble on Share Price Movements.

The presence of a speculative bubble in the Indonesian capital market during 1989-1990 was widely recognised. Hardouvelis (1988) argues that the speculative bubble existed due to the continuous market overvaluation and was unconnected to fundamental economic conditions. Furthermore, he stated that, this speculative bubble may subsequently burst very suddenly. According to him, an over-valued market is fragile. On the other hand, van Agtmel (1984) argues that the development of
securities markets in LDCs generally followed a sequence: dormant stage, followed by a more active market, speculation, consolidation or crash and maturity.

Referring to van Agtmel's argument, the development of the Indonesian capital market by 1993 followed this argument exactly. A dormant stage that has been discussed in previous sections existed in the period 1983 to 1988, and was followed by a more active capital market due to the policy reforms of the market and the economy. Further, the more active trading created a speculative bubble and facilitated fast growth of the market. This stage began in 1988 and continued until the middle of 1990. After this period the market was in the first degree of crash due to the declining activity. The slow down in market activity provided an opportunity for regulators and members of the capital market to consolidate their activities. At the consolidation stage, investors began to consider the fundamentals of the economic conditions. At the end of 1990, a new sophisticated set of regulations was promulgated in order to maintain the market growth and create a more mature capital market. Since this time the market is now beginning to enter the stage of maturity.

The presence of the speculative bubble in 1990, increased the price of shares significantly. After reaching the peak in April 1990, where the composite index was 639, the price began to decline. By the end of the year the index had dropped by 35%, to 416. A year later, at the end of 1991 the composite index was 247, a decline by 61 percent from the peak level. According to IFC (1992) at the end of 1991, the value of securities in the Indonesia capital market were the lowest among all the emerging markets of Asia.

The boom and the bust cycle that took place in the Indonesian capital market created both positive and negative effects on the development of that capital market. On the positive side, it left a legacy whereby most Indonesians came to realise that the market existed and needed to be managed in a proper manner, otherwise the market would crash. The bullish market during the 1980s to the middle of 1990, had been the
most effective educational tool in educating the Indonesian investors about the benefits of the stock market. In addition, the bullish market also left a very strong imprint on the people and therefore helped promote capital market institutions. As has been indicated earlier, by the end of 1990 more than 280 brokerage companies had emerged in the country and more than 50 securities houses were in business. Within these companies a great number of highly talented persons had been assembled, which was advantageous for further development of the capital market. Furthermore, the corporate community was also becoming more aware of the advantage of raising equity capital through the market.

The government also obtained invaluable experience from the great bull market. It learned that its regulatory agency, BAPEPAM, could be overwhelmed by a very rapid growth of the market. Its previously limited experience, poor staff and overly simplistic regulations caused the agency to carry out its role as a market promoter rather than the market supervisor. Although not widely prevalent, several market abuses had been found during the bull market. The most notorious was the Bank Duta case.

On the negative side, the bullish market creates a speculative bubble. As has been indicated, the bullish market caused some investors to suffer, especially the individual investors, who hardly earned income on their money. Many of those who invested in shares, following market sentiment, took the money from their daily consumption needs rather than idle income. Accordingly, the great losses of individual investors created a loss syndrome in that they may avoid the market in the future.

12.4.3. The Impact of the Bank Duta Case on Share Price Movements

As mentioned in the previous paragraph, there were some market abuses during the bull market in 1990. The most notorious was the Bank Duta case. It was
revealed that, three months after going public, the Bank was in a very bad financial condition due to the continuous losses for more than a year totaling US $ 450 million. This fact was not disclosed in the prospectus. This, indicated that the full disclosure concept was not really applied by the listed company. The formal prospectuses and the registration requirements alone were not adequate without legal liabilities against issuers and members of the capital market.

Consider the trading of securities of P.T. Bank Duta, the second largest private bank in Indonesia. After its financial crisis, a group of investors bought the securities of the bank in order to keep up the performance of the share prices in the market. Warta Ekonomi (September 1990, p. 71) stated that some investors predicted that the securities of Bank Duta increased because the securities of the company were bought by its associate company, P.T. Mitra Duta. This associate company bought a considerable number of Bank Duta shares after the crisis. Business Indonesia 17 September 1990, states that P.T. ASTEK bought 100,000 unit the shares of Bank Duta in order to keep up the performance of the company's shares. After this the share price movements of Bank Duta were shown to be relatively stable during September 1990.

Some evidence that supports the influence of political factors in investment decisions in the capital market is the statement of President of PT Astek, one of the largest insurance companies in Indonesia. He stated that "fundamental analysis cannot be used solely in buying securities. Another factor that should be considered, beside management performance and market sentiment, was the role of the company in relation to government policy". (Personal interview). For this reason, this company bought a lot of shares in order to keep up the performance of certain company shares in the market. Other public companies belonging to the government also took further action to keep the market stable. For further discussion see Appendix No.4 concerning the impact of political factors on listed company shares.
12.4.4. The Impact of May 29 and June 10, 1993 Policy Packages on Investors’ activities.

It is generally accepted that the basic fundamental underlying activities in the capital market are influenced by the existence of favourable political and socio-economic conditions in a country. As indicated in the period May to August 1993, after the government took further action in the case of counterfeit shares, the public did not question the credibility of BAPEPAM (the Stock Exchange Commission). Beside this factor, BAPEPAM was committed to bringing the Capital Market Acts into being in the near future.

In addition to this, there were rumours of an imminent issue of a regulation allowing greater foreign ownership of shares and a regulation permitting stock to be put up as collateral for credit. This was in anticipation of the inflow of surplus funds from the banking system into the capital market after the banking regulation of 29 May 1993. The most important factors were the improvement of macro economic conditions such as the strengthening balance of payments and the reduction of inflation in April and May as well as lowered interest rates. These factors caused investors to increase their activities in the capital market.

In May, daily trading averaged 12.02 million shares. In June, however, the average daily trading volume rose by 35 % to 16.20 million shares. Average daily trading also went up in value by 51 % from Rp 47.98 billion in May to Rp 72.42 billion in June. The trading activities in August increased significantly compared to the trading activities in July 1993. In August total trading volume rose to 344.51 million shares, or an increase of 8.1 % compared to the trading volume in July. The total value of trading in August increased by 29.8 % to Rp 1.61 trillion rupiah. This trading activity from January to August 1993 become the highest on record. For further discussion see Appendix No.2: The Development of Economic Policies in Indonesia and Its Impact on Development of Capital Market.
12.4.5. The Impact of Counterfeit Shares on Trading Activities in the Capital market.

The trading of shares in Jakarta Stock Exchange (JSX) from April 1993 was effected by counterfeit shares. The counterfeit shares occurred in the 5 (five) most liquid shares ie. Semen Gresik, Inco, HM Sampoerna, Indah Kiat and Inti Rayon Utama. This began when the sales orders for these shares issued from two investors who were considered bonafide investors in the capital market where transacted. In fact, in the middle of March 1993, these two investors sold not genuine shares, but only counterfeit shares. These counterfeit shares were sold via a broker/dealer to the buyers. As a result, there were some losses to the broker/dealer. These losses, represented being the money already paid by the broker/dealer to the two investors, came to the sum of four (4) billion rupiah, losses for the delay in delivering the original shares in order to replace the counterfeit shares to the buyers, and also losses due to the exchange rate conversion of the shares.

From the capital market perspective, the counterfeit shares created less confidence in the capital market institutions. As a result there was a decrease in activities in April 1993. From January 1993 to March 1993, the trading activities more than 200 million shares were traded with total value of more than Rp1 trillion rupiahs, but in April 1993, trading activities came to only 136 million shares with a total value of Rp 538.9 billion rupiahs, a drop of about 50 percent in one month. For further discussion see Appendix No.6 concerning counterfeit shares.
CHAPTER THIRTEEN

SUMMARY, CONCLUSIONS, IMPLICATIONS AND RECOMMENDATIONS

This chapter provides a summary, conclusions, implications and recommendations with respect to those discussions in the previous chapters of this study. The first part of this chapter summarises the historical developments of the capital market that were influenced by political and socio economic factors and the development of corporate reporting practices. The second part summarises some conclusions concerning the factors that influence investors in decision making and their impact on share price movements. The third part discusses some implications of this study and the last part discusses some recommendations and the need for further research in the future.

13.1. SUMMARY OF THE PRINCIPAL FINDINGS


Motivated by political/economic considerations, namely to appease critics concerning foreign investment, the Government of Indonesia reopened the stock exchange in 1976, under the Presidential decree no. 52 of 1976. The first consideration of this decision was to facilitate the transfer of corporate share ownership from foreign owned companies to the indigenous people, in order to improve the equality of income distribution within society. Other economic objectives such as promoting an active securities market as a medium for mobilising and allocating private savings in order to support economic development was secondary.

The performance of the market during the first ten years was very poor. Until 1987 there were only 24 companies listed in the market and the market capitalisation was about a hundred million rupiah. This poor performance can be attributed to two interrelated factors. Firstly, the regulation that governed the market was inappropriate due to its being rooted in social and political considerations, and it relied excessively on
merit standards and direct government intervention. For instance, the assignment of P.T. Danareksa to act as an agent for executing the political goal of the market in fact it had created many distortions in that market. P.T. Danareksa became a pseudo regulator that screened a listed company on its supposed merits. As a result, the securities market became highly inefficient. The regulatory costs imposed on the market participants, especially on listed companies were substantial. Therefore companies were reluctant to go public, and the secondary market was not sufficiently developed.

Secondly, the government’s economic policies during this period also did not support the development of the capital market. Between the middle 1970s and the early 1980s State financial revenues were mainly from the oil and gas sectors. The oil boom during this period gave the State plentiful funds. This led the government to become heavily involved in financing development. In this period also subsidised credits were abundant, and investment opportunities and economic activities in general were highly controlled. As a result, the allocation of resources in the economy was distorted. Preferential treatment of lending institutions vis - a - vis securities markets including the availability of subsidised credits had led the corporate community to rely mostly on debts as sources of capital finance. There was little incentive for private firms to go public. Slow economic growth during the early 1980s also had negatively affected the performance of the market.

In the early 1980s, the government started to adopt more liberal economic policies. These efforts which were intensified after the middle 1980s, centered around two main policies: a reduction of government control over the economy, and the promotion of a more dominant role for the private sector. To achieve a better allocation for finance within the economy a broad deregulation in the financial and capital market was adopted.
The deregulation of the capital market in 1987-1988 included a change of securities regulation from merit to a disclosure system. An absence of direct government intervention in the market, and a redirection of the market to achieving only economic objectives, led to a major increase in primary and secondary securities market activities. For instance, during 1989/1990 the market experienced significant growth. By the end of 1990, 122 companies were listed in the market with a market capitalisation of more than US$12 billion. By this time, despite the role of the market in the Indonesian economy being still relatively small, the capital market began to play a positive role in mobilising and allocating finance within the economy. The Indonesian corporate community began to appreciate the market as a viable alternative source of finance.

It is difficult to isolate the effects of one specific policy over another on the development of the Indonesian capital market. However, the evidence clearly indicates that the change of regulation from a merit system to a disclosure system combined with a broader liberalisation of the economy created a very favourable environment for the development of the securities market. Apparently, since the government pursued more liberal economic policies, it has been considered more efficient at allocating resources within the economy, and the economy has had significant growth since this period. These conditions have created, on the one side, a greater need for capital by the corporate community, and on the other has increased investors' confidence toward the prospects of the economy, especially the securities market. The change in the securities regulations ie releasing the market from excessive government control, allowed the capital market to fulfil its normal role as a medium for mobilising and allocating capital in the economy.

In order to strengthen the institutional infrastructure for further development of the securities market, the government issued a new set of regulations at the end of 1990. These regulations were based on modern principles of the capital market : full disclosure by listed companies and self regulation by the Securities Exchange
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Commission and other market professionals. The role of government was to oversee of the market in order to protect the interest of investors and the general public from abuse. Theoretically, and based on the experiences of more developed markets, such regulations are suitable for the capital market. Due to the disclosure regulations being non distortive and relying mostly on the initiative of the private sector. At the institutional level the Indonesian government has laid down a good initial legal infrastructure for further development of the capital market. However, at a practical level, the development of the capital market is conditional upon how well this regulation is effectively implemented so that the interests of investors are sufficiently protected and the credibility of the market can be enhanced.

13.1.2. Summary of Historical Development of Corporate Reporting Practices

It is generally accepted that the development of the capital market is associated with the development of corporate reporting practices. Since the stock market was founded in Batavia by the Dutch government, the development of corporate reporting practices was considered important, at least in the interests of the Dutch.

After Indonesia gained its independence, the role of corporate reporting was considered important by the government, as evidenced by its issuing of Law no.34/1954 concerning the use of the title “accountant” and the establishment of the accounting society in 1957. However, due to the development of the economy still being poor, the development of the corporate sector was considered too slow and it was recognised that development was in the early stages. Further development occurred since the authorised body of the capital market commissioned the development of standard and accounting practices in Indonesia in August 1972.

After this period, especially after the capital market was reorganised by the government in 1976, the development of corporate reporting practices showed
significant progress. This development is considered as the period of consolidation between the regulators and the users of information. Many activities were introduced relating to the importance of information provided by provider for economic decision, either by the government or the society. The society began to become a part of the professional that was needed.

The need for further development of corporate reporting practices and also the improvement of the quality of accountants existed in the beginning 1990s when the capital market became bearish. The Association increased the quality of accountants by improving accounting knowledge. Continuing accounting education became the major program of the Society. Furthermore, by permission of AICPA, the Association adopt the AICPA Professional Standards which cover the Statement of Auditing Standards, Statement of Attestation Standards, Statement of Accounting Review Services and Auditing Guidance for Special Industry which was commissioned by BAPEPAM and other government's departments.

13.2. THE CONCLUSIONS

Based on this summary, it can be concluded: Firstly, that for more than 10 years the capital market in Indonesia has experienced a poor performance. This poor performance has been argued as being due to inappropriate securities regulation, distortive government intervention in the market and a non-supportive government economic policy toward the market. It is generally accepted that a regulatory system plays an important role in the securities market, however, excessive reliance on the system, such as the merit standard that was implemented by PT Danareksa, can restrain the market from development. This was exhibited in the development of the capital market during the period 1977/1987. The market became highly inefficient and its function did not fit the financial need of the corporate community. Companies were reluctant to go public and, in turn, the market suffered from a lack of liquidity. The result of such an arrangement was that the market served neither the government's political objectives nor did it facilitate its economic purposes.
Secondly, the evidence shows that the fast growth of the market during the period 1989-1990 indicated that a capital market in developing countries could be successfully developed with a good combination of policies: a supportive economic environment and policies, appropriate capital market regulations and a proper role played by government, that is, allowing the private sector to act as an agent of development. Effective supervision by the government combined with suitable capital market regulations, will make a capital market efficient and will be beneficial for all players and the economy in general.

It can also be concluded that further development of the Indonesian capital market depends on three main variables. Firstly, the continuation of a favourable economic environment and policies including a further liberalisation of the economy. These factors create more advantageous conditions for securities market development. Indeed, an economy that is free from substantial distortions will lead to a better allocation of resources. Secondly, the ability of the regulator to maintain the credibility of the market. This includes how well the full disclosure requirements are implemented and how the interests of investors are sufficiently protected. Strict law enforcement and full disclosure requirements guarantee that the information regarding listed companies is reliable. The reliability of information is one of the most important aspect in protecting investors in investment decisions. Thirdly, the sustained growth of income per capita. The involvement of individual investors in the market is significantly influenced by market sentiment. This indicates that, after the market becomes bearish, the role of individual investors cannot be anticipated. Accordingly, in the historical development of the capital market in Indonesia, the role of foreign investors are considered very important.

In terms of corporate reporting practices, the development of corporate reporting is considered to be far behind the development of the economy, especially the development of the capital market. Accordingly, it can be concluded that at the first stage of the development of the capital market, the corporate reporting practices provided less reliable information to the users. This conclusion supports the previous research studies that argue that information disclosed in financial statements prepared in developing counties is relatively less reliable than
information contained in financial statements prepared in economically developed countries. At the second stage, since the full disclosure concepts and the law enforcement were applied in a committed way, the corporate reporting practices, apparently provide more reliable information. Before this, there was no indication, that the listed companies had financial difficulties before they listed on the market.

In association with the information used by investors, it can be argued that, during the 1970s and 1980s, investors used political/economic information to invest their money in the market. They tended to invest their money in portfolio investment. These portfolio investments are typically long terms investments. This type of investment caused trading activities in the market to be very poor. However, during the period 1989/1990 (the bullish market), rumours were the main information used by investors. In this period, physiological factors and market sentiment played important roles in the market for both institutional and individual investors. Investors tended to consider their investments as short-term investments. The short selling strategy was utilised by most investors in the market. As a result, there was a significant increase in trading activities. The investors, especially the institutional ones used political/economic information as secondary to the rumours in the market. However, individual investors particularly based their decisions largely on rumours and market sentiment.

After the period 1989 and 1990, when the market became bearish and the market crashed in 1990, the investors especially the individual investors become more rational. Apparently, some individual investors gave more attention to the fundamental factors than the market sentiment, but the others quit from market activities all together due to the great losses they experienced. The market is considered a lemon for individual investors. Although, the government since 1991 has implemented law enforcement and full disclosure principles, these kind of programs did not attract individual investors, due to the low per capita income, the high interest rates on deposits and the high prices of shares in the primary and the secondary markets.
13.3. IMPLICATIONS OF THIS STUDY.

One of the likely implications of this study is that, after the first experience of a bearish market, investors are more realistic than before. Investors tend to use information in public financial reports provided by listed companies. However, due to the weakness of the regulations, the role of market sentiment and psychological factors are still dominant in this market. The more rational investors were weakened by the opportunistic investors. Moreover, in this period people still did not predict share price movements based on fundamental or technical analysis.

The first issue of Barito Pacific PT shares, for instance, indicates this. When the firm listed its shares in the secondary market, the price increased significantly, however soon after, the price went down. Some analysts argued that the domestic investors included some individual investors who came to the primary market as a result of the firm belonging to one of the conglomerates in the country. However, after the IPO stage, only some of them traded in the market due to the dramatic increase in share prices. The foreign investors tend to restrain themselves and did not buy until the prices came down to a fair price. As a result, a week later the share prices came down to fair market prices.

13.4. RECOMMENDATIONS

The purpose of this section is twofold: Firstly, to translate the results of these findings into practical advice to those in developing countries where the study was located; and secondly, to highlight potential issues where further research would be beneficial to the parties involved in capital market activities.

13.4.1 Some Recommendations to the Government.

This study has clearly demonstrated that, from the beginning, capital market development can be associated with political economic and socio-economic factors.
Considering that, the one thing that is unseen and has to be solved by the government is that related to the public in "general" (emphasised added) being involved in market activities. Based on cross-sectional analysis, this condition only can be achieved if the income per capita of the people exceeds the consumption per capita. At this time, the income per capita in Indonesia is far behind that of Malaysia, Singapore and even the Philippines. Accordingly, if the government would like to develop the market into fast growth capital market, it should consider how to increase the income per capita, especially the equality of income distribution in this country.

On a practical level, the government: a) can ask for listed companies to offer their shares at low prices, which are within reach of individual investors; b) should continue to implement Stability, Growth and Equity as suggested by the World Bank. On a more practical level, BAPEPAM (The Stock Exchange Commission) should continue to implement the law enforcement and full disclosure requirements and to update the capital market regulations.

It should also be considered in the near future, especially in the globalisation era, that BAPEPAM be separated from the control of Minister of Finance and be directly responsible to the President, so that any decision that is considered critical can be made and issued immediately. This should begin with the improvement of professional staff. Staffing is critical at this time. The need for further education and training for staff to become more professional is very important. This program is in conformity with the national development programs relating to the development of human resources programs.

13.4.2 Some Recommendations for Future Research

The role of investors in developing countries is certainly very complex in nature. Obviously, a single attempt is not sufficient to explore the role of investors. The present study was conceived as an initial one under qualitative methods that attempts
to explore the variables used by investors, that is, the information likely to be used by such investors. Therefore, in order to explore other roles of investors and information, more research in this area is essential.

The discussion in this study has pointed to some issues and directions for further study. One such major direction is toward extending the boundaries of this research. It is possible that a replication of this research will include other variables to extend the results of this study, and also will contribute more towards a wider generalisation of the role of investors and information in the market

With regard to the results of the study, other directions for further research are to explore in more depth the kind of specific or preferential information used by investors, and how this kind of information is processed and generated into a decision by investors.

13.5. FINALE

This research was undertaken in the belief that, in the end, it would be possible to reinforce the calls of prominent accounting researchers in developing countries, to open paths for further research and to offer a base for empirical findings on which further research could be drawn. The experience gained through the course of this research indicates that research of qualitative methods is about extending our understanding to the new methodology used that was suggested by previous researchers. It is important to know that the real world is somehow difficult to understand. However, by using the archaeology of historical development on investment decisions and by examining its logical consistency, the factors that influence investors in making economic decisions in the capital market can be understood.

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