

Indonesia

Status Index (Democracy: 3.0 / Market economy: 2.7)		5.7	Management Index		4.9
System of government	Presidential democracy		Population	214.4 mill.	
Voter turnout	93.3 % (Parliamentary elections 1999)		GDP p. c. (\$, PPP)	2,940	
Women in Parliament	8.0 %		Unemployment rate	15-20 % (estimated, 2000)	
Population growth^a	1.8 %		HDI	0.682	
Percentage of the population constituted by ethnic minorities	55 %		UN Education Index	0.80	
			Gini Index	30.3 (2000)	
Data for 2001 – if not indicated otherwise. ^a Annual growth between 1975 and 2001. Source: UN Human Development Report 2003.					

1. Introduction

Suharto's fall in May 1998 paved the way for the re-democratization of Indonesia, which had had liberal democratic structures from 1950-57, immediately after it achieved independence. Political instability (seven governments in row), escalating rebellions, and the political elite's disdain for democratic rules of the game, however, led to the failure of the political system that had been created based on a European model. The subsequent four decades were marked by authoritarian rule under the presidencies of Sukarno (Guided Democracy) and Suharto (New Order).

Indonesia has been undergoing a democratic transformation since the elections of June 1999, the fundamental results of which have been the strengthening of party pluralism, participation, and at least partial curbing of the vetoing actors' powers. This report on the status of Indonesia's democratic and market economy transformation during the last five years comes to the conclusion that the realization of goals, even in light of the difficult structural framework conditions due to the massive economic crisis of 1997-98, has not met expectations.

Some key work remains to be done, particularly in the areas of fighting corruption, rule of law, reform of the existing organization of the market and competition, labor legislation and fighting unemployment, successful decentralization of political power, and ensuring the sustainability of economic development.

2. History and characteristics of transformation

The democratic transformational process began with the founding elections in June 1999, which followed on the heels of both the fall of President Suharto, who had led the nation with an iron fist since 1966 with the motto “New Order,” and the interim presidency of BJ Habibie. Megawati Sukarnoputri’s Indonesian Democratic Party–Struggle (PDI–P) emerged victorious from the parliamentary (Dewan Perwakilan Rakyat, DPR) elections, with 35 % of the votes. It was followed by the former ruling party, Golkar (22 %); Abdurrahman Wahid’s National Awakening Party (PKB); the political arm of the nation’s largest Islamic organization, Nahdlatul Ulama (12 %); and the Islamic United Development Party (PPP) (11 %).

In October 1999, the People’s Assembly (Majlis Permusyawaratan Rakyat, MPR) elected Wahid (Gus Dur) president and Megawati Sukarnoputri vice president. This was seen by both actors within the political system and a great many members of the public as disregard of the will of the voters, and as a result, the constitution of 1945 was amended in 2002, introducing direct election of the president. An impeachment trial against Gus Dur led to his removal from office in July, and Megawati was elevated to the office of president.

In the course of the democratization process, the DPR, which under Suharto was nothing more than a lackey of the administration, was able to establish itself over time as an effective monitoring body for the executive branch without the relationship between the powers being clearly regulated in the constitution. The constitution does not specify the type of political system and leaves open the question of whether the system should be parliamentary or presidential. The constitution of 1945 has been amended four times to meet post-authoritarian needs. In particular, the role of the military (Tentara Nasional Indonesia, TNI) has been reduced. Starting with the coming legislative period in 2004, there will no longer be any seats reserved for the military. TNI remains the main vetoing actor, and the threat of a coup d’état still exists. Some serious challenges on the road to democratization include ethnically and religiously motivated violence in several parts of the country, to which thousands have fallen victim since 1998; regional independence movements; lack of rule of law; inefficient administration; and the continued existence of patronage-based networks.

The economic transformation began in the late 1960s, but at first it was only to a certain extent the result of a modified economic policy after the change in leadership from Sukarno to Suharto in 1965-1966. Indonesia owes its ascent from being one of the world’s poorest countries to a lower-middle income country to two factors in particular: For one, the Suharto regime ended the international isolation caused by Sukarno and thus opened up the country to a massive influx of development aid; also, the explosive growth in oil prices brought rapid economic

growth along with them, resulting in an increase in the GDP of about 8 % per year.

Up until the early 1980s, Indonesia generally had a balanced current account balance, and sometimes even a small surplus. The dominant position of state authorities as actors in the development process was characteristic of the boom times of the 1970s. The economic success during this neo-statist period also helped create the breeding ground for the development of an inefficient and corrupt bureaucracy. As a result of the oil shock, the Indonesian economy showed its first signs of weakening in 1982, which intensified rapidly in the subsequent three years. While Indonesia had to dedicate 8.1 % of its export revenues to the debt service in 1980, in 1985 it was 37.3 %.

As a reaction to the crisis, which was largely a result of the country's major dependence on the oil trade, the Suharto Administration introduced a comprehensive national diversification program. The first attempts at fiscal and financial-policy reform in the years 1983-86 were followed by a series of deregulation measures between 1986 and 1990. The modification concept included among other things the dismantling of trade barriers, the reduction of control elements of a planned economy, the strengthening of the private sector's role in the development process, devaluation of the rupiah (twice), direct investment of profits from the oil business in underperforming trade sectors, and state subsidies for non-oil exports. The reforms made an impact in the first half of the 1990s in the form of GDP growth of 7-9 %, widespread improvements in welfare, and a significant reduction in poverty, among other things.

The 1997-1998 Asian crisis, which hit Indonesia the hardest, caused the GDP in 1998 to shrink by almost 14 % and the country as a whole to drop back to the economic development level of the mid-1970s, exposed the economic sector's structural weaknesses, which had been disguised by the preceding boom phase. During Suharto's almost 30 years of essentially sultanic rule, incestuous network relationships emerged between the president's family, the military bureaucracy, major corporations, and the country's banks. The economic process functioned primarily based on practiced informal processes which generally lacked transparency and monitoring by independent actors.

Under the strict supervision of the IMF, the administrations of the post-Suharto era (starting in 1998) have made an effort to reform the economic sector drastically. The macro-economic data has meanwhile regained a satisfactory level (in 2001 and 2002 the GDP grew appreciably again, with 3.3 % and 3.7 % respectively), but old networking relationships have yet to be shattered, and the primacy of formal institutions has not yet been achieved.

3. Examination of criteria for democracy and a market economy

3.1 Democracy

Indonesia has made progress in the transformation of the political regime in some evaluated areas, especially in political participation and the warranting of civil liberties. Transformation shortcomings exist primarily in the areas of stateness, rule of law, and political stability.

3.1.1 Political organization

(1) Stateness: The nationwide achievement of the state monopoly on the use of force has been one of the greatest challenges in the nation-building process since the country achieved independence. While the state monopoly on the use of force is considered to be generally achieved on the main island of Java, where about 80 % of the population lives, it exists only conditionally in the provinces of Aceh and Irian Jaya as a result of the separatist movements that have been active there for decades. These movements' pursuit of independence has not been slowed down by the laws giving both regions partial autonomy in 2001. The state monopoly on the use of force was also hindered during the period on the Moluccas by constantly erupting bloody conflicts between Christian and Muslim fundamentalists.

In parts of Kalimantan (ethnic conflicts) and Sulawesi (religious conflicts) the state monopoly on the use of force also works only to a certain degree. The secessionist movements cause individual population groups to question whether they qualify as citizens of the state. Apart from that, one of the state's outstanding achievements has been to achieve equal citizen rights for all citizens in a nation that is highly heterogeneous, both ethnically and religiously. However, during Suharto's New Order era, this was true only to a limited degree for the ethnic Chinese (about 3 % of the population), whose rights were limited by various laws.

It wasn't until late 2000 that approximately 140,000 ethnic Chinese finally were granted Indonesian citizenship, after some of them had lived as stateless people in Indonesia for more than four decades because of discriminatory citizenship laws. The often times informal discriminations of this minority still go on, for example during recruitment for administration, for the military sector from which they are almost completely excluded, and when it comes to public schools and Universities where they are subject to "negative quotas".

The separation of church and state, central to the Pancasila state ideology, is a major supporting pillar of the Indonesian nation. The demands of individual Islamic actors to establish Islam as the state religion and/or for sharia to be used as the legal system for the Muslim sections of the populace have been blocked successfully by the state on several occasions, most recently during the constitutional reform of 2002. At the same time, Islamic groups are politically influential just based on the sheer numbers of their membership – the two largest, *Nahdlatul Ulama* and *Muhammadiyah*, have more than 60 million members. Starting in the 1970s, Suharto intentionally supported Islamic actors politically in order to reduce the military's hegemonic position in politics.

Contrary to initial expectations, the democratic elections of June 1999 did not lead to Islamization or religious radicalization of Indonesian politics. The state is present with a basic infrastructure over the entire national territory, although large areas function only inadequately. The national bureaucracy has been strictly organized down to the last detail since the beginning of the New Order, and a civil service has been built up that is loyal to the authoritarian regime, increasingly professional, and also highly corrupt. Because of tendencies toward decentralization and the fact that the loyalty of the civil service has been greatly reduced by the conditions of democratic leadership (since it is no longer forced), the efficiency of implementing political decisions declined during the evaluation period.

(2) *Political participation*: The first general (although not universally transparent and characterized by isolated technical irregularities) elections for the Indonesian Parliament (the DPR) carried out since 1955 took place on June 9, 1999. Only 462 of the 500 officeholders were elected, however. As a relic of the authoritarian rule and an expression of the military's still accentuated socio-political position, 38 seats were reserved for unelected representatives of the armed forces (TNI) and the police (Polri). Although this number had already been reduced from the original figure of 100, these groups are still overrepresented, and therefore the process was publicly criticized shortly after the elections took place. A corresponding constitutional amendment made in August 2002 ends this privilege with the next parliamentary elections in 2004.

The majority of Indonesia's state and particularly civic actors considered the fact that the first president of the democratic era, Adburrahman Wahid, was not directly elected and only experienced limited indirect legitimation to be a significant restriction of the voters' will. According to constitutional regulations effective until recently, it was incumbent upon the People's Assembly (*Majlis Permusyawaratan Rakyat*, MPR) to elect the president and vice president. However, only the 462 elected DPR members of Parliament in the 1000-member MPR were democratically legitimized, while the remaining 538 members were hand-selected representatives of important societal function groups and regional

authorities. Likewise, this regulation was abolished with the constitutional amendment in August 2002 to elect the president directly.

Elections are now considered by all relevant actors to be the accepted method for selecting a leader. The armed forces continue to reserve the right to interfere with the current regime if they believe the unity and stability of the Indonesian nation to be threatened. The possibility of a military putsch cannot be discounted. In which case, the elected government representatives' power to govern and also the constitution could be cut back or even terminated by the TNI, as the most important vetoing actor. On the other hand, radical Islamic groups have not been able to establish themselves in light of the moderate and true-to-the-constitution tenor of the majority of Islamic actors and as a result of the war on terrorism, into which Indonesia was pulled in October 2002 with the bombing in Bali.

As part of the gradual conversion to a democratic basic order that has been occurring since May 1998, civic groups are now essentially guaranteed unlimited freedom of association and assembly. The same is true for the complete provision of freedom of the press and speech, which were significantly restricted under Suharto. Under Wahid, Chinese-language media was again allowed, after being forbidden in the putsch attempts and communist hunt of the late 1960s.

(3) *Rule of law*: Separation of powers did not exist until 1998; the DPR, the MPR, and the judiciary branch acted as dependent subordinate bodies to the executive branch and were linked to it through intricate network relationships. The DPR and the MPR have become emancipated during the transformation. However, it is still a problem that the constitution of 1945, which has endured despite a brief democratic interlude in the 1950s, was conceived as a temporary constitution and is vague in many regards, especially on the role of the legislative branch and how to separate the powers.

The constitution solidified the president's strong position and is weak in terms of institutional mechanisms of checks and balances. Although four rounds of amendments since 1998 have contributed to solidifying the constitution, the relationship between the executive branch and the legislative branch is still the object of conflicting interpretations of the constitution. The independence of the judiciary branch has grown during the transformation, and it is no longer directly dependent on the government's interests. Old networks still exist between the judiciary sector and Suharto's cronies, however, as the judgments in various high-profile cases during the period lead one to assume. One example is the August 2002 acquittal of six high-ranking officers in the East Timor case, who had been accused of involvement in the massacres there in 1999.

The judiciary sector is considered to be the most corrupt in Southeast Asia. Both the Indonesian NGO Indonesia Corruption Watch and the UN mission came to the conclusion in 2000 that the fact of systematic corruption in Indonesian courts,

including the Supreme Court, had not improved under the conditions of formal democracy; rather, it had been consolidated. Several public trials of corrupt Members of Parliament, such as the Speaker of the DPR and Chairman of Golkar, Akbar Tandjung, indicate that MPs can no longer use their office as they choose for their own private purposes. However, the prosecution of a few key figures, particularly from the Suharto regime, is not a conclusive indicator of a significant reduction in abuse of authority and penalties for such abuse.

Unambiguous qualitative advances can be recognized in the expansion of civil liberties, especially in the repealing of laws from the Suharto period that discriminated against ethnic Chinese and other minorities. The Freedom House ranking for civil liberties improved from 5 (1997-1998) to 4 (2001-2002).

3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability of democracy:* The democratic institutions are functional, in principle, but do not yet have intra- or inter-organizational stability due to the still-young transformation process. Their continuity is called into question primarily by the armed forces as the strongest vetoing actor. Thus, the main danger of an infiltration of the democratic institutional structure comes from the military (TNI). In accordance with the *dwi fungsi* doctrine (double function), the TNI traditionally considers itself to be not only the guarantor of the country's territorial integrity, but also the guardian of Indonesia's internal order. The high offices that members of the military still occupy at all levels of government and administration are a visible expression of the military's distinguished position in domestic policy.

(2) *Political and social integration:* On the whole, the party system must be considered instable at present. Forty-eight parties (from a total of 148) ran in the June 1999 elections, although four parties received 80 % of the vote and 382 of the 462 elected seats in the DPR, and only 15 other parties made it into Parliament at all. The parliamentary elections planned for 2004, for which 200 parties are already registered, will give a more conclusive judgment on the degree of fragmentation (and also of voter volatility), although a shift of power between the larger parties is more likely than the rise of a new major party.

The core of the Indonesian party system continues in the transformation phase to be a set of formal and informal institutions that has existed for more than 25 years and has considerable anchoring in society. The fact that the democratization process since 1998 has not led to the Islamization of the party system despite the presence of Islamic interest groups is noteworthy. Islamic associations are the most significant and best organized intermediary actors. This is especially true for the umbrella groups *Nahdlatul Ulama* (NU) and *Muhammadiyah*, which play significant intermediary roles between society and the political system. And they

are one of the opinion leaders in the debate about the future relationship between the state and religion.

Other actors on the intermediary level, such as trade associations and unions, play a lesser role. Indonesia has the lowest level of unionization in all of Southeast Asia – in the mid-90s it was only 1.4 %. The influence of KADIN, the Indonesian chamber of commerce and industry, on the economic policy decision-making process is significant. KADIN unites 27 provincial chambers, 300 on the district level, and more than 200 industry associations under its umbrella, but it mainly represents the interests of the upper middle class and major enterprises. In general the intermediary actors do not represent an anti-democratic threat.

Dependable survey data regarding opinions about democracy are not available, but a certain degree of frustration about the course that democratization is taking is unmistakable within civil society. While the key societal actors were expecting the establishment of basic democratic structures after 1998, the status quo of Indonesia's political system, frequently referred to as "elite democracy" within the country, is often criticized for being insufficient. Political protests have constructively questioned the constitutional framework and contributed to significant amendments (e.g., the introduction of direct election of the president) to the constitution of 1945, which is generally considered to be undemocratic.

The transformation has brought forth a number of new civic actors – called lembaga swadaya masyarakat (LSM - self-reliance organizations) in Indonesia – which can be described as a heterogeneous meshwork of autonomous, self-organized groups, associations, and organizations. Several hundred NGOs have been active in the area of political education and/or monitored the 1999 elections. Another field of activity for civic actors has arisen in the socio-economic area. Numerous NGOs have contributed to cushioning the social consequences, particularly unemployment, of the economic crisis that has been ongoing since 1997 – a task that the state cannot manage on its own.

3.2 Market economy

The economic transformation begun two decades ago preceded the political one, but has still not resulted in a free market economy system. The Heritage Foundation's 2002 Index of Economic Freedom classifies the Indonesian economy as "mostly unfree."

3.2.1 Level of socioeconomic development

Taking the absolute poverty indicator as a basis, the crisis of 1997-1998 initially significantly increased social exclusion, both quantitatively and qualitatively. The proportion of the population living in absolute poverty sunk from 56 % to 15 % from 1970 to 1990, increased during the course of the 1998 crisis to between 37 % and 50 %, depending on the estimate, and finally was back down close to its pre-crisis level with 16 % in 2002.

In other respects, exclusion was reduced during the period. The crisis affected all social groups and tended to reduce differences in income rather than aggravate them. Between 1976 and 1996 the income distribution in cities generally remained constant (Gini index of about 36). During the same time period, the Gini index actually improved in rural areas, from 31 to 27. The Gini ratio was 34.2 in the pre-crisis year of 1996, and it decreased to 33.3 in 2000 after reaching 31.7 in 1999.

The fact that the GDI value in all Indonesian provinces is lower than the HDI rate confirms the gender inequality. At the same time, at least the crisis did not lead to an increase in the gap between the GDI and the HDI. Between 1998 and 2000 the GDI increased nationwide from 0.664 to 0.678, while the HDI value improved from 0.67 to 0.684 during the same time period, and the difference between the two ratios remained constant.

3.2.2 Market structures and competition

Despite the reforms that have been going on since the mid-80s to strengthen free-market competition, it is being hindered by both formal and informal regulations and processes. Article 33 of the constitution solidifies the primacy of state-owned enterprises over private enterprise and serves as across-the-board justification for the preferential treatment given to individual actors in the economy. The requirements laid out in the constitution are intended to balance out the development differences brought on by the country's size and heterogeneity. The state airlines and bus and shipping companies, for example, are obligated to serve even unprofitable domestic routes. Also, state-owned enterprises are considered to be a stronghold of native entrepreneurs, a sphere protected from external competition.

Despite the reform pressure coming from the IMF, the political will to break up the patronage-based networks that arose between the political elite, the military, and large enterprises during the New Order era and the monopoly creation that goes along with them has so far been lacking. Although the new Cartel Act of 1999 is to regulate the formation of monopolies and oligopolies, the act contains passages that open the door once again to cronyism, neo-patrimonialism, and

corruption. Indonesia is obligated to liberalize its foreign trade because of its membership in the ASEAN Free Trade Area (AFTA) and the WTO. However, it has been slow to live up to the promise it made the WTO in 1998 to greatly reduce tariff and non-tariff trade barriers, citing the difficult economic situation during the Asian crisis.

For a long time, Indonesia insisted on regulatory exceptions and transitional regulations for the AFTA Agreement, but it joined the Southeast Asian free-trade area on January 1, 2002 as planned. Indonesia's external tariffs are between 0 % and 30 %, with the average being 6.2 %. In general, Indonesia can be rated as moderately protectionist. A lack of transparency and predictability in granting licenses and in the administrative implementation of trade policy seriously hinder the functionality of the trade regime.

The absence of effective regulations and supervision of the banking system and the capital market contributed greatly to the outbreak of the crisis in 1997, which drove many banks to insolvency. The state-run Indonesian Bank Restructuring Agency (IBRA) was put in charge of implementing large-scale reform programs that were intended to stabilize the banking sector. Despite some success – the proportion of non-performing loans fell during the period from 49.2 % (December 1998) to 14.7 % (September 2001) – the banking system must still be considered unstable 6 years after the crisis began. The majority of banks were able to stay afloat only with the help of massive state support. All in all, the IBRA distributed government loans worth US\$ 47.78 billion to recapitalize the banks. The banking sector consists of 161 banks: 91 private, 5 state-run, and 39 foreign or joint-venture banks, and 26 provincial development banks.

3.2.3 Stability of currency and prices

Not least as a result of the serious economic crisis of the early 1960s, during which the inflation rate sometimes exceeded 600 %, inflation control and the exchange rate policy were among Suharto's recognized economic-policy goals. The 1997 crisis again drew attention to their importance. Between 1991 and 2000, Indonesia's average inflation rate was 12.41 % – one of the highest in the region.

During the assessment period, inflation was fostered by the IMF-required reduction of state subsidies for such commodities as fuel and fluctuations in the exchange rate due to political and economic instability. Thus, the state's scope for action to create a consistent inflation policy and an adequate exchange rate policy is limited. The inflation rate for 2003 could level off at around 10 %, provided that the US dollar stabilizes at 9000 to 9400 rupiahs.

The Indonesian government is not yet in a position to implement a continuous stability policy on its own power. During the evaluation period, the focus was on

debt restructuring strategies. External debt grew from 38.8 % of the GDP in 1996 to 88 % in 2001, domestic debt amounted to 80 % of the GDP. The government's plans to reduce debt to 65 % of the GDP in 2001 by finding new sources of tax revenue and improving tax collection failed not least because at the same time public spending increased by 8 % per year during the period. The government justified its disproportionate increases, which were criticized by the IMF, with the high costs of the decentralization program. The fact that Indonesia has not lost the faith of international debtors despite these problems with goal-setting and performance, and that the Paris and London Clubs agreed to debt restructuring programs, is owed solely to the IMF's presence in the country, which is seen by outsiders as fostering stability. This presence is scheduled to end in 2004, however.

3.2.4 Private property

Property rights and the regulation of property acquisition are formally defined by law, but at the same time they are subject to informal acts of cronyism and corruption. As already explained in section 3.2.2 of this report, state-owned enterprises and monopolies, some of which are still maintained by Suharto's cronies and the military, dominate strategic economic sectors. The privatization of state-owned enterprises made very slow progress during the period. In 2001, for example, only 2 of the planned 16 enterprises were privatized, and the revenues from their sale added up to only about half of the estimated US\$ 630 million. The sale of state-owned enterprises has generally been blocked by the DPR, which is led by nationalistic motives, in particular the concern about alleged foreign domination of the Indonesian economy.

3.2.5 Welfare regime

The Suharto regime endeavored to build up a social network. In the field of health care, for example, a network of local health centers (*puskesmas*) was built; their quality, however, was low in many cases and they were not readily accessible to families with low incomes because of the fees required. Indonesia brought up the rear among developing countries in the number of hospital beds per capita during the 1990s. Indonesia also lags behind other countries in Southeast Asia, e.g., the Philippines and Thailand, when it comes to reducing infant mortality. The government has been more successful fighting poverty in the last two decades – especially as a result of the nutrition policy based on stable prices for staple foods and a massive increase in rice production.

The government endeavored somewhat successfully after the crisis to cushion the effects of the crisis on the most seriously affected social groups through strengthening social networks (e.g., by setting up the Social Safety Net

Scholarship Program). However, fighting the poverty that had increased massively after 1997 overtaxed the government and it was only possible with the cooperation of the expanded NGO sector and international assistance. In February 2003, the ADB (Asian Development Bank) announced a rural poverty eradication grant of US\$ 15 million for the next eight years, which supplements the activities of other donors, such as the Japan Fund.

Indonesian society is ethnically and religiously very heterogeneous. While the HPI (Human Poverty Index) in Jakarta had the best value, at 15.5 %, West Kalimantan trailed with 38.7 % (2000 figures). The fact that socio-economic inequality is not as bad as it was two or three decades ago is largely due to the success of the long phase of economic growth combined with the Suharto regime's education offensive, as a result of which virtually all Indonesians are guaranteed access to at least a primary education.

Unequal opportunities based on gender decreased significantly in the 1990s, which can be seen by the improved access for girls and women to education and the labor market. The percentage of women in the work force grew from 25 % in 1990 to 37 % in 1999. The average number of years that girls attend school climbed from 4.7 to 6.1 in that same time period. In 1996 41 % of secondary school pupils were girls (1980: 23 %) and the proportion in the tertiary sector was up to 50 % (1980: 35 %).

In Indonesia's paternalistic culture, it is still difficult for women to gain access to public office and the political will to introduce comprehensive gender-based reforms is lacking. On the whole, social networks and institutions meant to equalize glaring social differences were better developed than ever before in the history of Indonesia, but they are still sub par in comparison to most other countries in Southeast Asia.

3.2.6 Strength of the economy

Following a massive drop in the GDP of 13.7 % in 1998 and a slight increase of 0.2 % in 1999, growth has been higher since 2000, the first complete year of economic recovery, at 4.8 % in 2000, 3.3 % in 2001, and an estimated 3.2 % in 2002, but the pre-crisis GDP has not been reached yet. The ADB expects an increase of 4.4 % in 2003. Growth was due largely to private consumption and public spending, however, and less so to private economic investments. While the GDP has grown continuously every year since 1999, yearly average investment revenue has declined since the outbreak of the crisis.

Without a significant increase in private investment, sustainable growth of the Indonesian economy does not seem possible in the middle term. The improved macro-economic data for 2001 and 2002 is the result, in particular, of the IMF's

largely successful stabilization program, which led to improved monetary policy, which in turn has had a positive effect on inflation control. The inflation rate in 2002 was estimated to be 11 %, which is 0.5 % less than in the previous year. Although external debt in percentage of exports in 2002 (199) was slightly lower than in 2001 (210), far-reaching reduction of the entire public debt (both internal and external) is not expected in this decade due to the long-term implications of the crisis, according to the ADP. The unemployment rate, officially given as 8.1 % in 2001 (although it was actually more likely to be between 15 % and 20 %), reached its highest level since the first massive economic crisis of the early 1960s.

3.2.7 Sustainability

Environmental sustainability definitely takes a back seat to the pursuit of growth and it is barely anchored institutionally. The massive forest fires of 1997-98, which covered Indonesia and its neighbors in a cloud of smog for months and were the worst environmental catastrophe of the decade, were started by illegal but officially tolerated slash-and-burn fires set by large landowners in Indonesia. In addition, 2.5 to 3 million hectares of rain forest are cleared in Indonesia every year, approximately 70 % of them illegally.

In 1950 there were about 162 million hectares of rain forest, and only 98 million hectares remained by 2000. This illegal clearing is a result of the lucrative palm oil business and the building of too many too-large paper and cellulose factories – also supported by international development aid – the operation of which can be maintained only with the massive exploitation of ever larger areas of forest. The implementation of new environmental regulations regularly comes up against problems caused by lack of money, environmental consciousness, and trained personnel.

State investment in education has increased significantly since the economic reform program began in the 1980s, but most of the support has gone to primary education while higher education has gone neglected, as only 13 % of the education budget goes to that area. As of the late 1990s, there were approximately 75 state and about 1200 private colleges and universities. In 1999 the government initiated a pilot project in which four state universities became autonomous; the other institutions of higher learning are to follow. The primary goal is to increase the efficiency of educational management. Indonesia's educational spending (1.4 % of the GDP) is far below the regional average, resulting in significant deficits in the areas of research and development.

4. Trend

(1) *Democracy*: In the course of the democratization process, political participation along a wide front has improved greatly, and rule of law has improved somewhat over the situation in 1998, despite some remaining informal restraints. Stateness, however, has deteriorated. The bombing in Bali, and also the violent ethnically and religiously motivated clashes in some parts of the country, are an indicator of the failure to assert the state monopoly on the use of force.

The degree of consolidation of democracy has improved significantly in certain aspects since the elections, primarily as a result of the constitutional amendments and the reduction of the socio-political role of the military that goes along with it to some degree. Indonesia's level of development did not change significantly between 1995 (HDI: 0.681) and 2000 (0.684), primarily because of the crisis.

(2) *Market economy*: The institutional framework conditions for market-economy behavior have improved formally, but they continue to be subject to informal restraints. Based on the entire evaluation period, economic development declined as a whole (1.6 % drop in the GDP). Following the massive recession in 1998, the GDP did, however, grow again by a total of 11.5 % between 1999 and 2002. In light of high levels of debt and lackluster, regressive investment activity – the total volume of foreign direct investments was reduced to about half of its pre-crisis high, while there is also a low domestic investment volume – the quality of the framework conditions has not changed much since 1999. An improvement in quality can be seen only in comparison with the crisis year 1998.

Table: Development of socioeconomic indicators of modernization

	HDI	GDI	GDP Index	UN Education Index	Political representation of women	GDP p. c. (\$, PPP)
1998	0.670	0.664	0.55	0.79	13 %	2,651
2001	0.682	0.677	0.56	0.80	8.0 %	2,940

Sources: UNDP, Human Development Report, 2000, 2003.

Table: Development of macroeconomic fundamentals (1998-2002)

	1998	1999	2000	2001	2002 (est.)
Growth of GDP in %	-13.1	0.2	4.8	3.3	3.2
Export growth in %	-10.5	1.7	27.6	-9.8	10.5
Import growth in %	-30.9	-4.2	31.9	-12.2	10
Inflation in %	80	20.5	3.5	11.5	11
Unemployment in %	5.5	6.4	6.1	8.1	n/a
Budget deficit in % of GDP	-3.7	- 1.6	-3.2	- 4.2	-3.2
Current account balance in billion US\$	4.1	5.8	4	8	11.5

Sources: Dresdner Bank 2002: Indonesien: Licht und Schatten, http://www.dresdner-bank.de/meta/kontakt/01_economic_research/05_emerging_markets_2/ldk_ri_Indonesien.pdfAD B: Asian Development Outlook 2002 update, http://www.adb.org/documents/books/ado/2002/Update/southeast_asia.pdf; ADB: Asian Development Outlook 2002, <http://www.adb.org/Documents/Books/ADO/2002/ino.asp>; ADB: Asian Development Outlook 2001, <http://www.adb.org/Documents/Books/ADO/2001/ino.asp>; Landesbank Rheinland-Pfalz, Länderbericht Indonesien, März 2002, http://www.lrp.de/m6_ausland/download/m612indo.pdf [accessed 02/10/2003].

5. Transformation management

5.1 Level of difficulty

With a per capita GDP of US\$ 3,043, Indonesia belongs to the middle income countries group. The UN Education Index of 0.79 places the country in the lowest category. Indonesian society is deeply ethnically heterogeneous and includes about 60 % ethnic minorities. Violent social, ethnic, and religious conflicts, situations bordering on civil war (the Moluccas, Aceh, Kalimantan), and terrorism (Bali) intensified during the period. Starting with weak civic traditions, the political transformation process brought forth the rudiments of a civic culture and a rapidly enlarging NGO sector. As for rule of law, Indonesia just reached an intermediate status, while institutional stability is still categorized as low.

5.2 Reliable pursuit of goals

The successful process of amending the constitution, the decentralization policy initiated in 2001, and an economic policy oriented toward IMF requirements indicate a policy oriented toward long-term goals. While the right goals have generally been set, it is not unusual for them (particularly in the area of economic planning) to be set aside in favor of short-term gains; the debt problem is an example of this.

Also in quite a few cases the planned measures are not implemented successfully. Thus the government embarked on a plan on January 1, 2001 to transfer political power and responsibility for education, health, regional roads, environmental management and other public-sector interests from central authorities to regional governmental institutions. Insufficient supervision of the transfer process and the constitution of clear-cut norms and regulations have, however, led to a deterioration of public services and have thwarted development of the private sector. With a view to maximizing short-term benefits, quite a few local governments have started to impose new taxes without considering what negative effects they might have on growth and investment. It has not really been possible to orient local policies on the principle of sustainability in general and the protection of natural resources in particular. It is true in other areas as well that the central government is actually endeavoring to implement announced reforms, but key actors are working against each other, and as the centralization policy shows, individual policies sometimes have a counterproductive effect on other policies.

The sovereign guarantee of key civil and human rights has improved significantly since the fall of the Suharto regime. However, the government is only somewhat qualified to guarantee broad reliability of expectations for the lives of its citizens. In particular, there is a lack of protection against basic emergency situations and the use of force by non-state elements. Assurance of justice and stable economic framework conditions do not yet exist.

5.3 Effective use of resources

Although the government endeavors to use resources effectively, not least because of pressure from the IMF, it has been only somewhat successful. The state's administration is inefficient in many areas as a result of inadequate finances for the bureaucracy, unsatisfactory training and further education for public employees, contradictory laws, and corruption. At the community level in particular, clear boundaries are still set on transparent planning and execution. The decentralization program begun in 2001 has led more to a reduction of the

efficiency level rather than an increase in it, due to sometimes-contradictory and hastily passed laws. At the national level, transparency, predictability, and fairness in the actions of the customs and tax authorities have worsened since 1998.

During the evaluation period, the government was able to implement some of the announced reforms demanded by the IMF, as demonstrated by successes in the macro-economic area. The basic reform agenda remains open, however. Indonesia needs an annual GDP growth rate of 6 % in order to make significant progress in reducing poverty and unemployment. Thus far, the government has not been able to create the central framework conditions for economic consolidation, such as the reduction of public debts, thorough reform of the banking sector, and implementation of policies to improve the investment climate, although such changes have been announced many times. The will to reform is nevertheless clear.

The government has still not been able to implement an adequate labor policy, however, that would be able to create a balance between protecting employees and ensuring a flexible labor market. The main political challenge is the creation of an efficient, independent judiciary sector. In November 2002, the DPR passed a comprehensive, 72-article anti-corruption law, whose effectiveness still has to be proven. In the meanwhile, corruption continues to be a major characteristic of the state and administrative culture. With a value of 1.6 on the 2002 Corruption Perception Index (a rating of 10 means essentially free of corruption, and 0 indicates a very high level of corruption), Indonesia ranks 96 out of 102 nations. As such, the CPI value is now clearly worse than it was in 1997 (2.72), the final year of the Suharto regime. Corruption is now prosecuted more consistently than it was at the beginning of the assessment period, however.

In an extremely heterogeneous nation such as Indonesia, which does not really have a developed common cultural heritage and therefore needed to create constructed symbols (Pancasila, the national language Bahasa Indonesia, etc.) in the course of the nation-building process, the existing traditions are too weak to be used to support reforms. The short democratic period of the 1950s is also unsuitable as a reference, since it failed. The concept of a multiethnic and mixed-religious community of destiny (born during the fight for independence against the Netherlands from 1945-1949) is firmly anchored in the national consciousness, and the political elite are exploiting it in the reform process.

5.4 Governance capability

Judging by the changes in the political arena (e.g., constitutional amendments, reduction of the position and role of the military) and the economic sector (e.g., the first signs of budget consolidation) that were discussed previously, it can be

assumed that the key political actors are fundamentally adaptive. The standing and influence of the Megawati government is low. Although Megawati has a higher degree of legitimacy than her predecessor Gus Dur, the political authority of the administration as a whole is not sufficient to implement and carry forward the reforms. The distributive effects of state behavior are taken into account, whereby the disorder of economic resources cannot be overlooked.

The sluggish progress of the privatization of state-owned enterprises shows that the necessary efforts are not always made to improve the markets' distribution efficiency. The reform-oriented actors are capable of acting strategically, as they have demonstrated with the cunningly and far-sightedly executed constitutional amendments, among other things. Here the scope for action was also correctly assessed, since it would currently not be possible to reach a consensus on creating a new constitution, and it would have failed due to the resistance of key actors. Serious errors have slipped in during the course of the decentralization policy, which was not conceived and implemented with the necessary far-sightedness.

It is also questionable whether politicians used the necessary sensitivity when choosing tools and strategies in the aftermath of the bombing in Bali. Everything points to the continued separation of church and state, and the danger of a nationwide radicalization of Indonesian Islam appears to have been averted. However, the anti-terrorism laws passed after the attack in Bali give the military and the police new scope for action, in ways that are potentially damaging to democracy. Terrorism is defined rather broadly, so that secessionist movements and individual cases of opposition can also be classified as terrorism. Suspects may be detained for up to six months without charges. The question of political cunningness and far-sightedness is different when it comes to the economic transformation, because the scope for economic policy is determined largely by the IMF.

5.5 Consensus-building

Apart from basic agreement on the general goals of consolidation of democracy and a market economy, the key actors have not reached a consensus on what strategies to use to reach these goals. Some issues that have not been clarified include the future relationship between church and state, the institutional position of Parliament and the president, the extent of the decentralization process, and the role of state-owned enterprises or the scope of the privatization policy. Political parties, government agencies, intellectuals, and a growing number of NGOs and other civic actors are competing with each other in both the ranking of goals and also the concrete reform plans.

Although the armed forces are under a civilian Minister of Defense for the first time in 40 years, and a gradual reduction of the TNI's socio-political role and its

role in foreign policy are unmistakable, there is still no “pact” between civilian and military actors that would take away the armed forces’ footing in political interventions. At least the TNI’s use of blockade power has been limited, not least as a result of the abolishment of reserved seats in Parliament for the military. All in all, the judgment of whether the political reformers are able to control the vetoing actors is inconclusive. While the veto power of about a dozen radical Islamic groups has been curbed considerably, for example, there is hardly any control of the anti-democratic economic actors.

During the evaluation period, ethnic, religious, and regional conflict lines deepened in comparison with the authoritarian era, while the government was generally not in a position to efficiently deal with these cleavages. The economic crisis and the increasing development of civic structures and actors have also increased the people’s willingness to exhibit solidarity, although significant input from the government cannot be seen here.

The political elite are selectively willing to recognize the necessity of dealing with acts of injustice in Indonesia’s past. This is true, with reservations, of coming to terms with the human-rights abuses in East Timor, but no comprehensive reconciliation process has yet gotten off the ground. There is still a certain reluctance to deal with the mass murders of up to a million suspected communists, many of whom were ethnic Chinese, which were initiated early in the Suharto regime, in the late 1960s.

5.6 International cooperation

Indonesia’s political actors are obliged to collaborate with the IMF, and they have taken targeted advantage of aid to meet the demands of economic transformation. In addition, there is cooperation with a number of international donors. All of the more comprehensive projects with international assistance, however, include conditions that are meant to encourage the learning process and changes in behavior of Indonesia’s political actors. Loans from the ADB, for example, are linked to progress in the areas of fighting corruption, legal reform, decentralization, education and health, environmental protection, and improvement of the infrastructure. The government is attempting to present itself as a predictable partner, but it is coming up against both internal and external obstacles. Megawati’s government sits on the horns of a dilemma in its relationship with the United States. On the one hand, for reasons of trade policy if nothing else, it wants to maintain a conflict-free relationship; on the other hand, it needs to maintain the appropriate distance from Washington in the war on terrorism due to the anti-American sentiment within its populace and the interests of Islamic groups.

Indonesia's risk ratings have worsened further, largely due to the bombing in Bali. Lloyd's Insurance Committee has rated Indonesia as a war zone (along with 20 other countries, such as Israel, Oman, Pakistan, Angola, Libya, the Congo, and Liberia). Because of this, insurance rates for international trade with Indonesia have increased considerably, causing the competitiveness of the already weakened economy to suffer additionally.

Following a doctrine of "independent and active" foreign policy, Indonesia has been, since its independence, one of the busiest and most influential Southeast Asian states, in terms of international relationships. During this period, political actors have also been active in building up and deepening international cooperation agreements, except for a few brief periods of passivity. Indonesia is still one of the most politically influential countries within ASEAN, the ASEAN Regional Forum (ARF), the ASEAN Plus Three (ATP) Group, and APEC.

6. Overall evaluation

In view of the originating conditions, current status and evolution achieved, as well as the actors' political achievements (management), this report arrives at the following concluding evaluations:

(1) Originating conditions: In light of the long years of authoritarian rule, the originating conditions for a political transformation, which began about the same time as the evaluation period, were difficult. Market-economy structures have existed since the mid-80s, but they have not proven themselves to be functional or effective in the long term. The impressive economic growth in core economic sectors, such as energy, during Suharto's rule was based on state-owned monopolies.

The new political elite that emerged from the democratic elections of June 1999 were confronted with the necessity of a comprehensive economic and political new beginning. Not only had the massive economic crisis of 1997-98 caused the GDP to shrink by more than 13 %, but also there was a need to "re-invent" the nation in light of the regional secessionist movements and religiously motivated civil-war-like violence in several parts of the country. Government behavior in the period therefore focused primarily on crisis management, leaving little room for deepening the political and economic transformation.

(2) Current status and evolution: Considering the fact that Indonesia was governed by an authoritarian regime for almost four decades, the evolution of the democratic transformation since 1998 is at first glance very short. Except for some substantial constitutional amendments that foster democracy, the political actors did not manage to intensify the political transformation quantitatively.

The decentralization process begun in 2001, intended to both strengthen democracy and prevent the nation from collapsing, was implemented hastily and without thorough consideration. In addition, broad-based corruption has not been fought efficiently, so that the degree of corruption is now more than it was in 1998. Deficits exist primarily in the areas of institutional efficiency and stability of the government system, legal certainty, sustainability, education, and health. The blockade power of vetoing actors, especially the armed forces, was trimmed only partially.

The market-economy transformation during the period was attributed to the IMF regime. While the macro-economic data continued to improve in 2000, Indonesia still has not reached pre-crisis levels of economic development again. The high level of state debt is still a problem, which is unlikely to be mastered in the current decade due to the long-term effects of the crisis. Declining investments and falling revenues from tourism (both aggravated by the bombing in Bali in October 2002), a still-ailing banking sector, the highest level of unemployment in four decades, an unsatisfactory anti-trust and competition policies, the continued existence of patronage-based structures, and the sluggish privatization policy delayed considerably by vetoing actors paint a grim picture for the evolution in general.

(3) *Management*: The actors' relative managerial achievement is rated negative on the whole. The political transformation made gains in the areas of purposefulness and promise. But in the end, only the 2004 elections will show to which degree the constitutional amendments and the efforts toward institutional stabilization of the democratic political system will bear fruit. A broad pro-democratic consensus within society cannot be taken for granted.

Although the shortcomings in implementing economic-policy reform cannot be blamed entirely on the government because of the extremely difficult structural framework conditions, the management's deficits are clear. Although the necessity of strengthening the private sector is recognized, for example, not enough state-owned enterprises in key sectors have been privatized, because of political-nationalistic reasons and to do justice to the interests of vetoing actors. Also, the government did not follow up on its announcement that it would open and liberalize the banking sector, and it controls 80 % of assets. While considerable progress has been made in the area of poverty reduction, reform management during the period failed in many respects with regard to fighting corruption, creating legal certainty, and improving human development.

7. Outlook

Because of the unstable general situation, it is hardly possible to make a reliable prognosis regarding the further course of the transformation. A still-unknown

variable that will be decisive for the country's reform process in the future is the future of the IMF's involvement in the country, which has had a stabilizing effect over all, despite the bad economic data in key sectors. The IMF mandate ends in 2004, although there is the option of an extension, about which the political decision-makers have not yet been able to reach a consensus. In politics, the 2004 parliamentary elections and first-ever direct election of the president will be clear indicators of the chances for stability in the still-fragile political institutional structure. The race for president is still wide open.

It is unlikely that the parliamentary elections will bring any major changes to the spectrum of parties. Rather, it is more likely that there will be a shift of power among the four major parties that were successful in the 1999 elections. Now that seats are no longer reserved in the DPR for the armed forces, their political influence will surely be reduced, although probably not completely eliminated – the socio-political role of the military is too strongly anchored in the national consciousness for that to happen. It is urgent that the institutional relationship between the legislative and executive branches be clarified constitutionally, so that the question of whether the system of government is parliamentary or presidential can be answered.

Key tasks for democratic and market-economy reforms that need to be handled in the medium term are mainly found in the areas of fighting corruption, rule of law, reforming the existing organization of the market and competition, fighting unemployment, successfully decentralizing political power, achieving efficient administration, and ensuring the sustainability of economic development.