

**INDONESIA:
CRISES, REFORM, GLOBALIZATION AND SMEs**

By :

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A. Introduction

The shake of monetary crisis that developed into the economic and multidimensional crisis attacking, Indonesia, in the last five years has increasingly made us aware of the role of small and medium enterprises (SMEs) including co-operatives in our national life. We are greatly indebted to the three pillars of the grass root economy known “as people economy”¹, since the middle of 1997, when the horrible crisis hit Asian including Indonesia. Since that we realised that the government policies in the past emphasizing on the economic growth by giving various facilities as well as indulgence to big businesses so-called conglomerates resulted a lot problems and need to be corrected.

The worsened Indonesia’s economic condition of 1997 beside by the sudden monetary crisis also due to long drought affected the agricultural sector. With the crisis that struck in the Asian region, SMEs were also so affected that resulted to weakening of their activities and capabilities to compete and grow. Though not worsened than big enterprises, the existence of SMEs is still better than the big one. Compared with other Asian countries such as South Korea, Malaysia, the Philippines, and Thailand, the effect of crisis in Indonesia seems likely the worst.

Furthermore, the most severely affected countries, namely Indonesia and Thailand real GDP growth has turned abruptly from over 7 per cent per annum to zero or negative. Indonesia experiences a free-fall from 8 per cent in 1996 to 4.6 per cent in 1997 and to minus 13 per cent in 1998. Since 1999, Indonesia has slowly recovered from the crisis. From that year, the growth of Indonesia’s economy becoming positive, though still progressing slowly. Last year, Indonesia’s economy has grown 3.5 per cent and this year is also predicted around that number.

The Asian financial crisis which has global character has also influenced capital market, namely stock market and real estate market. The fall in equity and other asset prices further depressed aggregate domestic demand which in turn pushed down household consumption expenditures and income. Coupled with continuous instability in exchange rate, the fall in asset values adversely affected the health of banks and non-bank financial institutions. The implication is that nonviable financial institutions had to be closed down.

¹) The literal translation is the economy of common people or people’s economy as heritage by long history of dualistic economy as characterized by Bocke that exists until today see Bocke J.H, *Tropical Colonial Economics : The Problem*, Amsterdam 1910.

In Indonesia, from around 235 banks available in the pre-crisis period, the Central Bank closed down 16 private banks in November 1997. Other banks have been suspended in March 1998 and around 45 banks in April 1998 have been put under control and strict supervision by a newly establishing government agency in charge of banking reform so-called Indonesian Bank Restructuring Agency (IBRA). In March 1999, 38 more banks have been closed down, 9 banks have been recapitalized and some banks have been put under strict supervision. This process has been continued until recently. We are hoping to have strong and viable bank institutions in the future.

The crisis has affected not only financial institutions, but also real sectors, especially big companies and the state budget. In general, as mentioned above, the crisis has brought about a contraction in Indonesia's economic growth, high inflation rate, the fall of Rupiah value of almost 80 per cent against the US dollar, high interest rate and bankruptcy of many private companies. This phenomenon has also brought a social impact, characterized by the fall of real wages and incomes, greater unemployment and the increase of poverty.

B. SMEs And Economic Crisis

Small and Medium Enterprises (SMEs), as other developed countries recognise, have been notified as an engine of economic growth, job creation, and vehicle for equal income distribution. In addition, during the crisis hit Indonesia since the middle of 1997, SMEs showing their significant role to the growth of economy. Particularly, in 2000 with the growth of 4.7 per cent is recognized because of the role of aggregate consumption growth which reflect the strong support of the small economic undertaking. The remaining question is that whether the role of small and medium enterprises in Indonesia can be expected to be engine of growth in the long run.

Since the total numbers of SMEs are in particular very huge have contributed significantly to GDP and employment in particular, as well as their existence in all over regions of the country have made them to potentially become a strategic pillar for the Indonesian economy through their products and services in distribution. They can also be powerful institutions for improving income distribution in the framework of effort to eradicate poverty.

Further information, total number of SMEs in Indonesia including micro enterprises in 2000 is predicted around 40 millions or 99.99 per cent of total establishments. Although nearly 39 million of which or about 97 percent of small enterprises are micro enterprise with an annual sales of less than Rp. 50 million. The coverage of SME in Indonesia include all economic undertaking including agriculture Therefore SME in Indonesia cover SMI and services plus agriculture and extractive sector. They contribute not less than 55 per cent to total Gross Domestic Product (GDP) and employ more than 74.3 million workers or 99.4 per cent of the total available labor absorption in 2000. The agricultural sector has the largest employment provider with the amount of 32 million workers or 42.9 per cent, followed by trading, hotels, and restaurants in the amount of 18.4 million workers or 24.7 percent.

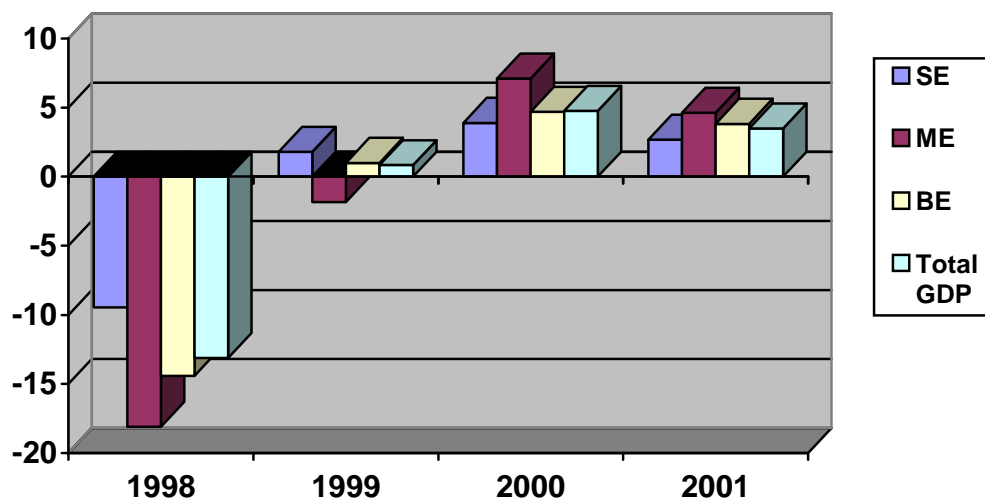
SMEs in developed countries, like USA, Japan, Canada, and Italy, have become one of the backbones of their economy. In the early 90s in the European Union - excluding agriculture and fisheries- there are 15.8 millions undertaking, of which 99.9 per cent were SMEs and some 14.5 million micro enterprises (0-9 workers), of which 7 millions without any employee (Moussis, 1994). This finding support the argument that the existence of small and micro enterprises are not the transitory phenomenon.

SMEs presence in economic development is by reality in the field that within the attack of horrible economic crisis the existence of SMEs is prominently very strong because of flexibility and must for survival. Our survey shows that only 4% of SMEs has closed down its activities, 31% has reduced its activities, 64% no-change, and 1% even has been growing well particularly to those SMEs oriented in agribusinesses and export oriented products (such as clove, coffee, cocoa, and the fishery products). In 2001, the ADB Technical Assistant has also conducted a survey in Medan and Semarang to identify the impact of crisis to SMEs. Its survey shows that 78 per cent of SMEs saying that there is no strong impact of crisis to their businesses.

The process of recovery is appeared better over present and last year give strong expectation that by the end of this year the aggregate indicator of Indonesia's economy will back into the level of pre crisis. However there are structural shift where big company in manufacturing sector will remain the prime contributor on value

added formation of nearly reach 19%, while crisis hits only temporary. On the other hand the back bone of grass root economy that is agricultural sector remain in the second place, but the increase in share the GDP during 1998-1999 has over, and decline to the level of pre crisis. This evidence seem to support that there will be a continuing process of declining share of agricultural sector in GDP as experienced during the period of pre crisis. For the purpose of looking at effect and response of different size of enterprise is appear in figure 1. The figure indicate that the monetary crisis hit SE less and quick to recover while big business responded slower. The medium business level seems suffer longer than the other groups.

Figure 1 :
GDP Growth By Group of Enterprise



The role of service sector namely trading, hotel and restaurants represented by small enterprise experienced the same path as agricultural sector with its contribution to GDP remain above 11 % although has declined compared with its contributions during the crises of 1999. The big mining sector has survived and shift the role of the SMEs in the trading sector to become the third contributor to GDP, while services sector of big business has back to its position during pre crisis. The big business in the mining sector, electric and gas has gained from the rationalization of subsidy by the government through adjustment in prices paid by consumers. Therefore there are big shifts in their contribution to GDP. The middle sector or medium

enterprise has worsened and can not be expected to be come the engine of growth and locomotive for reform in the near future. Unless there are significant effort to bring them into its competitive level.

The above analysis saying that SMEs can not be neglected in economic development, though their contribution to export is still very low compare to the big enterprises. In 2000, SMEs had contributed on export around IDR.438,853 billions, which is 2.94 per cent contributions of small enterprises and 11.76 percent contributions of medium enterprises. It means that contribution of SMEs in export was only 14.7 percent and this was much smaller than contribution of big enterprises which reached 85.3 percent. The lower performance of the share of SMEs in export is partly due to the dominant role of oil and gas and plantation agriculture products, which are belong to big companies mainly state owned enterprises (Pertamina and PTP). On the other hand exporting required better quality of services and evolve high risks make limitation to SME to participate in.

When a comparison been made on the SME sectors for the period of 1997 representing a situation of pre crisis and 2000 representing the end of crisis (see table 1), there are several important findings. Firstly, the number of small business increase, but the medium business decreases meaning that the crisis hit more on middle class. Many finding suggest that grass root economy are not much affected by the crisis and ever some sector enjoy growth, hence Indonesia is essentially has been facing monetary crisis not economic crisis (Mubyarto 2001). Secondly, relatively contribution of small sector to GDP is unstable since its dependence on agricultural sector and service sectors which has lower value added per enterprise or per worker. Thirdly, share in export has improved in small sector but decline in the middle sector. Fourthly, the crisis hits the big sector only temporary and the middle sector has been facing serious problem at all levels of production, finance and export. Fifthly, the employment creation remain dependent on small sector constraint the effort to improve productivity. These evidence suggest that the role SMEs is more on the employment provider and temporary safe guard rather than an engine of growth like what happening in other country. If SMEs are expected to be an important to growth, employment and export a comprehensive policy should be adopted

Table 1
Comparison of SE And ME Before And After Crisis

	Group	1997	2001*
No Establishment	SE	39.70 million	40.13 million
	ME	64,50 thousand	57.70 thousand
Share in GDP	SE	40.45 %	39.40 %
	ME	17.40 %	15.34 %
Share in Labour Absorption	SE	87.62 %	88.69 %
	ME	11.78 %	10.85 %
Value Added/Enterprise	SE	Rp. 6.40 million	Rp. 13.70 million
	ME	Rp. 1.81 billion	Rp. 3.55 billion
	BE	Rp. 126.13 billion	Rp. 288.67 billion
Share in Export	SE	2.17 %	3.37 %
	ME	23.82 %	10.93 %

Source : CBS

Note : (SE) for Small Enterprises
(ME) for Medium Enterprises
(BE) for Big Enterprises

*Projection Figure

C. Early Reform And New Economic Format

On May 21, 1998 presidential succession has occurred, continued with the formation of a development reform cabinet. It is the beginning of reform era, expected to be able to rectify various matters which are considered in contradictory to democratic principles, people's orientation and transparent implementation. The first cabinet under Mr. B.J. Habibie as the President was not long lasting. However, during his administration many fundamental changes have been made. At least there are three important changes that could be considered as a corner stone to the future democratic Indonesia. These are: (1) the move toward democratization thru democratic multi parties' election, (2) enactment and implementation of the law on district autonomy or decentralization, and (3) reposition of central bank and the banking sector as an independent institution in relation with the government. The separation of fiscal responsibility and monetary authority brought significant impact on modalities of government support to certain sectors of economy such as agriculture. The reform has been kept continuing by the administration of Presiden Wahid and President Megawati by considering the necessary step to make the process of recovery can be speed up.

Learning from many countries' experiences, people believe that our SMEs will also be able to become the backbone for our economy. In order to achieve this mission, its felt the need to shift the paradigm of economic development. While in the past the emphasis our the achievement of aggregate economic growth led by supportive policy in favor of economic conglomeration. In the future, it should be a broad based economy by strengthening participation of people, promotion human dignity and self-reliance. The new economic policy will put emphasis on development at district level as the basis for economic development and resources-based-oriented industry as part of our commitment toward decentralization.

The new economic format is aimed at creating a sound economic fundamental based on market friendly system with the necessary regulations to prevent SMEs from unfair market competition. Even though the new economic format seems to be in favor or SMEs, it does not ignore the role of the big businesses, because transparency on the rules of the games and independence between political authority and economic activities will be the basic

principles for guiding economic policy in the future as being set out by law on banking, law on anti monopoly, bankruptcy etc. All of the said efforts is part of improving the consciousness on good corporate governance.

This new economic paradigm is also expected to spur the growth of SMEs in the country. In our view medium enterprises particularly, have a strategic function to balance the wide gap between big and small enterprises in the national economic structure. The economic policy, particularly SME development policy, should clearly recognize the twin objectives of growth and export orientation on the one level, and poverty reduction on the other hand which also required appropriate policy instrument and implementations. Therefore, they have an important role in strengthening the national economy, while at the same time address social concerns.

D. Globalization : Challenges And Opportunities

As one of the WTO members, a lot of efforts, policies and programs have been enacted in line with the WTO agreements. Recognizing the position of Indonesia as a developing country, we feel still a lot of things to do in order to cope with and adjust with the era of globalization. The worldwide trend of globalization and trade liberalization which is characterized by strong competition has created many challenges and opportunities to firms in general.

In today's environment, there is increasing pressure for firms to operate trans-nationally. The simultaneous liberalization programs of different countries have opened up their domestic markets enabling foreign products to compete against local ones. Firms must now strive to be competitive and cannot depend on sheltering barriers of protection. But just as firms might now be threatened by foreign competition, they now have the opportunities to compete in foreign markets. They can now hope to penetrate export markets on the merit and strength of their companies and products without being frustrated by structural preferences for local firms.

The globalization trend does not just apply to the opening of markets and the consequent broadening of potential sales. The globalization trend is also apparent in the production and operations aspects of economy.

Many of our consumer products are in integration of components manufactured in production facilities spread throughout several nations. This is especially apparent in the automotive and electronics industries. And recently it is also applicable to the furniture industry, where auxiliary system are there while SMEs remain the main player. This is also evident in some service industries where facilities for programming, claims processing, encoding, and technical support are located in countries other than where the consumers or users are. The globalization of production and operations has enabled many firms to exploit the competitive advantages and resources uniquely present in different countries.

The impact of globalization and trade liberalization on SMEs in Indonesia is complicated the government policy in response to the economic crisis. Due to the crisis Indonesia has liberalized certain sector or commodities faster than the schedule of commitment under WTO Indonesia has set a schedule of implementation that care enough to the stages of changes. However, the new policy package under IMF agreement through several letters of intent has brought faster track that suffering a certain sector such as agriculture those used to be under close protection and involve massive players. Other SME that dependent from lower cost of import which able to offset the effect the fall in rupiah value. The problem of Indonesia is more on the adjustment process, rather than the threat of the trade liberalization, since indicated by the degree of openness of the economy as by total trade already high, that is approximately 55% of GDP.

E. SMEs Development Strategy

In order to strengthen the role of SMEs in export and in economic development in general, the government has tried to focus the issue of SMEs development on three main aspects namely: promotion conducive business environment, financial, and non-financial supports including industrial linkages aspects. On conducive business environment, the government tries to develop level playing field for all businesses to compete in the market place. On this aspect, some laws and other regulations may need to be revised or developed. In addition, the government is also trying to simplify procedure and mechanism for business licensing through one stop services. Recently harmonization of local regulation to meet the national object we are also increasing important.

On financial aspect, SMEs need to be given wider opportunities to access to sources of credits, particularly banking institutions. For this purpose, not only regulations and credit schemes need to be developed, but also improve the capability of SMEs utilizing banking credit. Since most of SMEs are lacking in collateral, which is very important for banking institutions as one of the criteria of customer selections, therefore it needs to have so-called credit guarantee institutions to back-up the necessary credit risk. In addition, since of those total SEs, 97.6 per cent are micro enterprises and very impossible to access into banking credit, therefore the existence of microfinance institutions, both banking and non banking institutions are also very important to be promoted. Being largest Moslem population country Indonesia has put serious concern on the promotion of Shariah banking both at national and local level. It is also extended with existence of Shariah non bank financial institution such as cooperatives and BMT or house of wealth and thrift.

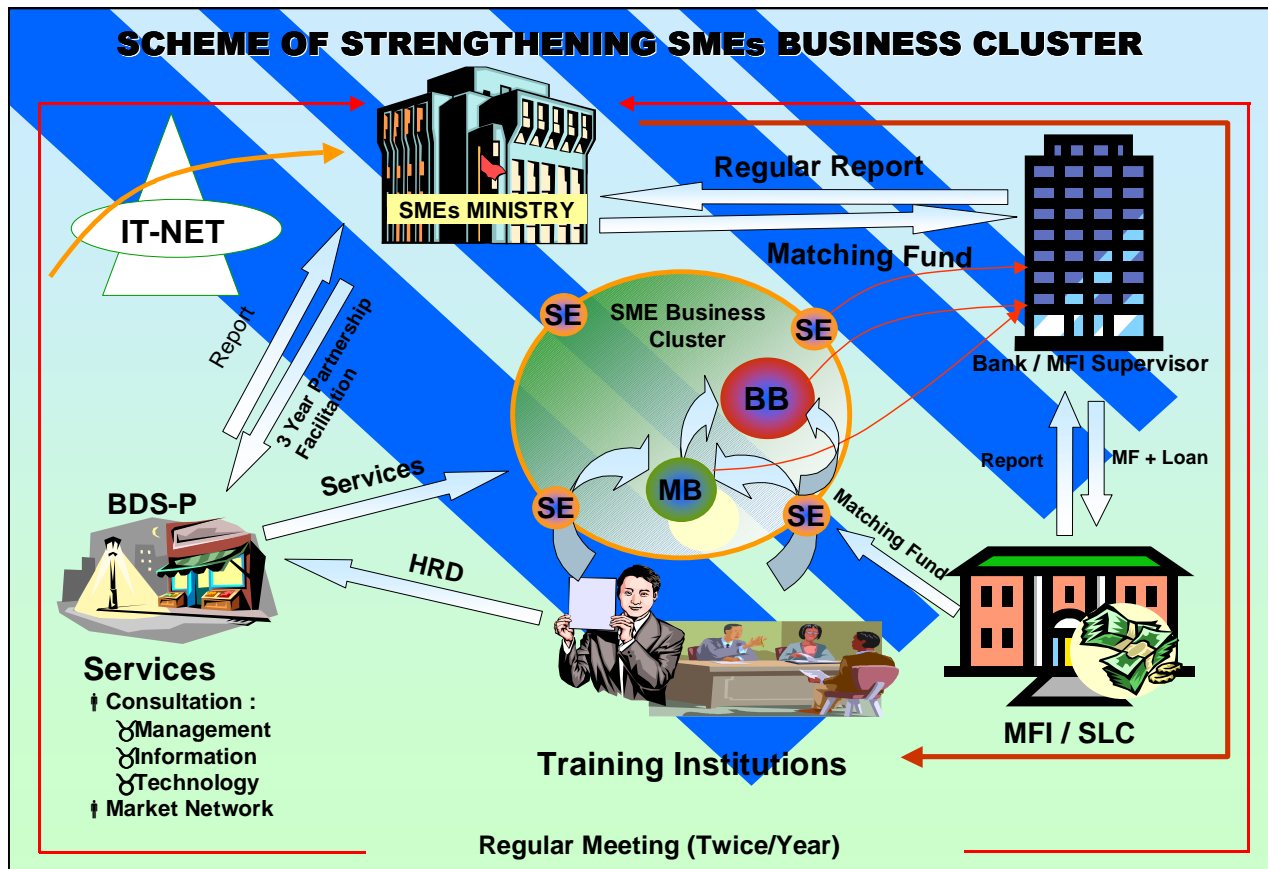
In order to support the development of the economy, the government has adopted a policy on continuation of handling carry over financial support credit program, that is for agricultural sector coordinated by Bank Rakyat Indonesia (BRI), property sector under Bank BTN and other credits for cooperatives and SMEs under PT. Permodalan Nasional Madani. This interim tasks is aimed at providing smooth process into new banking format particularly, law on central bank. Hence up to a present time this system still in operation, but government do not put any additional fund to the program.

At present intensive coordination between Central Bank and the Government to utilize the banking business plan to support SME promotion are oriented toward expansion of employment. It is also oriented to promote the poverty alleviation program through productive activities. This program will be financed through micro financial institution. The government provide extensive program for capacity building of the poor. The amount of total credit for SME and micro credit for 2002, is estimated 27,641 billion rupiah. This program is expected to spur the recovery of the economy and speed up the reduction of the poor. Harmonization of credit type and institution in accordance with the target group can be seen in table 2. All of the program are implemented in accordance with the existing banking regulation and not evolve any government subsidy.

Lastly, on non-financial including industrial linkages aspect, there are some issues needs to be addressed, such as: (a) strengthening of coordination among SME promotion policies, (b) strengthening of administrative capacity of local government, (c) strengthening of monitoring and assessment of SME promotion measures, (d) implementation of comprehensive policies for the promotion of supporting industry, (e) creating dynamic clusters for strengthening international competitiveness, and (f) measures for export promotion.

For the development of international competitiveness, the promotion of dynamic SMEs clusters, starting in 2001, have been adopted. In 2001 around 213 clusters and this year (2002) will be extended to 332 another clusters. Since the existence of SMEs business cluster, both manufacturing industry and non manufacturing industry, still at early stage it is important to recognize the stage of cluster from being survival, mature and advance. The approach, modalities of support and instruments will be made in accordance to the principle of market driven with the aim of developing strong integrated cluster.

In order to develop these clusters, support for business development services has been introduced as non financial component. The objective providing non-financial support among others are to give assistance of businesses consultancy, information, advocacy, and other developing network for SME development in the clusters. In addition, to support the SME's finance, the government also launched initial matching fund through saving and loan cooperatives under the supervision of commercial bank. Integrated support to SME in the cluster will serve as stimulus for dynamising SMEs in the respective areas.



MFI : Micro Financial Institution
 SLC : Saving and Loans Cooperatives

F. Agenda For Future Actions

Despite the intensive competition in the political sphere due to the democratization process, some economic indicators reveal that economic recovery is in sight. Indonesia has much potential for economic recovery. However, we must not be overly optimistic that the turn around will continue without considerable further policy reform. Large risks and potential fluctuations in economic conditions still lie ahead.

The most urgent priority is to sustain the recent trend towards macro economic stabilization. It should be achieved in the short term, by continuing the current approach of flexible exchange rates, targeting of base money and maintaining a budget stimulus. Such an approach is needed in the next few years to offset the collapse in private demand and to protect vulnerable groups through social safety

net needs to be ensured through well-designed and targeted programs. These require clear priorities of the target groups to minimize the budgetary burden. Other components include: placing sunset clauses on subsidies of special treatment, avoiding the entrapments of populist policies, and prioritizing needs for government support for bank restructuring. However efficient micro enterprising and SME in general must be continued under the objective national economic policy.

Government spending should remain subject to fiscal discipline, mindful of the possible inflationary effects that would, in turn, affect the monetary targets. Some revenue may be raised from the disposal of some state-owned enterprises, but significant budget deficits will still be unavoidable in the next few years. Non inflationary financing of these deficits will be possible only with substantial external support.

Beyond stabilization there are two priorities to restore growth. The first priority is the issue of restructuring of banking and the corporate sector. It is clear that public funds will be needed to restructure the banking sector. The most urgent need is to recapitalize the viable banks so that normal banking activities can be resumed as soon as possible. As stated above, 9 banks were recapitalized in March 1999. Other issues related to growth and development would be addressed in an open and transparent manner, taking into accounts the principles of justice and fair distribution. These include dealing with the troubled banks, non performing loans, and asset management of owners of the banks and debt to pay back to the government.

The second priority is to accelerate export growth. The sharp devaluation of the Rupiah has led to a substantial improvement in Indonesia's competitiveness, in spite of the limited export response. More needs to be done to remove administrative constraints and to supply adequate working capital for potential exporters. I believe that production and export costs can be reduced by further trade liberalization. An acceleration of trade liberalization by Indonesia, therefore, should be equally responded by its trading partners. In this context, renewed protectionism measures in various forms such as anti-dumping measures, safeguards and subsidies should be avoided.

Economic growth must also lead to grater equity. To achieve this objective, measures that are, economically sound and politically acceptable should be ensured. While direct subsidies targeted to

eradicate poverty are important part of the policy response to the crisis, the strengthening of market mechanisms is critical element in the promotion of equity specific initiatives should include:

- maintaining and improving communications and transport linked
- dismantling monopolies
- reducing administrative constraints to internal trade
- reducing high transaction costs facing small and medium-size enterprises (SMEs)

In current era of political openness it is important that measures which are supposedly designed to promote equity are not political favors to selected groups. Otherwise, these can ruin economic stability and jeopardize incentives and growth, and thus, increase the poverty level and inequality.

Many more issues will also arise in the next few years. One challenge is to maintain the momentum in augmenting social overhead capital. In addition, substantial investment is required in human resources to improve the institutional capacity of agencies entrusted with the implementation and monitoring of policies for recovery and reform. In this regard, the most critical need is to ensure that Bank Indonesia and other relevant agencies are able to safeguard the soundness of restructured financial sector in the future.

We believe that the empowering the grass root economy, it is crucial to give the opportunity for SMEs to have improved access and maintain legal requirements of productive asset. The ownership concept and productive asset management are in line with the concept to ownership limitation defined on business competition law, focusing on structural regulation, behavior limitation and performance towards monopoly. These concepts are also in line with privatization of State-owned Company (BUMN), to avoid economic centralization and to give wider participation to private sectors including employee though employee ownership program (ESOP).

Even though cooperative's and SMEs partially have succeed in showing successful achievements, but weakness in one part challenges and in another part are still found. Main weakness of cooperative is poor relation between members and its cooperatives and low educational attainment while at the some time to many cooperative engage in multi purpose societies lock of focus and found difficulty in the maintenance of its principle is business. Facing the

third millennium period, which is characterized by globalization process, there will be a trend of making interaction process among economic practices become transparent. There is nothing to be hidden but a bit part of anything due to have not been communicated properly. The era is free trade, demanding capability of self-adaptation of every economic practice, with no exception to cooperative's and SMEs.

It needs to have by various cooperative's and SMEs development policies which are more straightforward and oriented to micro and local productive resources utilization in line with effective effort strategy description. One of development focuses which can be carried out is the improvement in quality of cooperative's human resources in managing cooperatives in order to utilize external factors. Cooperative should be viewed as a suitable mechanisms in organizing the economy of micro undertaking with special focus on micro financing.

The most critical factor hinder the SME development is productivity improvement. To address this problem systematic effort such as clustering strategy and technology support will be crucially important. In this regard concentration on viable SMEs will help to identify competitive SMEs as the pillar for the economy. While serving the need for poverty reduction micro finance program combined with community development will ensure self sustaining program for poverty alleviation in a productive manner.

G. Concluding Remark

The existence of SME in Indonesia, these include SMI, services agricultural sector and micro enterprises, poses a very strategic position in employment and value added formation as well as their role in safe guarding the economy during the crises. However strong competitive SMEs, particularly export oriented upper small and medium enterprises are deemed important. Effective clustering combined with harmonized micro financial and banking development will meet the objective of growth, competitiveness and poverty reduction.

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