

Indonesia

Status Index (Democracy: 6.3 / Market economy: 5.79)	6.04	Management Index	4.84
HDI	0.697	Population	217.4 Mio.
GDP p. c. (\$, PPP)	3,361	Population growth¹	1.7%
Unemployment rate	8.7%	Women in Parliament	11.3%
UN-Education Index	0.81	Poverty²	7.5%
		Gini-Index	34.3
Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003).			

A. Executive summary

The success of Indonesia's largely free, fair and peaceful legislative elections and two rounds of the first ever direct presidential elections has to be considered an important step toward the consolidation of democratic institutions and processes in Indonesia.

However, while the electoral democratic institutions seem to be working in Indonesia, the political system is still constraint by a high level of corruption, patronage politics and other informal institutions. Reserved seats for unelected representatives of the armed forces (TNI) and the police (Polri), a relic of authoritarian rule, have not existed since the 2004 polls. While the possibility of a military putsch cannot be discounted, the danger of a coup d'état has decreased in the assessment period.

The establishment of Islamic groups has been impeded by the following: a majority of moderate Islamic actors in the political sphere who remain loyal to the constitution, and the war on terrorism, into which Indonesia was pulled after the bombings in Bali and Jakarta between 2002 and 2004.

The independence of the judiciary branch has grown during the transformation, and it is no longer *directly* dependent on the government's interests. At the same time the judiciary sector is considered to be the most corrupt in Southeast Asia.

The most substantial attempt to increase the judiciary's independent was made in April 2004 when the Supreme Court was *de jure* freed from direct government intervention.

The results of the 2004 legislative elections show that while the party system is still unstable overall, Golkar, the former state party, and the Indonesian Democratic Party of Struggle (PDI-P), have established themselves as the main political forces.

The economic transformation, which was begun two decades ago and preceded political transformation, has still not resulted in a free market economy..

Social exclusion has increased slightly in recent years after it had been reduced.

Since 2002 interest rates have declined, the currency has strengthened and the stock market has added value. This has contributed to increased economic stability.

Property rights acquisitions are formally defined by law, but at the same time, they are subject to informal acts of cronyism, corruption and state intervention. Court rulings can be arbitrary and inconsistent and do not provide adequate legal recourse for settling property disputes.

During the assessment period, continued macroeconomic stability and a stronger international economy have supported renewed growth in Indonesia, and have contributed to a reduction in poverty.

The government is committed to democracy and a market economy. However, those goals are sometimes compromised in favor of short-term gains, particularly in economic planning, judicial reform and anticorruption programs.

The state bureaucracy is inefficient because funding is inadequate, civil servants are poorly trained, laws are sometimes contradictory and corruption remains pervasive. At the municipal level, clear boundaries must still be set on transparent planning and execution. The decentralization program started in 2001 has led to less efficiency due to hastily passed and confusing legislation.

During the assessment period, ethnic, religious, and regional conflict lines have further deepened, while the government has not been in a position to efficiently deal with these cleavages. The government has yet to find an appropriate strategy to effectively deal with increasing levels of terrorist activities and violence.

The tsunami disaster raised the prospect of a reconciliation and eventual peace in Aceh between the Free Aceh Movement (GAM) and the government. However, if the provision of humanitarian aid and subsequent reconstruction in Aceh is not handled efficiently, resentment towards Jakarta could deepen further.

B. History and characteristics of transformation

The democratic transformation process began with the elections in June 1999, which followed 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 first parliamentary elections with 35% of the votes.

In October 1999, the People’s Assembly (Majlis Permusyawaratan Rakyat, MPR) elected Wahid (Gus Dur) President and Megawati Sukarnoputri Vice President. This drew much criticism from politicians and the public. As a result, the constitution of 1945 was amended in 2002 to allow a direct election of the president for a five-year term.

An impeachment trial against Gus Dur led to his removal from office in July 2002, and Megawati was elevated to the office of president, which she held for two years. Megawati was defeated in the second round of the first direct presidential elections of September 2004 by Susilo Bambang Yudhoyono, who received 60.9% of the vote in a landslide victory. Indonesia’s sixth president is a retired general from TNI’s “reformist” wing and has not been involved in any human rights violations committed by the armed forces in East Timor and elsewhere under the New Order regime. He led the Indonesian UN peacekeeping contingent in Bosnia in the 1990s and served as minister of mines and energy under Gus Dur before becoming coordinating minister for political affairs, security and social welfare in the Megawati administration. He is the only person in the Cabinet who did not have his reputation tarnished. His comfortable majority means that he has a strong popular mandate, but his Democrat Party is only the fourth biggest party in the House of Representatives (DPR), having won just 56 of 550 seats in the parliament. The second parliamentary elections of the post-Suharto era in May 2004, described by European Union monitors and most other observers as having “credibility and integrity”, have strengthened Indonesia’s democracy. At the same time, the polls produced a fragmented vote.

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. Since 2002 constitutional amendments and reforms have significantly strengthened the power of the legislature. In particular, the role of the military (Tentara Nasional Indonesia, TNI) has been reduced. A crucial constitutional amendment came into effect with the 2004 general elections and terminated the practice of reserved seats for TNI in the unicameral DPR five years sooner than originally planned.

For the first time all seats in the parliament were contested. Furthermore, at a special meeting in April 2002, some 150 top TNI leaders decided that the military should begin to withdraw from its involvement in political affairs and instead, focus on its external defense role. However, TNI has not yet surrendered its self-proclaimed traditional role as a domestic stabilizer of last resort. The military remains the main vetoing actor, and the threat of a coup d'état still exists, although it became less likely in the period between 2001 and 2005. It is important to note that all main political actors have accepted elections as the only 'game in town' and no sphere - the president, the military or even militants - seriously threatened to prevent the scheduled 2004 elections. However, some serious challenges on the road to democratization persist. They include ethnically and religiously motivated violence in several parts of the country, to which thousands have fallen victim since 1998; regional independence movements, particularly in Aceh and Papua (Irian Jaya); lack of rule of law and inefficient administration; and the continued existence of patronage-based networks.

Economic transformation began in the late 1960s, but was more of a manifestation of a modified economic policy following the change in leadership from Sukarno to Suharto in 1965-1966. Indonesia owes its ascent as one of the world's poorest countries to a lower-middle income country to three 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. Second, the explosive growth in oil prices brought rapid economic growth along, resulting in an increase in the GDP of about 8% per year. Third, Suharto established an authoritarian regime with military support, which eventually developed (labor-intensive) industrialization with firm control on labor movements. Thus, rapid industrialization occurred at the expense of human rights and democracy.

Up until the early 1980s, Indonesia usually enjoyed 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 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 policies 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 under-performing 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.

The 1997-1998 Asian crisis hit Indonesia the hardest. It caused the GDP in 1998 to shrink by almost 14%. The country regressed to the economic development level of the mid-1970s. The economic sector's structural weaknesses, which had been disguised by the preceding boom phase, were exposed. 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 through processes that 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. President Megawati is credited with stabilizing Indonesia's volatile post-1997 economy. However, she has failed to reign in what is widely seen as a corrupt elite whose unchecked self-interest has sapped the economy and stunted political development. It is believed that corruption has increased since Megawati took office, in part because of a lack of enforcement and the recent decentralization of government in Indonesia. For example, the plethora of local taxes issued since decentralization has become a deterrent for investors.

The conclusion of Indonesia's five-year IMF program at the end of 2003 did not result in the calamities some economists had predicted. The government issued a White Paper that commits Indonesia to maintaining fundamentally sound macroeconomic policies previously established under IMF guidelines. The Yudhoyono administration has identified infrastructure as a priority area. In January 2005, the government launched an auction for participation in 91 infrastructure projects worth an estimated US\$ 22.5bn.

The tsunami disaster of December 26, 2004, posed a major challenge to the Indonesian government and the country's economy. The total damage of the disaster in North Sumatra and Aceh in particular has been extensive. More than 230,000 people may have died. While it is not possible to put a price on the human suffering

caused by the tragedy, the direct economic impact is expected to reduce the country's 2005 GDP rate by 0.1 to 0.4%.

Indonesia's donors have generously supported the process of economic transformation. The 14th Meeting of the Consultative Group on Indonesia (CGI) in January 2005 pledged US\$ 5.1bn in aid for 2005, significantly exceeding the expectations of the Indonesian government. The package contains US\$ 1.7bn for reconstruction in the provinces of Aceh and Northern Sumatra. The remaining US\$ 3.4bn will mostly be used in reducing Indonesia's budget deficit.

C. Assessment

1. Democracy

Indonesia's legislative elections on April 5, 2004 were "the world's largest and most complex election ever held on a single day" (European Union Election Observation Mission to Indonesia 2004, Final Report), followed by two rounds (July 5 and September 20) of the country's the first ever direct elections of a president. The success of the largely free, fair and transparent polls has to be considered a milestone in the consolidation of democratic institutions and processes in Indonesia. As the EU Election Observation Mission notes: "The peaceful atmosphere and the first ever successful transition of power from a democratically elected administration to another were historic." Both elections of the democratic era have brought incremental, rather than seismic, change to the country's democratic system. However, while the electoral institutions of democracy seem to be working in Indonesia, the political system is still constrained by a high level of corruption, patronage politics and other informal institutions.

1.1. 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 some provinces, particularly Aceh and West Papua 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 and, in the case of Aceh, big shares of

revenues from the province's oil and gas fields. However, the full implementation of the laws and peace negotiations with the Free Aceh Movement (GAM) have been blocked by the armed forces, who viewed any significant changes to the status quo as contrary to the political and economic interests of Tentara Nasional Indonesia (TNI), the Indonesian Army. In 1976, Suharto put the armed forces in control of Aceh. Since then, TNI's reign over the province has been accompanied by violence, ill-discipline and abusive conduct. After assuming office, President Yudhoyono immediately started a fresh initiative to bring peace to Aceh, which, however, has again been undermined by the military. Any hope that the tsunami disaster would instill a sense of urgency and a spirit of compromise in negotiations between the government and GAM, had not materialized by February 2005.

In parts of Kalimantan, which faces ethnic conflicts, and Sulawesi, a site of religiously motivated conflict, the state monopoly on the use of force also works only to a certain degree. The secessionist movements lead individual population groups to question whether they qualify as citizens of the state. Apart from this, one of the state's outstanding achievements has been to achieve equal rights for all citizens in a nation that is both ethnically and religiously highly heterogeneous. 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 was not until late 2000 that approximately 140,000 ethnic Chinese were finally 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 informal discrimination against this minority still goes on, for example in recruitment procedures in the state administration, or in the military sector, from which they are almost completely excluded. When it comes to public schools and universities, the ethnic minority Chinese 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 Shariah law 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, based on just the sheer numbers of their membership – the two largest groups, Nahdlatul Ulama and Muhammadiyah, have more than 60 million members. Neither the democratic elections of June 1999 nor of April 2004 have led to Islamization or religious radicalization of Indonesian politics. In 2004, nationalist and moderate Muslim parties won two-thirds of the vote; radicals received only 10%. This said, the elections also produced a fragmented vote which, combined with Indonesia's complex

electoral and party systems, might open a window of opportunity for extremists to advance their agendas. Though radical political groups are small in number, they are believed to be well-organized and well-funded. During the assessment period, however, religious dogmas have had no noteworthy influence on politics or law.

The state's fundamental infrastructure extends to the entire territory of the country (administrative institutions, office-holders, fundamental administration of justice, making and implementing political decisions), but its operation is to some extent deficient, particularly with regard to the administration of justice and the efficiency of implementing political decisions. The ongoing process of decentralization represents the most decisive transformation of the administrative infrastructure in Indonesia's history. Central civil servants were transferred to other locations, over 16,000 public service facilities were handed over to the regions and a new intergovernmental fiscal system was put in place. Most government services have not been interrupted following the handover of administrative authorities. On the other hand, decentralization has expanded the power of local officials without improving their oversight. Furthermore, as the result of an amendment to the law on decentralization (completed at the end of Megawati's presidency) some powers of the district or regency are taken back by the central government. This indicates the ambiguous behavior of the Indonesian government towards decentralization.

1.2. Political participation

Elections are held every five years. Indonesia's parliament consists of the House of Representatives (Dewan Perwakilan Rakyat, DPR) and the People's Consultative Assembly (Majelis Permusyawaratan Rakyat, MPR). The MPR meets every five years to approve broad outlines of national policy and has yearly meetings to consider constitutional and legislative changes but does not formulate national policy. The 550 members of the DPR automatically become members of the MPR, which also includes the regional delegates of the Regional Representative Council (Dewan Perwakilan Daerah, DPD). While DPD members are elected on a constituency basis, DPR members are elected on the basis of party lists. It should be noted that the DPD is not an upper house in a bicameral parliament. The DPD's powers are limited to submitting bills to the DPR and giving advice to the DPR on important matters, as indicated in the amendment of the 1945 Constitution.

General elections are held and accepted in principle as the means of filling leadership positions. Both the legislative and presidential elections of 2004 were conducted largely in line with democratic standards. Reserved seats for unelected representatives of the armed forces (TNI) and the police (Polri), a relic of authoritarian rule, no

longer exist since the 2004 polls. However, regulations on political party registration and participation in the elections were constrained by significant restrictions. Universal suffrage was not fully implemented. Members of TNI and Polri did not have the right to vote and former members of the Indonesian Communist Party (PKI) were not allowed to campaign for elections.

The majority of Indonesia's state and particularly civic actors considered the fact that the first president of the democratic era, Abdurrahman Wahid, was not directly elected, as a significant restriction of the voters' will. As a result, new electoral laws were passed by the DPR in July 2003, which – in addition to laying down the composition of both houses of the legislature and of provincial legislatures – paved the way for the first direct elections of the president and vice-president in 2004. However, the nominations for presidential tickets can only be made by parties which receive either 3% of seats in the DPR or 5% of the overall vote.

Elections are now considered by all relevant actors to be the accepted method for selecting a leader. At the same time the armed forces continue to play the role of the most important vetoing actor as they reserve the right to interfere with the elected government, if they believe the unity and stability of the Indonesian nation to be threatened. The possibility of a military coup cannot be discounted but has decreased in the period under review. TNI's opportunity to seize control lies primarily with the economic success or failure of Indonesia's democratic government. Radical Islamic groups have not been able to establish themselves in the 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 drawn on October 12, 2002 with the bombing in Bali and the subsequent attacks on the Marriot Hotel in Jakarta in August 2003 and the Australian Embassy in September 2004.

As part of the gradual conversion to a democracy 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 were again allowed, after being banned in the coup attempts and communist hunts of the late 1960s.

1.3. 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 increasingly emancipated during the transformation. However, it is still a problem that the constitution of 1945 is vague in many regards, especially on the role of the legislative branch and the separation of powers. The constitution solidifies the president's strong position. Despite various rounds of amendments, it is still weak in terms of institutional mechanisms of checks and balances. Recent constitutional reforms have significantly strengthened the power of the legislature. On the other hand, the empowered legislature may not be able to effectively use this power because other reforms have made it easier for smaller political parties to gain seats in the proportionally allocated DPR. In general terms, a party is affiliated with its leader rather than its ideology. When a leader moves away from the political scene, the party loses much of its identity. Hence, the floating identity of political parties makes it difficult to form coalitions along party lines.

The independence of the judiciary branch has grown during the transformation, and it is no longer directly dependent on the government's interests. At the same time, the judicial sector is considered to be the most corrupt in Southeast Asia. Systematic corruption in Indonesian courts, including the Supreme Court, did not improve under the Megawati presidency; in fact, it was consolidated even further. Overall, the judiciary has in practice remained subordinate to the executive and has regularly been influenced by the military, business interests and politicians outside of the legal system. Bribes have influenced prosecution, conviction, and sentencing in countless civil and criminal cases. Courts also often limit defendants' access to counsel and allow forced confessions to be used as evidence in criminal cases. The judiciary's weakness has helped perpetuate human rights abuses by the security forces, particularly in Aceh and Papua. Indonesian forces also enjoy near impunity in encounters with ordinary criminal suspects. While TNI claims that it is no longer a political player, the military's influence over the judicial branch persists. Acquittals of high-ranking officials accused of human rights abuses are the norm. For instance, in 2004 the head of the *Kopassus* special forces unit, Major General Sriyanto Muntarsan, was cleared of gross human rights violations connected with his role in the 1984 killing of up to 24 protestors, in the Tanjung Priok port area of the capital Jakarta. An Indonesian appeals court acquitted two generals and two other military and police officers, earlier sentenced to jail by a lower court for involvement in the gross human rights violations in East Timor in 1999, and reduced the sentence of a militia leader.

A further reason for the judiciary's weakness is Indonesia's adherence to the antiquated Dutch colonial legal code, which significantly restricts the ability of courts to resolve modern conflicts, particularly those pertaining to intellectual property rights (IPR) violations, financial and cyber crimes.

Between 1998 and 2001, numerous constitutional changes were approved to create an independent judiciary, but the lack of political will to enact those changes has hindered reforms. A new and by far the most substantial attempt to increase the judiciary's independence was made in April 2004 when, for the first time in almost four decades, the Supreme Court was de jure freed from direct government intervention, assuming administrative and financial responsibility for the lower court system from the Ministry of Justice and Human Rights. In 1964 the country's founding president Sukarno placed the entire legal system under his control. A separate Constitutional Court or *Makhamah Konstitusi* was established in 2003.

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. Indonesia is evolving into a more open society. The private press, while at times shoddy and sensationalist, reports aggressively on corruption, government policy and other formerly taboo topics. Journalists, however, face some police violence and intimidation and occasional attacks by paid thugs, student activists, and religious extremists. In war-torn Aceh, the press has been heavily censored. The Freedom House ranking for civil liberties improved from 5 to 4 in 1998 but has remained unchanged since.

1.4. Stability of democratic institutions

The degree to which the democratic institutions perform their functions has improved, but waste still occurs because of friction between institutions, particularly in relations between the executive and legislative. The danger of an infiltration of the democratic institutional structure from the military (TNI) has decreased but is still possible. In accordance with the *dwi fungsi* or double function doctrine, 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. The elections of 2004 demonstrated that the institutions of the democratic state are accepted by most relevant players, with the most notable exception of a small number of radical or fundamentalist splinter groups and the secessionist movements in Aceh and Papua.

1.5. Political and social integration

The result of the 2004 DPR elections indicates that the secular-nationalist parties (PDIP, Golkar, PD, PDS and some others) secured 51% of votes, the Islamist parties (PPP, PKS, PBB, PBR, and some others) secured 20%, and a combination of Islamist and nationalist parties (PKB and PAN) secured 19%. The direct presidential elections gave more incentives for political parties and president candidates to form coalitions with other political groups, called *aliran*.

The results of the 2004 legislative elections show that while, on the whole, the party system is still unstable, Golkar, the former state party, and the Indonesian Democratic Party of Struggle (PDI-P), have established themselves as the main political forces. However, Megawati's PDI-P lost its position as the strongest political force in the parliament to the Golkar party. While this result had been anticipated, the real surprise was the emergence of two new parties, Democrat Party (PD) and Prosperous Justice Party (PKS). Before the election they did not seem to stand any clear chance of winning any seats. PD's success has been credited to the personal popularity of its leader Susilo Bambang Yudhoyono, who later won the presidential polls. PKS is the party of "Islam-centrist turned anti-corruption champion" Hidayat Nur Wahid. 24 parties took part in the 2004 elections, as against 48 in the 1999 election, due to the stricter norms imposed by the election commission prior to the second democratic polls. The voting pattern indicates that the majority of voters still prefers the established political forces, whose roots date back to authoritarian days (Golkar, PDI-P, PPP). On the other hand, young and urban voters seem to be looking for political change as reflected in the emergence of new parties such as PD and the PKS.

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 since 1998 the democratization process 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. They are some of the opinion leaders in the debate about the future relationship between the state and religion.

Other actors at the intermediary level, such as trade associations and unions, play a less significant role. Although Indonesia's level of unionization has risen from 1.4% in the mid-1990s to about 9% of the total labor force in 2004, the unionization rate is still among the lowest in Southeast Asia. There are at least 86 trade union centers at the national level registered under the Department of Manpower, some of them

independent. The influence of the Indonesian chamber of commerce and industry, KADIN, 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. During Megawati's presidency, workers seemed to have gained better deals at the expense of employers. The appointment of former labor activist Jacob Nuwa Wea as Minister for Human Resources resulted in new industrial relations favoring workers in the cases of layoffs, remuneration, special treatment for female workers, and in disputes on working hours. Although in terms of democracy this seems to indicate a positive sign, this situation has nevertheless generated obstructions in business activities. Both foreign and domestic investors are reluctant to make new investments, as they can no longer rely on cheap labor. This may partially explain why the level of job creation tended to slow down between 2001 and 2004. Generally, the intermediary actors do not present an anti-democratic threat.

Dependable survey data regarding the degree of consent to democracy are not available but a study by the Asia Society concluded, "by and large, the general public only has a vague understanding of the concept of democracy. If they have an opinion at all it is broadly in the area of freedom and liberty." (Indonesia: A Report on Public Opinion. and the 2004 Elections, February 2003)

The transformation has brought forth a number of new civic actors or self-reliance organizations (*lembaga swadaya masyarakat*, LSM) in Indonesia, which can be described as a heterogeneous network of autonomous, self-organized groups, associations and organizations.

2. Market economy

The transformation of the Indonesian economy began two decades ago and preceded the country's political transformation, but has still not resulted in a free market economy. The Heritage Foundation's 2005 Index of Economic Freedom classifies the Indonesian economy as "mostly unfree." In fact, according to this index, Indonesia is among the least free economies in the world, occupying rank 121 among 161 countries. On a scale of one (best) to five (worst), Indonesia's overall score decreased from 3.0 in 1998 to 3.72 in 2004 but went up slightly by 0.22 points in 2005 due to a better trade policy, a reduction of the fiscal burden of government and less government intervention.

2.1. Level of socioeconomic development

Social exclusion has slightly increased, after it was reduced during the economic crisis of 1997-1998. The crisis affected all social groups and tended to reduce differences in income rather than aggravate them. The Gini ratio was 34.2 in the pre-crisis year of 1996, which decreased to 33.3 in 2000, before it increased again to 34.1 in 2002. The average HDI value (based on data compiled by the Indonesian National Planning Board, Bappenas) in 2003 was 0.66. However this masks a considerable variation across the country. There are significant differences between the provinces, from 0.76 in Jakarta to 0.58 in West Nusatenggara. However, there are even greater differences between the districts – whose HDIs range from 0.76 in East Jakarta to 0.47 in the district of Jayawijaya in Papua (Bappenas/UNDP: Indonesia Human Development Report 2004. The Economics of Democracy, p. 10).

The fact that the GDI value in all Indonesian provinces is lower than the HDI rate confirms 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 2002 the GDI increased nationwide from 0.664 to 0.685, while the HDI value improved from 0.67 to 0.692 during the same time period. The difference between the two ratios increased from 0.6 to 0.8, indicating a growing inequality in human development achievements between women and men.

2.2. Organization of the market and competition

In the 1980s and 1990s, the economy of the New Order regime was characterized by crony capitalism. Yet Indonesia appears to not fare much better at the point of this writing. Despite the reforms that have been carried out since the mid-80s to strengthen free-market competition, liberalization is being hindered by both formal and informal regulations and processes. Property rights remain largely insecure and contracts cannot be enforced. The legal institutions, procedures and structures are still inadequate in supporting a modern market economy. Article 33 of the constitution solidifies the primacy of state-owned enterprises over private enterprise and serves as a cross-the-board justification for the preferential treatment given to individual actors in the economy. 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 meant to regulate the formation of monopolies and oligopolies, the act contains passages that open the door once again to cronyism, neo-patrimonialism and corruption.

As a member of the ASEAN Free Trade Area (AFTA) and the WTO, Indonesia is obliged to liberalize its foreign trade. However, it had initially been slow to live up to the promise it made to 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, 2003 as planned. More recently, though, the WTO has praised Indonesia for the liberalization of its trade policies over the last four years and the reduction of import tariffs to an average 7.2% in 2002. Simultaneously, the WTO voiced concerns about moves to impose protectionist trade policies in the form of import licenses for textiles and steel products. In general, Indonesia can be rated as moderately protectionist. A prevailing 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. All in all, the IBRA distributed government loans worth \$ 47.78 billion to re-capitalize the banks. The agency closed down its operations in February 2004. Since 2003 Indonesia's banking industry has been showing signs of recovery. The government has taken steps towards returning nationalized banks to the private sector and reducing the number of ailing financial institutions that remain in government hands. As a result, the number of licensed banks decreased from a peak of 240 in the mid-1990s to 141 in 2003. However, the Indonesian state still holds the vast majority of banking sector assets. Partly supported by a surge in private consumption as well as the recovery in lending for investment purposes, the banking sector grew strongly in 2004. Banking stocks have been among the best performing on the Jakarta Stock Exchange. At the same time, cross non-performing loans remain high in relation to total loans with state-owned banks reporting a ratio 7% and private banks with 4% (2004 figures). However, banks have also increased their provisioning to cover the non-performing loans. The long-proposed Financial Supervisory Agency (FSA) had not been established in February 2005 but the Yudhoyono administration announced it was determined to set up the new oversight body to monitor and regulate the financial system as soon as possible.

2.3. Currency and price stability

Since 2002, Indonesia has enjoyed increased economic stability as interest rates declined, the currency strengthened and the stock market climbed. 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 drew special attention to their importance. Between 1991 and 2000, Indonesia's average inflation rate was 12.41% – one of the highest in the region. Since then, however, the attempts of the subsequent post-Suharto administrations to control inflation and to implement an appropriate foreign exchange policy have been increasingly successful. Inflation stood at a manageable 6.4% in 2004, below the government's target of 7% but slightly above the central bank's prediction of 6.2%. The Rupiah appreciated significantly during the assessment period and volatility was reduced. In 2004, the average exchange rate for was Rp 8,945 8.945 to the U.S. dollar compared to Rp 10,294 10.294 in 2001. At least in part, this was due to capital inflows attracted by the government's assets sales. The improvement of the exchange rate, in turn, has helped to reduce public debt from almost 100% in 2000 to about 60% in 2004. While it remains to be seen whether the Indonesian government will be in a position to implement a continuous stability policy on its own power in the long term, recent achievements look promising. According to the IMF, the Indonesian government "has made very substantial progress ... in financial sector reforms" (*AsiaInt Economic Intelligence Review*, November 5, 2004). In sum, a culture of a policy for stability is gradually emerging, but institutional safeguards needs to be strengthened to reduce the risk of populist policy backlashes.

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 and state intervention. Court rulings can be arbitrary and inconsistent and court system does not provide adequate legal recourse for settling property disputes. Despite pressure from the international community for Indonesia to honor internationally binding contracts, the government has suspended various private infrastructure projects for economic and political reasons.

The 1997 crisis and the ensuing IMF reform program accelerated Indonesia's privatization program especially in the sectors of water, energy and health. Meanwhile, Suharto's cronies and the military, who maintain control over state-owned enterprises and monopolies, continued to dominate strategic economic sectors.

While the Wahid administration did not make much headway in the privatization of state-owned enterprises, the succeeding government of President Megawati made some progress in selling off state-owned banks and companies to comply with asset-sales requirements of the IMF in return for \$5.1 billion in loans. Indonesia sold a 20% stake in Bank Mandiri and a 40.5% stake in Bank Rakyat Indonesia. At the same time the sale of state-owned enterprises was slowed down by the DPR, which is led by nationalist motives, in particular the concern about alleged foreign domination of the Indonesian economy.

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 financially accessible to families with low incomes. During the 1990s, Indonesia was one of the worst-rated among developing countries in the number of hospital beds per capita. Indonesia also lags behind other countries in Southeast Asia, such as the Philippines and Thailand, when it comes to infant mortality rates. The government has been more successful in 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.

During the assessment period, continued macroeconomic stability and a stronger international economy have been supporting renewed growth in Indonesia, and contributing to a reduction in poverty. Results from the 2003 SUSENAS household survey (*Survei Sosial Ekonomi Nasional*) show that poverty levels have continued to decline. The ratio of Indonesians living below the poverty line (people who live on less than \$1 per day) dropped from 16.0% in 2002 to 15.1% in 2003, which was lower than the pre-crisis level of 15.7% in 1996. However, while poverty is declining, 52.9% of the population lives on less than \$2 per day (down from 65.1% in 1999).

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).

Indonesian society is ethnically and religiously very heterogeneous and characterized by a high degree of socioeconomic inequality. While according to the 2004 Human Development Report, poverty incidence has come down to single digit levels in Jakarta (from 15.5% in 2000) and Bali, it remains as high as 30% or more in Aceh and Maluku and 42% in Papua. The fact that socioeconomic inequality is not as poor 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. At the same time, the ratio of female earned income to male earned income is still relatively low at 0.51. Indonesia's women are still heavily under-represented in political life. During the 1999 elections, women made up 57% of the voters. However, women held only 45 (about 9%) of the 500 seats in the national parliament. In 2004, that figure increased to just 11.1%, with 61 women elected. Only 12 sitting female candidates were re-elected. The 2003 electoral reform bill mandated that women must make up 30% of candidates for the 2004 parliamentary elections, but no party achieved this goal. On the local level, the figure of female representation is between 0% and 2%. 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. Women in general remain marginalized in various sectors. Not only do they rarely occupy strategic positions in both private and public sectors, but they also hold subordinate positions in most households.

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 below par in comparison to most other countries in Southeast Asia.

2.6. Economic performance

Indonesia's economy expanded 5.1% in 2004, its strongest performance since before the 1997-98 economic crisis, beating a government target of 4.8% and independent forecasts. The crisis resulted in a massive drop in GDP of 13.7% in 1998. GDP per capita grew by an estimated 4.1% in 2004, which was significantly above the annual average of 2.0% in the period from 1990 to 2003. This was largely due to a growth in private and government consumption by 5.09%, and increase in exports of 11.49% to a record high \$69.71 billion (2004 figures year-on-year) and lower cost of borrowing due to low interest rates. According to estimates it could cost \$4 billion to rebuild the tsunami-ravaged Aceh province alone, while the government is targeting a major push on infrastructure nationally. At the same time, Indonesia is expected to benefit from billions of dollars of aid and donor cash flowing into the country in the wake of the December 26, 2004 tsunami, which killed more than 232,000 people. However, there is growing concern among the international community as well as Indonesians of possible corruption and nepotism in the reconstruction program in the tsunami-

affected area. The Indonesian media has been critical of the appointment of contractors for such immense projects as they point to the involvement of Vice President Jusuf Kalla's companies in the reconstruction project. There was also fear that the Indonesian military might be playing a decisive role in allocating assistance to those in desperate need of food, medicine and shelter.

The economy has benefited from a business-friendly political climate. The election of Yudhoyono has strengthened domestic and international confidence in Indonesia's economy because of a perception that the current administration is strongly committed to reform and integrating Indonesia within the global economy, a stance which was not very clear during the previous administrations of Megawati, Wahid and Habibie. However, without a significant increase in foreign direct investment (FDI), sustainable growth of the Indonesian economy does not seem possible in the medium term. In 2004 FDI approvals dropped 27% to \$10.28 billion from \$14.05 billion in 2003. A far-reaching improvement of Indonesia's infrastructure is an essential precondition to attract FDI on a larger scale.

The improved macroeconomic data is also the result of an improved monetary policy, which in turn has had a positive effect on inflation control. The inflation rate in 2004 was 6.4%, higher than the record 2% in 2003 but lower than 11.9% in 2002. Fiscal consolidation has continued during the assessment period and government debt as a proportion of GDP fell from over 100% in early 2002 to less than 70% in 2003 and is predicted to decrease to around 60% of GDP in 2004. The unemployment rate is officially given as 8.7% in 2004 but is actually more likely to be between 15% and 20%.

2.7. Sustainability

Before the economic crisis the Indonesian government made serious efforts in the area of environment by requiring every construction project to fulfill the "environmental impact assessment" (*Analisa Mengenai Dampak Lingkungan*, AMDAL) administered by the Ministry of Environment in cooperation with NGOs. However, after the 1997-1998 crisis the government seemed to have lost interest in pursuing AMDAL. This has generated concern among environmentalists of the seriousness of the post-Suharto governments to pursue the principle of sustainable development.

Environmental sustainability definitely takes a back seat to the pursuit of growth and it is barely institutionally anchored. The massive forest fires of 1997-1998, 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 forest 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.

According to estimates, currently over 500,000 hectares of rainforest have been logged illegally each year. Only about half of Indonesia's 162 million hectares of rain forest in 1950 still exists today. This illegal clearing is a result of the lucrative palm oil business and the building of too many 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 been 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; other institutions of higher learning are to follow. The primary goal is to increase the efficiency of educational management. Indonesia's educational spending (currently 1.3% of GDP) is far below the regional average (for example, Malaysia 7.9%; Thailand 5%), resulting in significant deficits in the areas of research and development.

3. Management

3.1. Level of difficulty

The structural framework conditions for governance performance have improved overall during the assessment period but serious structural constraints remain, such as a high level of corruption and violence. Various constitutional amendments, the reduction of the position and role of the military, the fair and free parliamentary and presidential elections of 2004 and the ongoing process of economic recovery since the crisis of 1997-98 have had a positive impact on the leadership's governance capacity. On the other hand, the struggle for political stability and order and a just and prosperous society in the post-Suharto era has been marred by insurgencies in Aceh and Papua, bomb attacks in Bali and Jakarta, sectarian conflicts in Sulawesi and Maluku, ethnically and religiously motivated violence and terrorism. Rampant corruption, lack of rule of law, inefficient administration, and the continued existence

of patronage-based networks, high unemployment and underemployment which is thought to affect 40% of the workforce, and an inadequate infrastructure have put major constraints on the governance capabilities of all administrations during the assessment period. The tsunami disaster has further increased the level of difficulty for governance.

It is important to distinguish between separatism and communal conflicts. On the issue of separatist sentiments in areas such as Aceh, West Papua, and Riau, the main problem appears to be ongoing conflicts between central and local governments over control on local resources. People in those resource-rich areas are frustrated with the central government's domination over local resources (oil and gas in Aceh and Riau, copper and gold in West Papua). Thus, more than simply being an "identity-based conflict", separatism in those areas is driven by local demands on control over natural resources. This has made the separatist insurgencies different from other type of conflicts in Kalimantan and Maluku, which are purely identity-based conflicts.

While the decentralization program, implemented since 2001, has been carried out with no major dislocations in public service provision, it does not seem to have improved the structural conditions for efficient and effective governance. Concerns remain regarding the non-equalizing nature of revenue-sharing arrangements and the lack of adequate central fiscal instruments to reduce regional disparities.

Although in Indonesia the roots of civil society lie in a variety of voluntary associations that have existed since colonial times (particularly Muslim voluntary organizations such as the Muhammadiyah, founded in 1912), the fall of President Suharto in 1998 created the environment for the emergence of a politically influential civil society. Several hundred NGOs have been active in the area of political education and monitoring the 1999 and 2004 elections. Another field of activity for civic actors has arisen in the socioeconomic area. Numerous NGOs have contributed to cushioning the social consequences, particularly unemployment, and the long-term implications of the economic crisis: a task the state cannot manage on its own.

As for the level of difficulty which is likely to be faced by the SBY government, it is important to note that the SBY government received support from a minority of DPR members, the so-called *Koalisi Kerakyatan* (PD, PKS, PBB, and PPP). In dealing with various strategic issues, SBY may face challenge from the *Koalisi Kebangsaan* (PDIP, Golkar, PBR, PDS and some others) who secured more seats in the DPR. But this argument has been dismissed by the fact that Jusuf Kalla (the vice president of SBY's choice) is now the new chairman of Golkar. However, a new problem can emerge: an elected president (whose party won only 7% of votes in the DPR) has to work hand-in-hand with a vice president (whose party control 22% of seats in the

DPR). The possible “dualistic leadership” in the current government may reduce effectiveness in terms of governance and administration. Rumors have already spread among the Indonesian media that Jusuf Kalla has more influence in allocating positions in the cabinet ministry and in handling post-tsunami reconstruction program in Aceh.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	2
System of government:	<i>Presidential</i>	Electoral system disproportionality:	3.4
		Latest parliamentary election:	05.04.2004
		Effective number of parties:	7.1
1. Head of State:	<i>Megawati Sukarnoputri</i>	Cabinet duration:	07/01-10/04
2. Head of State:	<i>Susilo Bambang Yudhoyono</i>	Cabinet duration:	10/04- present
Type of government:	<i>oversized coalition</i>	Parties in government:	> 5
		Number of ministries:	32
		Number of ministers:	21
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

3.2. Steering capability

The successful process of amending the constitution, the decentralization policy initiated in 2001, and an economic policy that has been oriented toward IMF requirements and guidelines even after the completion of the IMF regime in 2003, indicate a policy oriented toward long-term goals. According to an IMF assessment of November 2004, "while GDP growth is still below Indonesia's potential, and poverty and unemployment remain high, economic performance has continued to improve in recent months, and financial markets have rallied. This improvement has come about through continued sound policy implementation, and a favorable market response to the peaceful election outcome and policy intentions announced by the new government." During the assessment period, the government was indeed able to implement some of the announced reforms demanded by the IMF and has maintained a commitment to structural reforms since the IMF regime ended as demonstrated by successes in the macroeconomic area, for example debt reduction. On the one hand, the government has been successful in improving the central framework conditions for economic consolidation. On the other hand, far-reaching structural changes, such

as a thorough reform of the banking sector and implementation of policies to improve the investment climate, have not taken off the ground yet. The will to reform is nevertheless clear. While the government is committed to democracy and market economy and the right goals have generally been set, it is not unusual for them (particularly in the areas of economic planning, the fight against corruption and judicial reform) to be set aside in favor of short-term gains.

In 2001 the government embarked on a plan 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 decentralization policy shows, individual policies sometimes have a counter-productive effect on other policies.

The implementation of reforms has been hindered by the low standing and influence of the Megawati administration. Although Megawati enjoyed a higher degree of legitimacy than her predecessor Gus Dur, the political authority of the administration as a whole was not sufficient to implement and carry forward reforms. For example, the government was not able to implement an adequate labor policy that would create a balance between protecting employees and ensuring a flexible labor market.

The main political challenges have been the creation of an efficient, independent judicial sector and the reduction of corruption. In November 2002, the DPR passed a comprehensive, 72-article anti-corruption law, which, however, has not been effective. Corruption continues to be a major characteristic of the state and administrative culture. However, currently, it is prosecuted more consistently than it was at the beginning of the assessment period, particularly since Yudhoyono became president. It remains to be seen whether his announcement to apply a "shock therapy" to the problem of endemic corruption will bear fruit. Yudhoyono's anti-corruption measures have, however, gone further than those of the preceding administrations. In late 2004 the government launched investigations in allegations of corruption against 13 senior officials and announced plans to establish a new anti-corruption court and to introduce a "presidential instruction" requiring the suspension of any public official

facing a corruption investigation. A further draft plan calls for the formation of a supervisory committee to oversee the country's weak judiciary. If these measures were implemented it would show that the political leadership responds adequately to mistakes and failed policies and changes. During the assessment period, however, the government's policy has often remained stuck in the same routines.

3.3. Resource efficiency

The government endeavors to use resources efficiently, not least because of pressure from the IMF until 2003 and general domestic and international reform pressure since then, stemming partly from the necessity to attract FDI on a much larger scale than at the time of this writing. However, success in this area has only been partial. 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 not 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 often contradictory and hastily passed laws.

The government's ability to coordinate conflicting objectives and interests is constrained by the prevalence of strong veto actors, such as the armed forces and patronage networks. The Aceh autonomy law, signed in August 2001, is a case in point. It gives Aceh the power to determine its own judicial and education systems and grants the province increasing revenues from its oil and gas resources to 70%. Under normal conditions, provinces receive only 15% from oil and 35% from gas revenues. However, due to the government's inability to coordinate between the conflicting objectives and interests of the administration in Jakarta, the armed forces and local actors in Aceh, the implementation of the law is still pending.

With a value of 2.0 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 133 out of 145 nations. As such, the CPI value is now clearly worse than it was in 1997 (2.72), the final year of the Suharto regime, but slightly better than in 2002 and 2003 (1.9 in both years).

3.4. 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 religion 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. However, during the assessment period, both government and parliament have successfully dealt with the challenge posed by radical Islamic groups and defended the secular nature of the Indonesian state. Furthermore, legislative-executive relations are now better institutionalized than they used to be at the beginning of the assessment period. In particular, the role of the parliament (DPR) has been strengthened vis-à-vis the quasi hegemonic position of the president as stipulated by the 1945 constitution.

Although the armed forces are under a civilian Ministry of Defense and a gradual reduction of the TNI's sociopolitical 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 assessment period, ethnic, religious, and regional conflict lines have further deepened, while the government was generally not in a position to efficiently deal with these cleavages. The government has yet to find an appropriate strategy to effectively deal with increasing levels of terrorist activities and violence. The economic crisis and the increasing development of civic structures and actors have increased people's willingness to exhibit solidarity, although significant input from the government cannot be seen here.

The political elite is selectively willing to recognize the necessity of dealing with acts of injustice in Indonesia's past. With certain reservations, this is true of coming to terms with the human rights abuses in East Timor, but no comprehensive reconciliation process has yet gotten off the ground. The acquittals of high-ranking military officials accused of human rights abuses have been the norm. This has resulted in a growing perception among civil society actors that the government was not serious about bringing the perpetrators of the New Order regime to justice. 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, that were initiated early in the Suharto regime, in the late 1960s.

3.5. International cooperation

Until the end of 2003 Indonesia's political actors were obliged to collaborate with the IMF, and they took targeted advantage of aid to meet the demands of economic transformation. In addition, there was cooperation with a number of international donors, which has intensified in the wake of the tsunami disaster. All of the more comprehensive projects with international assistance, however, include conditions that are meant to encourage the learning process and changes in the behavior of Indonesia's political actors. Loans from the Asian Development Bank (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. The governments of both Megawati and now also Yudhoyono have to sit on the horns of a dilemma in Indonesia's relationship with the United States. On the one hand, for reasons of trade policy if nothing else, both administrations wanted to maintain a conflict-free relationship. On the other hand, they needed to maintain the appropriate distance from Washington in the war on terror in general and the war in Iraq and its aftermath, in particular due to the anti-American sentiment within its populace and the interests of Islamic groups. Overall, according to analyst Rizal Sukma, "the Islamic factor serves as a 'control mechanism' rather than a primary motivating factor in Indonesian foreign policy."

Indonesia's risk ratings, which had worsened after the Bali bombing in October 2002, have recently improved. The impact of the tsunami on risk is ambivalent. The tsunami has raised the prospect of reconciliation and eventual peace between the Free Aceh Movement (GAM) and the government. However, if the provision of humanitarian aid and subsequent reconstruction in Aceh is not handled efficiently, resentment towards rule from Jakarta could deepen irrevocably. The Financial Action Task Force on Money Laundering (FATF) of the Organization for Economic Cooperation and Development (OECD) has removed Indonesia from the list of countries reported as having weak regulations, preventing money-laundering and other financial wrongdoing. It was expected that Indonesia's country risk would further decline and its investment rating would increase accordingly. As for the crisis-ridden banking sector, in early 2005, Fitch raised its ratings on 10 Indonesian banks.

Following a doctrine of “independent and active” foreign policy, Indonesia has been, one of the busiest and most influential Southeast Asian states since independence, 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. In sum, Indonesia cooperates politically with its neighboring states, complies with the rules set by regional and international organizations and promotes regional integration. In October 2003, Indonesia hosted the ASEAN summit of the heads of states and governments which concluded with the announcement of an ambitious plan to establish a Southeast Asian Community, partly modeled on European integration, by the year 2020.

4. Trend of development

4.1. Democratic development

In the course of the democratization process, political participation along a wide front has improved greatly. About 127 million voters (90% of the voting age population) cast ballots on April 5, 2004 to select nearly 16,000 members of legislatures at the national, provincial and district levels, presumably the largest single-day election exercise in history. The legislative elections and two rounds of presidential elections in 2004 were an important litmus test for Indonesia’s democratization process which started only five years earlier with the first legislative elections of the post-authoritarian era in 1999. The fair and peaceful conduct of the 2004 election rounds can be considered a major step toward the consolidation of democratic institutions and processes in Indonesia.

The degree of consolidation of democracy has also improved as a result of the constitutional amendments and the reduction of the sociopolitical role of the military that goes along with it to some degree. While the rule of law has not notably improved during the assessment period, a consequent implementation of the judiciary reform program as announced by the Yudhayono administration might offer the change of a breakthrough. Stateness has further deteriorated. Terrorist attacks and 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. While the bomb attacks in Bali and Jakarta made the international headlines, the country is primarily gripped by the daily violence in the provinces. For instance, in February 2004 alone, there were 13 bombings in Sulawesi.

4.2. Market economy development

Indonesia's HDI improved from 0.677 (1999) to 0.692 (2002), which was a slight increase of 0.015. The institutional framework conditions for market-economy behavior have improved, but they continue to be subject to informal restraints. Based on the entire assessment period, GDP grew by an impressive 16.4% between 2001 and 2004. A more detailed analysis reveals a more complex picture, though. The Megawati administration managed to reduce the inflation rate from low double digit figures to around 6% and to keep the Rupiah exchange rate at a firm level. At the same time the economic growth remained far below that of the Suharto era, prices were relatively high and unemployment and poverty were growing. Most worryingly, investment – both domestic and foreign – has been constantly declining during the assessment period due to an inadequate infrastructure, rampant corruption and the inability of the government to efficiently implement structural reforms on a large scale. The total volume of foreign direct investments was reduced to less than half of its pre-crisis high, while there is also a low domestic investment volume.

In a report prepared for 14th Meeting of the Consultative Group on Indonesia (CGI) in January 2005 entitled "Indonesia: New Directions", the World Bank concludes that good progress on its economic reform agenda and macroeconomic stabilization over the last few years have boosted Indonesia's economic resilience. However, while accelerated growth, macroeconomic and political stability have resulted in the highest level of market confidence since the 1997 crisis, Indonesia still lacks fundamental reforms to the investment climate and needs continued improvements to governance and urgent attention to infrastructure. Despite the signs of economic consolidation, Indonesia's recent impressive economic growth is still well below the level of 6-7% that is needed to keep pace with new entrants in the labor market and to substantially reduce poverty. In sum, the overall economic development has significantly improved and the institutional framework has at least changed to the extent that political stability has brought about a higher degree of predictability as far as the framework conditions for market-based action are concerned. The institutional framework as such (safeguards of property rights, an independent and non-corrupt judiciary, market-friendly legislation, the abolishment of cartels and monopolies etc.) has, however, not substantially improved. There is great hope – albeit no clear and convincing indication yet – that the Yudhoyono administration will both be willing and capable to overcome to reform deadlock.

Apart from the lack of structural reforms and rampant corruption, the business sector has been distressed by a non-favorable environment in the area of labor relations, taxation, and poor handling of smuggling of cheap products from China. The business

sector complained about the remuneration rates (three times higher than that of China and Vietnam), the income tax (highest in all ASEAN countries), and the continuing smuggling of cheap products (textiles, electronics and so on) from China.

Table 1: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	4.9	3.5	3.7	4.1	5.1
Export growth in %	27.7	-9.3	1.5	6.8	8.5
Import growth in %	39.6	-7.6	0.9	3.5	24.9
Inflation in % (CPI)	3.7	11.5	11.9	2.0	6.2
Investment in % of GDP (Gross Domestic Capital Formation)	16.1	17.7	15.7	16.0	-
Tax Revenue (in billion Rupiah)	115,788	185,541	210,953	248,470	-
Unemployment in % (official figures)	6.1	8.1	9.1	9.5	8.7
Budget deficit in % of GDP ¹	-2.26	-2.40	-1.81	-1.88	-
Current account balance in billion \$ ²	7.992	6.901	8.124	7.534	1.583

Source: ADB Key Indicators 2004, available online at http://www.adb.org/Documents/Books/Key_Indicators/2004/pdf/INO.pdf; Economist Intelligence Uni (EIU)

¹ ASEAN Statistical Indicators, at http://www.aseansec.org/macroeconomic/annual_main.htm.

² IMF, *International Financial Statistics*.

D. Strategic perspective

The system of direct presidential election presents a challenge to Indonesia's political stability. Abdurrahman Wahid's was elected president in 1999. Although his party, the PKB, only won 12 % of the votes in the parliamentary election, Wahid still held the right to form a government. President Wahid's policies repeatedly encountered resistance in parliament and only about a tenth of parliament members defended him. The ongoing wrangles finally led to Wahid's dismissal in 2001. Although one can point to Wahid's erratic and unpredictable nature as the main reason behind the dismissal, the fact remains that a president with only minority support in the parliament can be forced to resign. This situation was repeated in the 2004 election when Susilo Bambang Yudhoyono – whose party (*Partai Demokrat*) only secured

7% of votes in the DPR election – secured the right to form a government. In this situation, the post-2004 election government may face potential instability.

A main challenge for the further consolidation of democracy will be the stabilization of the party system and the creation of a solid institutionalized framework for executive-legislative relations, which so far has been shaped by inter-personal networks rather than institutions. For example, after the 2004 elections the DPR could not function as a legislative body due to a disagreement between the supporters of President Yudhoyono and the opposition over the selection of commission-heads in the parliament. The opposition parties threatened to block all the policies of the Yudhoyono administration. This might have forced the president to rule by executive decree. It is only due to the election of Yusuf Kalla to the chair of Golkar in the DPR that Yudhoyono now faces a less hostile legislature. The party system is complex and fluid, but, broadly, the two large nationalist parties, Suharto's former state party Golkar and the Indonesian Democratic Party of Struggle (PDI-P), have emerged as the pre-eminent political forces. Neither, however, has the votes to govern on its own, so each must seek the support of the smaller parties that hold the balance of power. As the price for their support, some small radical parties have frequently demanded Islamic legislation or strategic positions in the government. This structural setting is unlikely to change in the mid-term.

Neither the influence of Islamic, and in some cases radical parties in the DPR, nor the high level of violence, however, are expected to result in the radicalization of politics in general. Indonesia is unlikely to go the same way as Algeria or Egypt, for several reasons:

- Unlike in the Arabic world, there is generally little tendency towards religious fanaticism among Javanese who form the majority of the Indonesian population. Javanese are traditionally open in their personal approach to religion, even polytheistic according to some, rather than adhering to a conservative or fundamentalist Islam.

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- Although some new urban Muslim leaders seem to be orientated towards Saudi Arabia and Pakistan in their concept of Islam, most influential Islamic leaders and scholars are more inclined to Western culture, partly because of their US-based education, and believe in a dynamic and progressive Islam. While elsewhere in the Islamic world – Egypt is a case in point – liberal thinkers and moderate institutions are often isolated, Indonesia’s moderate Islamic groups and their leaders are the very visible and highly respected key voices in any debate on religion.

 - The largest Muslim organizations, NU and Muhammadiyah, which have some 60 million members between them, joined forces to fight religious extremism. Since the Bali bombing both have offered strong public support for the government’s anti-terrorism program.

 - Any attempts to change the secular nature of the Indonesian nation have failed.

 - As a result of secularism, Indonesia is more sensitive to gender rights than most other countries with Muslim majorities. There is strong opposition towards any moves that could jeopardize the modern status of women in society.

As for its economic prospects, Indonesia seems to have the potential to grow at over 6 percent a year until the end of the decade, provided it follows through on its reform agenda successfully. Sustained efforts to improve the weak investment climate are of central importance with a particular focus on resolving a number of high-profile investment disputes and addressing crime, corruption, excessive and uncertain regulations, the unreliable infrastructure, taxes, customs, decentralization, labor, and investment regulations. Equally important is the strengthening of the financial sector foundations by clarifying the role of state banks. Diversifying the financial sector by strengthening capital markets needs to be carried out.