Anatomy of a disaster: the IMF’s war on corruption in Indonesia and the effects of structural adjustment

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Chapter 7

The Fallout: Politics and Business in the Messy State 1998-2004

There is only one thing to say about Indonesia today: If you can’t take a joke, you shouldn’t have come.

(Thomas Friedman, 2000)¹

7.1 Background

Indonesia’s political and economic situation should have been, by all IMF projections, out of the ‘red’ by the turn of the new millennium. The IMF anticipated that the necessary switch to a free market economy, under a newly democratic framework, would remove the opportunity for vested interests to cause further distortions and economic chaos. The assumption was that by relaxing the regulatory hand of the central government, primarily through the implementation of regional autonomy and a new set of foreign-investment-friendly laws, foreign investment was sure to return, thereby providing the necessary boost to the economy that would result in a rejuvenation of domestic investment and overall economic growth. Instead, Indonesia found itself engulfed in a storm of domestic tensions both between and within political parties, and with the TNI, NGOs and other social groups. The TNI was largely divided over its future role in democratic Indonesia, that is, whether it should rescind its position within government to allow for civilian supremacy, or if it should retain its dwifungsi role and have a hand in administrating the day-to-day affairs of the country.

While this thesis is primarily concerned with the impact of IMF reforms upon corruption, foreign investment and economic growth in Indonesia, it is important to recognise the other global and regional factors that also impacted upon Indonesia’s recovery. The most notable of these were the violence that accompanied the 1999 decision by the people of Timor Leste to reject autonomy within Indonesia (and hence become an independent state); the attacks in New York and Washington on the World Trade Centre and Pentagon in 2001; the Bali Bombings of 2002 and 2005; the war in Iraq carried out by the Coalition of the Willing from 2003; the August 2003 bombing of

the Marriott Hotel in Jakarta; the December 2004 tsunami that devastated Aceh; and the bombing attack on the Australian embassy in Jakarta in September 2005. While the direct impact of these events upon Indonesia differ, they have all had ramifications to some extent upon Indonesia’s political and economic situation. Furthermore, it must also be noted here that the attempt to attract foreign direct investment back to Indonesia was hampered by the cheap supply of labour and materials offered by China during its economic liberalisation phase. This particular factor was a pre-existing concern for Indonesia and other countries in the bloc the lack of political and economic stability in Indonesia, and China’s highly flexible labour market, have had a notable influence. Furthermore, the chaotic conditions of the post-crisis climate were accompanied by a significant increase in crime and an overall sense of lawlessness. Again, a common concern for foreign business and investors remains the physical security of premises and staff. Therefore, while it is essential to acknowledge that international market sentiment and FDI flows are by no means isolated from non-fiscal influences, this thesis, and this chapter specifically, focuses upon investor responses to the domestic changes that occurred in post-Suharto Indonesia, particularly those concerning the IMF. In particular, the chapter will address the ramifications of the IMF’s self-imposed involvement in Indonesia’s democratisation process and the way in which the Fund’s regional autonomy policy only served to exacerbate an already unstable political, economic and civil environment.

O’Donnell and Schmitter assert that the primary factors in transition to a democracy are necessarily domestic. They also note, however, that a transition from authoritarian rule may not necessarily result in a democratic system of governance. In the case of Indonesia, democratic transition was indeed shaped by domestic factors, yet elements of the process itself were hijacked by an external agent. This was problematic as the external agent, the IMF, was then directly involved in what it believed to be the correct path for Indonesia’s democratisation. The Fund thus demanded the implementation accompanying economic reform that it saw fit to facilitate. This came primarily in the form of economic liberalisation, deregulation and an overall reduction in the role of the state in the economy. These reforms, as we have seen in the previous

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2 Interview with select foreign business people, Jakarta, 2005.
chapter, were both extensive and fundamentally neo-liberal. Rosser contends that
economic rationalism cannot be the exclusive force in creating economic change,
“rather it will be an inherently political process in which struggle and conflict between
contending interests...play a determining role”4. Furthermore, if we recall the position
of Adrian Leftwich on transitional democracies, he asserts that it is essential that a
policy overhaul does not occur in the initial stages of democratic transition as this will
destabilize the process considerably.5 Rather, it is important that the necessary
institutions are allowed to develop properly so that they can cope effectively with major
political and economic reform. This was not the case for the presidents in the post-
Suharto era, who were subject to considerable pressure from the IMF to implement
drastic reform, not only at a time of democratic transition and political tension but
during the highly unstable environment of an economic crisis.

After thirty-two years under the New Order regime, the problematic nature of
Indonesia’s democratic transition was most notably evident in the political instability
that was reflected in the rapid and often tenuous succession of presidents in the first
three years after Suharto. The ‘teething problems’ associated with newly democratic
regimes that Indonesia was already experiencing were exacerbated by the numerous and
extensive reforms demanded by the IMF. Thus the presidencies of Bacharuddin Jusuf
(B J) Habibie (21 May 1998 - 20 October 1999), Abdurahman Wahid (Gus Dur) (20
October 1999 - 23 July 2001), and Megawati Sukarnoputri (23 July 2001 - 20 October
2004), saw the inflammation of an already tense political and social situation. Indonesia
had little chance of undergoing a smooth transition to democracy as the IMF demands
did not allow time for the accompanying institutions to adjust in order to facilitate such
a transition. Instead, the economy continued to contract as the Fund ordered the closure
of numerous financial institutions and enterprise, whilst stripping the central
government of its politico-fiscal authority. Furthermore, with only limited factional
support from the military and ongoing internal party conflict, the post-Suharto
presidencies were unable to gain the popular support and legitimacy that would allow
them to control not only Indonesia’s political and economic situation, but to retain
checks upon the existing business-government networks so that they were not

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detrimental to economic growth. However, as we shall see later in this chapter, the central government’s preoccupation with political in-fighting, tension with the military and constant pressure from the IMF to implement policy reform saw a lessening of attention to areas outside of Jakarta by the president.

Although Thomas Friedman’s epigraph at the head of this chapter may appear pessimistic and somewhat scornful, it reflects the somewhat anarchic character of post crisis Indonesian politics and economics, much of it a direct result of IMF initiatives. By 2004 the post-New Order period, the Indonesian economy had recovered only slightly but the social cost was high. Unemployment remained rife and rural poverty had increased after the implementation of regional autonomy. According to the ADB, although poverty declined slightly to 16.6 per cent in 2004 from 17.6 per cent in 2003, unemployment increased from 9.1 per cent at the beginning of 2003 to 9.3 per cent in February 2004. The ADB was particularly concerned because formal-sector employment had significantly declined and informal-sector employment had consequently increased. In fact, the UNDP’s Human Development Report showed that the Human Development Index in Indonesia stood at 110 in 2003, an improvement of one place from the previous year.

Indonesia’s figures were comparatively worse than those countries’ that were also affected by the crisis. The post crisis era was marked by old problems and new challenges, to borrow the at title from Basri and van der Eng’s book. The IMF had failed in its attempt to fix the perceived impediments to economic growth and investment. In fact, it may be argued that the changes that were implemented under the auspices of the Fund exacerbated existing problems. Its effort to disable the role of the state in the economy had failed as vested interests and predatory relationships held their influence, albeit in an altered manner. Any major changes appear to have been relatively superficial, as if the government of the day was only concerned to be seen to be working to eradicate KKN. After the initial shock and volatility that was caused by the crisis subsided, many of the big conglomerates such as Moctar Riady’s Lippo Group and

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6 In 2004 formal sector employment had contracted by 4.7% from 2003.
Bambang Suharto’s Bimantara Group, retained a lot of their influence. Most major players involved in corrupt activities escaped punitive action. Those who did go to jail, such as Bob Hasan, who was sent to Nusakambangan penitentiary, served relatively short sentences and often received reprieve on \textit{Idul Fitri}.\textsuperscript{10} This was also the case for ‘Tommy’ Suharto when he was jailed for ordering the murder a Supreme Court judge. Of his fifteen year sentence that commenced in 2002, Tommy served only four years, being released in 2006. In February 2008, he won five hundred thousand dollars in a counter-law suit after initially being prosecuted on the grounds of corruption.\textsuperscript{11} In fact, as we have discussed, the reform of the judicial system that did take place was minimal, and Indonesia’s reputation for a weak and corrupt judicial system prevailed amongst the international economic and business community.

Importantly, the diminished role of the central government saw the rent seeking activities of customs and tax officials left unchecked. In June 2004 the Fund conceded that its own medicine appeared to be the cause of Indonesia’s new problems and subsequent lagging economy:

\ldots the economic recovery [of Indonesia] had not been robust enough to ensure a sustained reduction in poverty and unemployment. Slow progress in addressing underlying structural weaknesses has impeded the development of the institutions needed for a stable and efficient market-based economy, and contributed to the sluggish recovery. In particular, legal and judicial reforms have lagged; despite recent advances, tax administration remains inconsistent and nontransparent; and corruption and weak governance remains a major source of concern.\textsuperscript{12}

Since the crisis, it has become increasingly difficult, and almost impossible by some accounts, for both international and domestic investors to do business. In the pre-crisis period, Indonesia had attracted amongst the highest amounts of foreign direct investment in the region, peaking in 1996 at US$7,960 million (Table 7, Chapter Six

\textsuperscript{10} \textit{Idul Fitri} is a public holiday where a feasting celebration takes place for the end of Ramadhan. In Indonesia the President may reduce the sentences of people serving prison time on this day. Anonymous, ‘Prisoners Get Remission on Idul Fitri’, \textit{Antara}, 6 December 2002, p. 1.


page 183). In 2005, however, the country’s *Ease of Doing Business* ranking stood at 131 in comparison to Malaysia (25), Korea (23) and Thailand (19).\textsuperscript{13} In 2004, the number of days to start a business in Indonesia was around 151, with 12 procedures required. The same indicators for Malaysia, Korea and Thailand stood at 30, 22, and 33 days with 9, 12, and 8 procedures respectively.\textsuperscript{14} Such complexities were a reflection of IMF policy demands in the post-Suharto era. Decentralisation or Regional Autonomy, in particular, was a key IMF-instigated reform that impacted directly upon business operations in Indonesia. Although the IMF insisted upon this particular policy, by 2004, the year after Indonesia had repaid its loans, it acknowledged its disastrous ramifications, admitting that “decentralization has increased uncertainty...and created new rent-seeking opportunities”\textsuperscript{15}. The report also goes on to say that “illegal fees are a major problem of doing business in Indonesia, and decentralization has exacerbated the problem”\textsuperscript{16}.

In this chapter, we explore the changes that occurred in Indonesia and the influence of the IMF that saw the country come close to being a total backwater for international business. During the *reformasi* period a number of contending forces struggled for power in Indonesia’s political (not exclusively government) spectrum. Most important were the business elite (which had held power during the New Order but had to redefine their networks), the ABRI/TNI, political parties, Islamic organisations, NGOs, academics and intellectuals. While some of these groups, such as the ABRI/TNI, experienced tensions both internally and in their relationship with the government, other groups such as NGOs and students looked towards playing a more consultative political role. The sorts of political and social instabilities that are a result of such tension and competition are largely unavoidable and perhaps conditional to the process of democratic transition. However, in the case of Indonesia, the IMF’s programs served only to exacerbate tensions and conflict as it insisted on structural changes in governance that were inappropriate or overly expeditious.

\textsuperscript{14} World Bank, *Doing Business* Database.
7.2 The Fall of Suharto and *Reformasi* Politics in Indonesia

The beginning of the 1990s marked an increase in anti-Suharto sentiment as he continued to suppress any serious political opposition. Resistance to Suharto’s regime and the desire for a democratic system of governance was not only pursued by social movements, student groups, academics and NGOs, but was also evident within an increasingly discontent parliament and other members of the political community. These tensions were further exacerbated in July 1996 with an incident involving the headquarters of the *Partai Demokrasi Indonesia Perjuangan* or the Indonesian Democratic Party-Struggle (PDI-P), Megawati’s party. In protest to her ousting as PDI chairman by a rival PDI faction supported by the military, Megawati and her supporters occupied the PDI’s headquarters in June 1996. Suharto sent in riot police on 25 July 1996 who removed Megawati and the supporters from the building. This sparked the riots which ensued on the streets between 27 and 28 July.\(^\text{17}\) From 1997, the aforementioned anti-Suharto movements gained support from broader echelons of Indonesian society as the economic crisis perpetuated the increasing levels of unemployment, poverty and hunger. This was partially due to the IMF reforms that had demanded a reduction in subsidies as part of the fiscal austerity measures, and thus inflated the prices of cooking oil and kerosene. However, Suharto’s popularity continued to decrease as he was seen to be protecting the interests of his children and close business associates while the rest of the population continued to remain impoverished.

The re-election of Suharto in the 1998 elections by the MPR did not reflect a re-emergence of broad based support, rather the population became even more defiant in its demands for an end to KKN and that the President step down. From around this time public protests and defiance against Suharto were not merely voiced by student groups, who had protested against him in the past, but by all strata of Indonesian society, from farmers to taxi drivers to middle class professionals. It was at this point, where broad based opposition to the sentiment had gained substantial momentum, that key members of ABRI and the Suharto cabinet distanced themselves from him. As Robison and Hadiz note, in such a climate, the ruling elite of ABRI and Golkar realised they could no longer protect their own interests and continue to support the president who had become

a ‘liability’. This was most evident on 20 May 1998 when Ginandjar Kartasasmita, the Coordinating Minister for Economic and Finance at the time, announced that the economic ministers would no longer be carrying out their duties under Suharto. While Habibie was nominated by Suharto as his successor, the legitimacy of his position was continually questioned and undermined not only by ABRI (TNI as of 1999) but also other political parties. Yet, as we shall see, the unstable climate of the Habibie presidency did not subside when Gus Dur was elected, nor when Megawati became president.

The Post-Suharto presidencies and cabinets were forged on the basis of securing control over the state mechanism so as to preserve access to resources, thus maintaining the predatory nature of the state and the patronage networks embedded within it. Successive presidents, however, lacked the authority to exercise the necessary control over these networks and the tensions that inevitably arose amongst them (political, military, business), as Suharto had been able to. While it was not necessary to hold absolute power as Suharto had done, nor probably was it their intention, the successive presidents felt it was necessary that they attained the authority required to ensure that the patronage networks and the subsequent in-house squabbling (a result of their realignment after the crisis and IMF program) did not interfere with the country’s economic recovery. So while KKN and the major patronage networks continued to operate in a manner to the New Order state, problems occurred with an effective vacuum and the absence of an effective power that could ‘pull rank’. For example Hadiz notes that Gus Dur retained little authority over the in-party squabbling for the control of IBRA, which had “taken-over private assets worth about Rp600 trillion [and was] widely regarded as vulnerable to abuse of power by its officials...Similar competition was seen over control of a number of state-owned enterprises”.

Part of the presidents’ inability to maintain the necessary grasp of power and keep a check on these networks was the diversion of the military, which was undergoing a reformasi of its own. The popular anti-Suharto sentiment was also accompanied by popular anti-military sentiment, an issue that the presidents had to acknowledge. On the other hand, support

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from the military and Golkar was vital to secure the presidents’ terms in office. The tensions and divisions that surrounded the proposed new role for the military, and the presidents’ distance from the military, was at the centre of debate. This served as a significant distraction from other just as pressing matters for the Habibie, Wahid and Megawati administrations.

7.2.1 The Military and Golkar in post-Suharto Indonesia

Much of the popular resentment that had been directed towards Suharto was also directed towards the military. The underlying divisions within the military surfaced after Suharto’s resignation, thus the future direction of the institution was heavily contested. This section aims to provide an outline of the various military factions and tensions during the post-Suharto period, so we might later see how the role of the military affected the presidencies of Habibie, Gus Dur and Megawati. According to Kingsbury, ABRI was split into two major ideological groups in the 1990s. The first of these was considered the pro-Suharto and pro-Islam faction. The main players in this camp were General Feisal Tanjung, the ex-commander in chief of the armed forces, ex-army commander General Hartono, and lastly General Prabowo Subianto. All retained close ties to the Suharto family, with Feisal being directly appointed to his position by Suharto and allied with ICMI. Hartono who was connected with Tutut, Suharto’s daughter, and Prabowo was Suharto’s son-in-law. Furthermore, Prabowo’s father was Sumitro Djojohadikusomo, who served as Finance Minister during the 1950s and also founded the Indonesian Socialist Party. Kingsbury maintains that Indonesia is a “country that views lineage as important” thus Prabowo’s family history was pertinent to his position (as commander of Komando Strategis Cadangan Angkatan Darat or the Strategic Reserve Command / Kostrad) and his overall influence within the military. While Feisal had the support of both Suharto and Habibie, he was not overly popular in the military and in 1998 Wiranto took over his position as commander of the armed forces. This faction was known as ABRI Hijau (or Taliban), and Suharto had moved notably closer to this group during the 1990s. According to Rinakit, other key individuals in the ABRI Hijau camp included “…Sjarfrie Sjamsuddin, Kilvan Zain, Z.

A. Maulani, Subagio H. S., Fachrul Rozi, Zaki Anwar Makasrim and Djoko Subroto.”

The second faction, known as ABRI Merah Putih (or Pancasila), included Wiratno, and gained greater strength when he became commander of the armed forces. The faction’s power and influence grew when Wiranto also took on the role of Defence Minister. The red and white faction also included “A. M. Hendropriyono, Agum Gumelar, Susilo Bambang Yudhoyono and Farid Zainuddin.” Ultimately, the merah putih faction gained the necessary positions and influence to render them the stronger faction in post-Suharto era.

Rinakit identifies three major TNI groups that had quite different positions on the future role of the military: the Status Quo, Reformist, and Radical Reformist as he calls them. The Status Quo group was comprised of “former Soeharto adjutants” from an abangan background, with no university education. This particular group did not support the proposed internal reforms, particularly during the Gus Dur government, where the military would play a less active role in government and politics. The main actors in this group included Wiranto and Soegiono. Although the Reformist group were also from abangan backgrounds, most of them held overseas university degrees. While they had successful careers in the military they were no mere Suharto adjutants. The group included Susilo Bambang Yudhoyono, Agus and Widjojo. Finally, the Radical Reformist group was led primarily by Agus Wirahidikusumah and Saurip Kadi. It was also known as the Group of 20 and considered ‘ill-bred’ by the Status Quo group. Rinakit maintains that the Radical Reformists “…wanted the military to become professional and submit to civilian supremacy, as had been proposed so long ago by General Soedirman.” It appears that the Reformist and Status Quo factions held most of the power, as they included the individuals that held important government and military posts. Later, we shall see how the military played a key role in undermining the powerbase of Habibie and Wahid when these two presidents began to give preferential

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24 S. Rinakit, *The Indonesian Military After the New Order*, p. 84.
treatment to the Radical Reformists in order to ensure the implementation of military internal reforms.

The military underwent a number of significant changes in the immediate post-New Order period, however, it is debateable as to what extent such changes were merely symbolic rather than real. In late 1998, ABRI held a seminar that involved both Indonesian and foreign intellectuals to discuss the reformation of the ABRI in the post-Suharto era. Subsequently, the Paradigma Baru ABRI, or the ABRI’s new paradigm was announced\(^\text{28}\), the four key aspects of which were

1. ABRI’s disengagement from the ‘forefront of politics’;
2. shifting ABRI’s role from that of ‘controlling’ politics to ‘influencing’ politics;
3. shifting ABRI’s political commitment...from a ‘direct’ role to an ‘indirect’ role; and
4. sharing power with civilians.\(^\text{29}\)

These four aspects reflect the set of proposed new measures which would see the redefinition of the military’s role and operations. Some, but not all, of the new measures proposed as part of this were realised. This shift partially involved an effort by the military to be seen as ‘neutral’ rather than supporting a particular political party.\(^\text{30}\)

Basically, the new paradigm changes proposed the abandonment of military sociopolitical control, the separation of the police, POLARI, from ABRI and the termination of Golkar as a military specific party. On 1 April 1999, under the Habibie administration, ABRI became TNI, and POLARI therefore became its own unit also.

The change to the TNI as part of Paradigma Baru ABRI occurred at the same time Wiranto rose to dominance, ensuring the ousting of Prabowo and his men from any positions of influence. During the Habibie administrations and at the beginning of Wahid’s tenure a number of prominent military personnel aligned with Wiranto, such as Susilo Bambang Yudhoyono, Agum Gumelar and Freddy Numberi, or ‘Wiranto’s men’, held various ministerial or high government-related positions at the behest of Wiranto.\(^\text{31}\)

However, Wiranto’s inability to escape his association with East Timor and the brutality

\(^\text{28}\) J. Honna, Military Politics and Democratization in Indonesia, pp. 165-166.
\(^\text{29}\) S. Rinakit, The Indonesian Military After the New Order, p. 102.
of the Suharto regime saw him take a back seat in government from mid-2000.\textsuperscript{32} The military’s economic role was reduced to an extent, particularly at a central government level as “it cannot any longer intervene in the bureaucracy so effortlessly to win government tenders for cukongs...close to the military”.\textsuperscript{33} While the military’s mandate over non-security operations was reduced largely in the 1990s as a response to mounting calls for reform by various social movements and strata of the Indonesian civilian population since the 1980s,\textsuperscript{34} it was still imperative that the post-Suharto presidents retained control over the TNI. As we shall see, such allegiance from the military could potentially provide the necessary authority for the presidents over the ever-present vested interests and subsequent vying for power and resources that remained in play in the post-New Order state.

In the immediate aftermath of the Suharto regime, Golkar’s influence initially diminished. Golkar did not escape the tarnished image of Indonesia’s former president, which also implicated the political party and the military. Thus as part of the new paradigm initiative the military distanced itself from Golkar somewhat and began to show interest in other political parties. By the time Habibie was ousted in favour of Gus Dur, the absoluteness of Golkar’s authority was all but shattered.\textsuperscript{35} While the Golkar party still played an integral role in government, it did not have the military support it once did to exercise the sort of power that it had wielded during the New Order. However, the party managed to retain ties and funding at a grass roots level, particularly when local elections commenced. As Indonesia’s economic situation continued to deteriorate, Golkar was able to exploit the popular romanticised nostalgia for the New Order era, and support for the party was reinvigorated in 2001 when Gus Dur was ousted. By 2004, Golkar was referred to as “…one of the biggest political comebacks in Asia”\textsuperscript{36}. The party’s primary tactic to bolster support was through the reinvigoration of its image, whereby it attempted to distance itself from the unfavourable elements of the Suharto regime, such as KKN and heavy handedness, whilst also promoting a return to

\textsuperscript{33} S. Rinakit, \textit{The Indonesian Military After the New Order}, p. 166.
\textsuperscript{34} For further reading on public contestation of the military’s socio-political role in Indonesia during the 1980s and 1990s, see J. Honna, \textit{Military Politics and Democratization in Indonesia}; S. Rinakit, \textit{The Indonesian Military After the New Order}; Z. H. Ahmad and H. Crouch (eds), \textit{Military-Civil Relations in Southeast Asia}, Oxford University Press, New York and Singapore, 1985.
\textsuperscript{36} M. Shari, ‘Indonesia: Suharto’s Party is Surging’, p. 58.
the political stability of the New Order era. In 2001 Golkar chairman, Akbar Tanjung, announced that the party had “shucked off its authoritarian past and the rule of the law”\textsuperscript{37}. However, at the time that Akbar made this announcement he was also under investigation in a scandal involving the siphoning off of funds from Bulog. Yet the success of the Wahid and Megawati presidencies were still reliant upon the support of Golkar, particular at the time of presidential accession, due to the party’s success in gaining popular support and its ties with the TNI.

\textit{7.2.2 Bacharuddin Jusuf (BJ) Habibie}

Indonesia was in the midst of financial, social and political crisis at the time of BJ Habibie’s accession on 21 May 1998. The economic situation was dire and the repercussions were being felt throughout the archipelago as almost half the population was living in poverty. The country needed a leader who would steer it through the crisis whilst regaining a degree of political and social stability. Various groups such as students, academics, and also politicians were particularly critical of Habibie and his policies due to his reputation as a Suharto crony.\textsuperscript{38} President Habibie also needed to respond to the multitude of demands that had been voiced by the population, regarding the current poor economic situation, and broader issues such as the role of the military, democracy and KKN. Habibie achieved traction on none of these goals. From the outset of his presidency, Habibie was faced with the obvious political and economic challenges, yet the legitimacy of his position was not recognised by many groups, including political, military, business, student and unions, and was therefore consequently undermined continuously during his short term in office.\textsuperscript{39} In fact, the anti-Habibie movement was far larger in numbers (both in the military, government, and population) than the pro-Habibie movement. The anti-Habibie movement was comprised primarily of nationalists, who viewed Habibie as too closely aligned with prominent Islamic groups, in particular ICMI, and it was feared that this would lead to Indonesia to become an Islamic state. Furthermore, Habibie lacked the military support that was essential to maintaining the authority and legitimacy of the central government. The military’s discontent with Habibie primarily stemmed from his reaction to popular

demand to end *dwifungsi* and wind back the role of the military. As a president who was in need of broader support, Habibie indeed attempted to retract the military from politics and social and economic life in Indonesia, but ultimately was not successful.

The policies that Habibie implemented to appease the population further antagonised the military, particularly regarding East Timor. Although General Wiranto, acting in the capacity of both ABRI commander and Defence Minister, publicly stated his support for Habibie, it was commonly understood that Habibie ruled “at the pleasure of the armed forces”\(^\text{40}\). This was never more apparent than when, despite the Habibie cabinet’s refusal to approve the measure, Wiranto declared martial law in East Timor.\(^\text{41}\) Habibie attempted to gain military support by currying favour with Wiranto, whose *merah putih* faction had prevailed by undermining Wiranto’s closest rival, Prabowo. On 15 February 1999, at the opening ceremony of the Second Asia-Germany Editors’ Forum, Habibie “accused Prabowo of threatening him at midnight on 22 May 1998, one day after Soeharto handed power over to him”\(^\text{42}\). He claimed that Prabowo made such threats because Habibie would not appoint him as Chief of Army Staff (KASAD), nor would he appoint Soebagio to the position of Commander in Chief.\(^\text{43}\) Yet Habibie’s desperate attempts to gain military support were futile. The resentment of the military towards the president also led to further unrest in the provinces as it refused to intervene in riots and even at times ignited violence, resulting in the First and Second Semanggi affairs.\(^\text{44}\)

Like Gus Dur and Megawati Sukarnoputri would later do, Habibie promised that he would ensure Indonesia’s economic recovery and political reform. Because Suharto’s seemingly arrogant attitude towards the IIT’s since the intervention of the IMF in 1997 contributed to his declining popularity, Habibie announced Indonesia’s cooperation with the IMF and World Bank in order to foster support.\(^\text{45}\) The policy changes included

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\(^{42}\) S. Rimakit, *The Indonesian Military After the New Order*, p. 93.

\(^{43}\) S. Rimakit, *The Indonesian Military After the New Order*, p. 93.

\(^{44}\) The First Semanggi affair on 13 November 1998, where five students were shot dead, and the Second Semanggi affair on 23 September 1999, where one student was shot dead, only fuelled the anti-Habibie movement.

the promotion of democracy by allowing the creation of political parties, the East Timor ‘independence’ referendum and the abolition of KKN, considered at the time to be the chief cause of the crisis and the main reason behind the spike in poverty. Unfortunately these initiatives, particularly in the case of KKN, were generally piecemeal and were the cause of further resentment. In order to achieve the image of a clean government Habibie ordered the sacking of individuals from the DPR/MPR who had acquired their positions through nepotism.\textsuperscript{46} He also named William Soeryadjaya from the Summa Bank and Hendra Rahardja from the BHS Bank as being involved in corrupt activities. Yet such manoeuvres were largely token and succeeded only in further eroding support for the president on behalf of Indonesia’s business elites and entrepreneurs.

Habibie did not have the charisma or the political surefootedness of Suharto, as characterised by his response to the malnutrition epidemic when he insensitively suggested that “if all Indonesians fasted twice a week during daylight hours, as the most devout Muslims do, the country could save 3 million tons of rice a year”\textsuperscript{47}, a comment that was not received well by a population that was already starving. In fact, in mid-1998 the Central Bureau of Statistics reported that around 80 million people were earning under $4 a month and were subsisting on less than 2,100 calories per day, which is “barely two thirds the intake required for a normal diet”\textsuperscript{48}. The government and World Food Program also estimated that over 7 million people were living on one meal a day or less.\textsuperscript{49} While there was no shortage of staples, the general population did not have the income to purchase food, despite government subsidies.

With Indonesia’s economic situation continuing to decline, Habibie’s already shaky grasp on power was further eroded as he found it virtually impossible to muster significant support from either the government or military. Pratikno describes the situation in this way:

The problem of political legitimacy of the Habibie government, the political environment that limited the use of military coercion and the economic and financial

\textsuperscript{46} S. Rinakit, \textit{The Indonesian Military After the New Order}, p. 93.
\textsuperscript{47} R. Moreau, “To Starve a Tiger”, p. 32.
\textsuperscript{48} R. Moreau, “To Starve a Tiger”, p. 32.
\textsuperscript{49} R. Moreau, “To Starve a Tiger”, p. 32.
crisis of the central government all undermined the political authority of the central government.\footnote{50}

Habibie himself was also tied to corrupt activities, such as the Bank Bali scandal, where around $60 - $70 million was siphoned off from the Bank to fund Golkar. He was furthermore suspected of interfering with IBRA, INDRA, and JITF.\footnote{51} The relatively amicable relationship that Habibie had retained with the IMF was strained when it learned of his involvement in these scandals.\footnote{52} Further economic deterioration occurred as the violence in East Timor escalated, which led the IMF and World Bank to suspend funding.\footnote{53} With political instability and economic decline, foreign investors became even more hesitant towards extending credit and putting capital into Indonesia.\footnote{54}

7.2.3 Abdurrahman Wahid (Gus Dur)

In October 1999 Abdurrahman Wahid, aka Gus Dur, relied upon three main axes of support to secure the presidency. The first of these were the main political parties of the Suharto era including PDI-P, Golkar, PKB and PPP, which indeed received the most popular support at the 1999 election, winning 34, 22, 12, and 10 per cent of the vote respectively.\footnote{55} Second was the military, which had been promised key positions in the Wahid cabinet. And third, he pandered towards an increasingly pro-Moslem Suharto and was thus successful in securing resources and support for the election from Cendana. However, Gus Dur immediately alienated the military by breaking his election promise of making either Wiranto or Akbar Tanjung vice president. He maintained that it would reflect badly and increase the present anti-military sentiment in the population.\footnote{56} Not long into his presidency he too provoked discontent from other political parties and the general population.

\footnote{53}{IMF, ‘The Situation in Indonesia and the IMF’, 16 September 1999.}
\footnote{54}{A. L. Smith, ‘Abdurrahman Wahid’s Economic Agenda’, p. 216.}
\footnote{56}{S. Rinakkit, \textit{The Indonesian Military After the New Order}, p. 132.}
Gus Dur attempted to push radical military reform through very rapidly. This move received support only from the ‘radical reformist officers’, which comprised the smallest group. He also tried to dismantle the Socio-Political Council in an effort to diffuse military power in areas other than that specifically of national interest. Gus Dur ordered an audit into the military’s financial activity, which further antagonised the military. It responded by hiring its own auditors—the results of which were quite different to those produced by the government auditors. He further attempted to strengthen his resolve by announcing in early June 2001 at morning prayers in Jakarta that ‘he would serve out his term of office until 2004 even if the palace were to be surrounded by hostile soldiers’.

Gus Dur then tried to pacify the TNI by re-shuffling the head positions, offering the posts of Air Force Chief of Staff, Army Chief of Staff, Navy Chief of Staff and TNI Commander-in-Chief to four senior officers he considered to be sympathetic to his intended military reform. However, the plan backfired when the officers involved refused the request and it was reported that although the generals were tempted, said Indra, in the end they rejected the goodies on offer on the grounds that the replacements were not being carried in accordance with the required procedures. Lt. Gen Ian [Santoso Perdanakusumah] directly rejected the offer, saying that the timing was inappropriate. But, according to one general who is close to Ian, he confided his true reason as: ‘I didn’t want to go against the TNI, my very own family.’ Ardana’s response was the same.

When the attempt to re-shuffle power failed, the president instead sought popular support for reining in the activities of the military by openly accusing members of the TNI of being involved in and responsible for the mass civil unrest in East Java in May 2001. The situation only deteriorated when Indonesia’s human rights commission found Wiranto and five other TNI officers were responsible for the violence that occurred in East Timor on 30 August 2001 when the independence referendum was carried out. In an effort to present a tough front to the military an already unstable Wahid cabinet decided to support the commission’s calls to bring Wiranto and others to

57 S. Rinakti, The Indonesian Military After the New Order, pp. 141-142.
trial for crimes against humanity.\textsuperscript{61} These events only resulted in an \textit{increase} in regional violence, as the military stood by as a sign that it refused to be limited by the president.

As with Habibie, the military and non-Islamic political parties regarded Gus Dur’s close ties with Islamic groups such as \textit{Dewan Syuriah} as evidence that Indonesia would become an Islamic state. There is some basis to support this claim as he relied almost exclusively upon \textit{Dewan Syuriah} when consulting on political decisions and policy, rather than with members of his own cabinet. He further angered the other major political parties when he sacked a large number of ministers and made allegations of corruption against them. In particular, PDI-P and Golkar were very annoyed when the president ordered the resignation of Jusuf Kalla, Laksamana Sukardi and Wiranto from their respective positions as Minister of Trade and Industry, Minister of State-Owned Enterprises, and Coordinating Minister of Politics and Security. Finally, he outraged both the defence forces and parliament when he fired General Surojo Bimantoro, the Chief of Police, without receiving approval from parliament.\textsuperscript{62}

Gus Dur’s attempt to convince the population that he would indeed be putting a stop to KKN was undone dramatically with the so-called ‘Bulogate’ and ‘Bruneigate’ scandals. In the case of Bulogate, $3.6 million was stolen from Bulog at the behest of Gus Dur by his business associate and masseur. Bruneigate tarnished Gus Dur’s reputation considerably both within Indonesia and also externally as it involved foreign funds. The Sultan of Brunei’s donation of $2 million for food projects went missing.\textsuperscript{63} While these sorts of ‘off-budget’ fiscal activities occurred under Suharto there was less public outcry about them, first, because the cornerstone of Suharto’s legitimacy was economic growth, and second, public protests were suppressed by the military. However, Gus Dur’s involvement in these two scandals were well publicised and a disgruntled military made no effort to suppress public protest. Rather, these scandals were seized upon by the military and disgruntled political parties as an opportunity to discredit and impeach the president. Thus on 23 July 2001, the MPR voted to have Gus Dur impeached and Megawati became Indonesia’s third post-New Order president.

\textsuperscript{62} S. Rinakit, \textit{The Indonesian Military After the New Order}, p. 197.
\textsuperscript{63} J. Sprague and W. Cragata, ‘Going Nowhere: As Parliament and Street Protestors in Indonesia Clash Over President Wahid’s Future, Reforms are Stalled’, \textit{Asiaweek}, 16 February 2001, p. 1.
7.2.4 Megawati Sukarnoputri

Moreau commented at the beginning of Megawati’s presidency that “...in order to get anything done, she must rely politically upon the two pillars of former dictator Suharto’s all-powerful New Order: the Indonesian military and the Golkar party”64. Yet due to continuing anti-dwifungsi sentiment, and the events in East Timor, Megawati had to strike a balance whereby she could both appease the military and Golkar but retain a clean political image that was distanced from corruption. In order to walk the tightrope of both avoiding antagonism from the military and appearing to remain somewhat distanced from them, Megawati’s attitude towards ABRI was largely one of ambivalence. To maintain stability Megawati did not make the mistake of pushing for rapid internal reform in the military as her predecessor had done. She also made this clear to external observers, informing Washington that “military reform would be on Friday’s not Monday’s agenda”65. This stance was generally accepted by the US, particularly after 9/11, when global security held a prominent position on the international relations agenda. Yet, as Rinakit notes, the relationship between Megawati and the TNI was not built on trust but on compromise: the military continued to support the president so long as she did not intervene in its interests.66 However, in the eyes of the public, preferential treatment towards the military was viewed critically.67

By 2004 popular resentment towards Megawati was surging as her term in office had given way to nothing more than economic stagnation, with little done to address the key issues of KKN and violence throughout the archipelago. Although Megawati herself was not considered corrupt, her reputation was tarnished by the well known shady dealings of her husband, Taufik Kiemas.68 Indonesia’s sluggish economy was also accompanied by high unemployment and unprecedented levels of corruption that were not only crippling the population but also what remained of foreign business interests. Public discontent with the president was compounded by the government’s

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64 R. Moreau, ‘Ring in the Old; Even as They Usher in a New President, Indonesian Lawmakers May Have Opened the Door Once Again to Elements of Suharto’s Ancient Regime’, Newsweek, 6 August 2001, p. 20.
consideration of amnesty for Suharto on charges of corruption.\textsuperscript{69} A 2004 article by Janssen discusses a World Bank and Asian Development Report that shows the three primary foreign investor concerns for Indonesia were “macroeconomic instability, political uncertainty and corruption”.\textsuperscript{70} Janssen asserts that the blame for the political uncertainty in Indonesia could be laid squarely at the feet of the Megawati administration. As a president who said and appeared very little in public, she was considered to be disconnected from the people and lacking in political strength.\textsuperscript{71} Furthermore, the support from the TNI swung away from the PDI-P and back towards Golkar as the 2004 elections loomed. The series of major terrorist attacks, the ongoing regional violence, the overall sense of lawlessness and lack of direction saw a change in voter sentiment to a “nostalgia for the strict law-and-order stance of the authoritarian rulers they had until the first democratic elections of 1999”.\textsuperscript{72}

Although the presidents of the post-New Order period did not seek to emulate the absolute power (which was at times excessively violent and coercive) and authority of their predecessor Suharto, it was vital that a degree of presidential control was asserted in order to successfully manage the country’s democratic transition. However, for various reasons noted, these presidential administrations were unable to gain the necessary control over the major forces that were contesting power in the reformasi era. The disruptions that are associated with democratic transition were only exacerbated by an IMF program that required extensive and frequent yet not entirely appropriate changes to the political and economic (and subsequently civil) landscape. In the prelude to the 2004 presidential elections, Soo Kang noted that “regardless of the result...it would be a difficult task to overcome the current crisis after IMF-led reform”.\textsuperscript{73} At the conclusion of the Megawati Sukarnoputri regime, the overwhelming political and military contest for power saw the post-Suharto presidents divert their attention away from the national agenda towards suppressing or supporting these interests in order to maintain their office. This meant that the presidents were unable to comprehensively attend to issues of economic reform and democratic transition. As we shall see in the


\textsuperscript{70} P. Janssen, ‘Conditional Success’, \textit{The Banker}, 154(936), 1 February 2004, p. 76.


\textsuperscript{72} Anonymous, ‘Megawati squeezed between tough guys’.

following section, the government’s diminished focus on the economy, bureaucracy and the relevant institutions was felt most acutely by the middle and lower classes and poor of Indonesia.

Thus Indonesia’s political, social and economic circumstances in post-Suharto Indonesia were far from desirable for foreign investors. The friction between the presidents, particularly Habibie and Gus Dur, and the military, led to perceptions that the government’s power base was unsound, as did the visible split in military factions. Furthermore, Indonesia experienced a rapid succession of presidents, and one of whom was impeached, which served to further perpetuate political and social instability. The aforementioned riots that occurred at different times for the reasons previously discussed were evidence of a population that could not be contained by its government, which lacked the necessary military backing. As a result of the financial crisis and the IMF program, domestic economic conditions remained poor. While the instability that ensued after the ousting of Suharto and the transition towards democracy is somewhat typical of a newly democratizing state, the IMF’s demands for overwhelming change in a short period of time served to only exacerbate tensions and thus this instability to an almost intolerable level. Therefore, the international business community generally viewed Indonesia as something of a basket-case and a high risk country in which to do business and invest. Subsequently, foreign direct investment levels continued only to decline in Indonesia when in other crisis affected countries they were beginning to recover.
7.3 Effects on Economic Growth and FDI in Indonesia: Decentralisation, Democracy and the Judicial System

Although corruption and money politics are not a new phenomenon in Indonesia, investigative reports and opinions covered by the mass media show the growing spread of corruption in Indonesia following decentralization and democratisation. (Pratikno, 2005)\(^{74}\)

7.3.1 Decentralisation and Democracy

Decentralisation was a cornerstone of the IMF’s strategy, and it aimed to achieve democracy and good governance by diffusing power from the central government and TNI. It was assumed that decentralisation would promote equitable growth throughout the archipelago and minimise not only fiscal but social disparities between the regions by eliminating corruption. According to Hadiz, neo-institutionalists and neo-liberals advocate decentralisation as it induces democracy and “leads to greater prioritization of local needs in development policy, as it encourages greater accountability of those who govern local communities. It can also enhance political stability and even national unity”.\(^{75}\) However, Hadiz also argues that “‘democratic decentralization’ in the sense envisaged by theoretically sophisticated neo-institutionalist authors...was not something that could have reasonable been expected to transpire in Indonesia, given the context of the broader system of power relations”.\(^{76}\) According to a Far Eastern Economic Review article, when Indonesia appeared hesitant to act on a number of Fund requirements including the decentralisation initiative in 2000, the government received a letter from the IMF deputy director for Asia and the Pacific demanding “that Jakarta move decisively to minimize risks in its fiscal decentralization plan, use higher oil revenues to repay government debt and set a firm time-table for asset sales”.\(^{77}\) The Fund’s primary concern here was to prevent the local government from being given the mandate to borrow from overseas. It was furthermore implied in the letter that the Fund would seek to suspend or terminate funding to Indonesia by the end of 2000 if the demands were not carried out.

There is some evidence of a shift to more democratic practices at the regional level since decentralisation. The *bupati*, for example, are required to present an annual accountability speech, which must be accepted by the parliament. Upon two rejections of his/her speech the *bupati* must resign, and there have been instances where this has occurred. Pratikno cites two pertinent examples during 2001 and 2002 in Semarang and Surabaya respectively, where the respective district and municipal heads of government have resigned after pressure from the local parliament. 78 However, these sorts of cases constitute the exception rather than the rule, and the effects of decentralisation have been generally problematic. This has impacted most adversely upon the poor and working classes in regional Indonesia.

There have been fiscal allocation issues from the outset as the ambiguity of laws 22/1999 and 25/1999 led to variance in their regulation. In an ad hoc manoeuvre, the Dana Alokasi Umum (DAU) was devised as a grant in kind, based upon a formula, for official’s salaries, services, education and health and was distributed to the regions proportionate to their net fiscal gaps. 79 Furthermore, the government oversaw the transfer of 2 million employees from Jakarta out to regional Indonesia as part of the regulation strategy. 80 However, these and other ad hoc measures that were enacted did not improve the problems that evolved out of the original regional autonomy laws; 81 the DAU formula proved inadequate and non-egalitarian. As Fane notes, the DAU allocations did not manage to alter the status quo- in fact it was perpetuated. To illustrate this he cites a comparison between Jember and Denpasar. In Denpasar “only about 5,000 people are below the poverty line, [and it] received a slightly larger share of the DAU on account of poverty than Jember, where almost a million people were below the poverty line!” 82 The transfer of employees noted above was also problematic when ethnic issues arose between the local official personnel and the Jakarta transferees.

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78 Pratikno, ‘Exercising Freedom: Local Autonomy and Democracy in Indonesia’, p. 28.
82 G. Fane, ‘Change and Continuity in Indonesia’s New Fiscal Decentralisation Arrangement’, p. 171.
The effects of corruption and rent-seeking behaviour adopted in the wake of decentralisation were not the only disadvantageous products of regional autonomy. Rather than producing a democratic alternative, the devolution of power resulted only in delegating authority to a lower level, but with unexpected consequences. Many regional governments lacked the basic know-how to generate revenue and administer the responsibilities allocated to them. Fundamental issues such as health and water management were not properly attended to as regional governments were simply too small to take on such tasks and the existing problems associated with them. An article in the *Financial Times* reports that Indonesia’s media has been particularly concerned with the recent child malnutrition epidemic in rural Indonesia. The health problem appears not to be an issue of food shortages but rather is “a long-term structural issue” relating to the poor quality of community health in Indonesia. The incidence of severe child malnutrition has only re-emerged since the decentralisation of the health system as part of the overall decentralisation strategy. Indonesia’s *posyandu* programmes, or health centres, were established by the Suharto government to keep a check on infant health. However in 2005 about half of the 250,000 previously operational health centres were reported as dysfunctional by Unicef. It has been suggested that since health funding is now controlled at a regional level, “the local governments often prioritise revenue into channels other than health”. This claim was reiterated by Dr. Hadi Soesastro, a democracy advocate and the Executive Director of the Centre for Strategic and International Studies (CSIS) who commented on the “consequences of democracy” in reformasi Indonesia, observing that it was something of a double-edged sword:

Just recently in North Sulawesi, the provincial parliament [tried] to get each member of the provincial parliament a brand new car, with each car costing 300 – 350 million rupiah...This is the result of decentralisation and autonomy, but in the budget priority they do not put that much importance on the allocation of...health and...education but more on what is needed by the parliament members, by the governor, by the

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83 Luky Djani, Vice-Coordinator Indonesia Corruption Watch, Interview Jakarta, August 2005.
bureaucracy. They all have their power and they use their power in a very different way. Is this democratic? Yes.\textsuperscript{87}

Where prioritisation is not an issue, sufficient funds to maintain regional infrastructure has been a significant problem. Often, local districts were forced to rely all too heavily on the DAU and other funds of revenue from the central government.\textsuperscript{88} For example, a study by Greg Fane shows that in 2002 “local governments generated just under 5\% of their total revenue from own-tax and non-tax sources, while transfers from the central government accounted for the remaining 95\%.”\textsuperscript{89} Income disparities between regions only increased and while a handful of regions received increased revenues other areas remained substantially poor and officials were forced to pursue alternate, and sometimes quite ridiculous, means of raising regional income. For example, one report showed that in Padang officials seized and took over a state-owned cement plant that was to be privatised by the central government, similarly in Bogor an illegal tax on importing goats was introduced.\textsuperscript{90}

Contrary to IMF anticipations, decentralisation did not eliminate corruption, it was in fact exacerbated. The Suharto era oligarchy remained intact; and the economy continued to decline at both a regional and national level. A number of sources point to decentralisation as the predominant factor behind the increase in corruption and Indonesia’s inability to make an economic recovery. Former Coordinating Minister for Finance and Economy, Rizal Ramli argues that the old oligarchy not only survived decentralisation and democratisation but in fact benefited from the changes. It was the oligarchy’s core that possessed the resources and influence necessary to regenerate themselves in reformasi Indonesia. The elite power structures were essentially preserved, despite changes in other facets of Indonesia’s political system. As Rizal Ramli notes, “…they become the chairman of the party, become the major, become government of Indonesia. This is the same guy, the same oligarchy during the New Order.”\textsuperscript{91} He went on to say:

\textsuperscript{87} Dr. Hadi Soesastro, Interview Jakarta, August 2005.
\textsuperscript{89} G. Fane, ‘Change and Continuity in Indonesia’s New Fiscal Decentralisation Arrangement’, p. 169.
\textsuperscript{90} Anonymous, ‘Asia: Autonomy or Anarchy’, p. 16.
\textsuperscript{91} Rizal Ramli, Interview Jakarta, September 2005.
...there is always a general perception [that] if you have [a] democratic transition to democracy then everything will be okay with the economy. But people forget that the one that is able to benefit will be much more organised, they have more resources [and that] is essentially the old oligarchy.92

In 2005 Indonesia Corruption Watch (ICW) reported that although there were frequent changes in the executive, around 70 per cent of the day’s parliament were also in office during the New Order. A more pragmatic reason behind the retention of power by certain individuals was the necessity to prevent further economic deterioration. For example, IBRA and the Salim Group renegotiated a deal whereby IBRA acquired 104 Salim companies, yet executives from the Salim Group still managed those companies in which the Salim Group was allowed to retain shares. This is common knowledge in Jakarta, a foreign investor commented on the Group’s ability to actually profit from its dealings with IBRA. He recalled that “I understand that the Salim Group was able to pass in assets to pay off debt and then buy back the assets, at least some of them, at bargain basement prices”.93 However, observers argue that if major players, such as Salim, were removed then the companies that they owned would fail. A Jakarta-based American banker stated that “Salim has the most widespread distribution network in the country…If you take that away, the company loses value”.94 The failure of the major conglomerate groups would have seen a perhaps unrecoverable blow to Indonesia’s domestic economy and further increases in already significant levels of unemployment. The Salim Group alone employed around 200,000 people in 1998. The suggestion that “Jakarta believes Indonesia needs Salim, and its business savvy”,95 reflects the reality that completely dismantling Jakarta’s oligarchies would have resulted in a complete collapse of the domestic economy and a further outflow of foreign capital. Yet, the operations of Indonesia’s business elites have been somewhat altered as there is no central authority to curb or regulate their business activities. The IMF’s liberalisation strategies, whereby the state has a reduced role in the economy, has seen an uneven dispersion of domestic investment so that some sectors, such as the financial sector, are in surplus, and other sectors, such as hard and soft infrastructure, are in deficit.

93 Foreign Businessperson, Interview Jakarta, August 2005.
95 S. Tripathi, ‘Pulling punches’, p. 110.
While the retention of power by oligarchic interests allowed for the protection of some Suharto-linked families and cukong, the fragmentation of power that occurred at a regional and bureaucratic level proved detrimental to foreign capital. Hadiz and Robison note that decentralised governance, with reference to the Indonesian case, is not necessarily implicit with transparency and ‘good governance’ any more than is centralised governance; that is, there is no guarantee that these by-products will emerge if they are also previously absent at a national level.96 Despite original arguments by the Fund that the decentralisation process (as part of Indonesia’s transition to democracy) would break-up the central power base, the undesirable elements of governance associated with it, and foster a system possessing the necessary elements of ‘good governance’, the evidence suggests otherwise. Luky Djani, of ICW concurs with this, arguing that “although the central government gives its power and authority to a kebupaten level, it’s not automatically a democratic process”97. Rather, the newly fragmented power structure, and the subsequent opportunities that now presented themselves at a regional level, saw a sudden shift in local government regulation that consistently conflicted with the national interest. Under a centralised system of governance, Suharto’s legitimacy, and his longevity in office, rested predominately on his ability to ensure continual and mostly equitable national economic growth. However, after 2001, the shorter tenures for regional officials meant that neither regional nor national economic growth was a priority as they turned their attention to the elections.

The unregulated increase of KKN at a regional level and the continuing disparities between the wealth of the regions, were not necessarily issues that were endorsed by the local communities subjected to the changes, that is, who were originally optimistic at the prospect of regional autonomy. But regional autonomy was quickly regarded as a ‘free-for-all’ amongst those officials who realised the new potential for control over resources and state institutions.98 In effect, dealing with the regions became, for many, like dealing with ‘hundreds of little Suhartos’. Importantly, according to Honna, instead of a reduced role for the TNI in regional Indonesia, the military presence actually increased as local officials co-opted local TNI commands to

97 Luky Djani, Vice-Coordinator Indonesia Corruption Watch, Interview Jakarta, August 2005.
ensure stability. Honna cites a bupati who stated that “…the military is crucial for political stability here, and I have successfully incorporated the TNI in my administration”. 99 Thus the relationship between local officials and local TNI elites became much closer than was the case during the New Order. 100

The decentralisation strategy, discussed in great detail in Chapter Five, ultimately resulted in a system whereby rules, regulation and licensing became arbitrary processes and the bupati exercised discretionary power. Rent-seeking channels were pursued vigorously, so much so that investment and regional economic development was drastically impeded due to the excessive amount of revenue raising regulations on inter-regional trade. In fact almost immediately after the enactment of the Regional Autonomy laws in 2001, Kamar Dagang dan Industri or the Indonesian Chamber of Commerce and Industry (KADIN) reported on an influx of complaints relating to the increase in corruption in the local governments and the ridiculous number of ‘taxes, levies and permits’ that were required to carry out business and trade. 101 While the central government ultimately intervened, it cancelled only 38 regulations implemented by regional governments. 102 The central government insisted that it would counter these problems by increasing accountancy measures and “cancelling problematic regulations” 103. Therefore, the systems of patronage, which the Fund vehemently attempted to abolish, not only survived but prospered in a manner that was far more detrimental to regional and national economic growth than during the Suharto era.

100 J. Honna, ‘Local Civil-Military Relations During the First Phase of Democratic Transition’, p. 94.
7.3.2 Foreign Direct Investment and Foreign Business

When people are choosing where to put their next factory, at the moment they are not choosing Indonesia, says one leading foreign businessman (Donnan, Hidayat and Mallet, 2005)\textsuperscript{104}

One of the areas which is regarded as essential to Indonesia’s economic recovery has been the return of foreign investment; “from bankers to bartenders, everyone seems to understand that the resumption of foreign direct investment is vital to the economic future”\textsuperscript{105} Foreign investors cite economic uncertainty, corruption and an unpredictable judicial system as the main deterrents to doing business in post-Suharto Indonesia. One foreign Jakarta-based businessman noted that after the fall of Suharto “nobody really knew what the ground rules were. The implementing regulations [for most laws in Indonesia] seem to come out a year or years afterwards and people just have to blindly find their way through the system in the meantime…The laws are so general it leaves it so open to interpretation so everyone just interprets it differently to their own purposes”\textsuperscript{106}

Yet in New Order Indonesia, the legal system was hardly transparent and was one of the most corrupt in the region. Like the political and bureaucratic power structure in which it resides, corruption in its fragmented form has resulted in a lack of continuity in the regulations and rules between institutions, government departments and between the centre and the provinces. Consequently, business became increasingly costly and uncertainty was thus unmanageably high for foreign investors due to the continuous cycle of negotiation, re-negotiation, and execution with various bureaucratic officials and government institutions, all of which were to be dealt with on an individual basis, rendering it almost impossible for companies to produce accurate budgets. A prominent Indonesian businessperson noted that this level of uncertainty was a primary deterrent for foreign investors and business people during the post-Suharto era. He illustrated his point stating “I think that’s a phenomenon that we see day to day: that there is no coordination between one government agency and the other, so there is a total lack of co-

\textsuperscript{106} Foreign Businessperson, Interview Jakarta, August 2005.
ordination”. Soo Kang notes two distinct decreases in FDI, the first and most obvious being at the onset of the crisis in 1997/1998 and the second that takes place in 2001, the reason for which she attributes to “deteriorating market conditions and rapidly implemented decentralization” as part of the IMF-led program. In 2005 Luky Djani (ICW) commented that because it was necessary for foreign investors to deal with so many official levels, operational costs and the ‘phantom budget’ were significantly increased. However, this was not the case in other Southeast Asian countries that were considered more democratic than Indonesia, such as Thailand, where “if you just settle with some of the high ranking officials in Bangkok, or even if you met with the high ranking military generals…they will manage your interests down level. But here, not anymore, because the regime is fragmented and it is not consolidated in one hand or in two hands but it’s in several hands and you need to entertain all of them”. Therefore, it was essential that business, both foreign and national, made the same sort of alliances at a local government level that were once required at the centre. Yet, due to the discontinuity between the governments and bureaucratic institutions, and the absence of a centralised authority, these relationships of patronage did not yield the same amount of certainty. Wehrfritz and Cochrane outline the differences between decentralisation and democratic transition in Indonesia compared with that of India and China:

As democracy took root, power leaked from Jakarta to the provinces. But while decentralization in India and China had spawned local corruption, it also gave birth to regional dynamos like Shenzhen and Bangalore, which are leading nationwide booms. In Indonesia, devolution has spawned mainly official corruption, a booming underground economy and what one high-profile Jakarta lawyer calls “black-market justice” for foreign investors.

Effectively, Indonesia ceased to be a ‘one-stop-shop’ marketplace. Foreign investors’ biggest complaint with the decentralisation process is that instead of dealing with a centralised government that possesses the authority to honour guarantees and contracts, they now must negotiate with officials at both a central and regional government level.

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109 Luky Djani, Vice-Coordinator Indonesia Corruption Watch, Interview Jakarta, August 2005.
(although they are usually in opposition with one another), as well as bureaucrats, the police and the TNI, again at both a national and regional level. Thus the number of bribes have increased, the overall cost of bribing has increased, yet efficiency and certainty of result for payment has declined.\textsuperscript{111} Overall, the decentralisation laws, or their poor construction and application, have resulted in higher operating costs for business and proved a deterrent for foreign investment. Van der Eng’s study reports that companies such as Proctor and Gamble and Sony have left Indonesia, and although never admitting it formally, have indicated that the cost of corruption has been the main reason for their relocation.\textsuperscript{112} In 2005, then-economic advisor to President Yudhoyono, Dr Sjahrrir, commented on the state of corruption during the Habibie, Gus Dur and Megawati administrations, stating that “I think everybody agrees that corruption in the reformasi era is not less, it is probably...worse compared to during the Suharto era, so this is something that has got to be changed”\textsuperscript{113}

Licensing in particular has provided a lucrative channel of personal revenue for rent-seeking officials, which led to tensions for both national business and foreign investors.\textsuperscript{114} Ironically, in 2005 an IMF Country Report noted that foreign oil and gas companies commonly struggled with conflicting and often unpredictable licensing between the central and local governments.\textsuperscript{115} The negative aspects of decentralisation have been particularly evident in the resource rich regions where uncertainty and security concerns have resulted in a massive flight of capital and investment in the mining and resources industries.\textsuperscript{116} Before 1998, Indonesia’s oil and gas sector attracted the highest levels of FDI in its export oriented industries. However, it was reported in 2006 that “Over the past five years, exploration activities by foreign oil companies have all but stagnated".\textsuperscript{117} The central government’s reduced capacity to exercise authority in the regions has resulted in increasing tensions between companies

\textsuperscript{113} Dr. Sjahrrir, Interview Jakarta, August 2005.
\textsuperscript{114} V. R. Hadiz and R. Robison, ‘Neo-liberal Reforms and Iliberal Consolidations’, p. 235.
\textsuperscript{116} V. R. Hadiz and R. Robison, ‘Neo-liberal Reforms and Iliberal Consolidations’, p. 234.
such as Chevron-Mobil Oil and Pertamina. Kuncoro’s study shows that, in a comparison of firm sentiment for 2001 and 2003, the amount of uncertainty increased so significantly as a result of decentralisation that many firms were forced either to close down or relocate overseas. Investment procedures in general became problematic as officials “at all levels of government- central, provincial and local- claim[ed] ultimate authority over many kinds of investment activity.” For many foreign investors the process became excessively time consuming and costly, with little certainty that agreed outcomes would eventuate or that requirements wouldn’t change despite the mandatory bribes and ‘extra payments’ to officials. Increasingly, the kota splits and other by-products of regional autonomy, such as newly allocated official authority, drastically increased the overall level of rent-seeking at a regional level. This, and the aforementioned issues, resulted in a situation which rendered Indonesia less attractive to potential and existing business and deterred the much needed investment essential to the country’s recovery.

7.3.3 Judicial System and Law

The other major issue that has been cited by both existing and potential foreign investors has been the lack of integrity in the Indonesian judicial system. Reform of the law concerning foreign investment has sent mixed messages to foreign investors and has reiterated their sceptical attitude towards Indonesia’s legal system. The fragmentation of power has led to different departments producing seemingly excessive and/or conflicting laws, regulations and an overall lack of policy congruence. Jansen outlines the problems, listing a number of recent legislative changes, such as the abolition of the free tourist visa in Bali, the labour minister’s proposal that all foreigners be fluent in Bahasa Indonesia (despite existing aversions to working in Indonesia). He comments that “such regulations, even if they are not implemented, have sent a negative signal to investors.” Although there has been a multitude of anti-corruption and good governance laws, accompanied by judicial reforms, the changes appear to be primarily superficial. While political cannon fodder such as Hamid Awaluddin, the minister for justice and human rights, attracted a lot of media attention in connection with corrupt

122 P. Janssen, ‘Conditional Success’, p. 76.
dealings, political and TNI heavyweights, such as Aburizal Bakrie, Jusuf Kalla and Tommy Winata, are considered ‘untouchable’.\textsuperscript{123}

Indonesia’s judicial system has a reputation amongst foreign businesspeople as an exceedingly corrupt institution, and investors fear there is no assurance of adequate protection for their business and assets. The arbitrary application of law in Indonesia has been a primary element of concern for foreign business. One Australian lawyer in Jakarta noted that although the actual anti-corruption laws, and laws that are designed to protect private investment, are relatively adequate, they lack standardised regulation and implementation.\textsuperscript{124} This sentiment was reinforced by an Indonesian businessperson who declared that “The root of evil in my view is the lack of legal certainty…The whole body of regulatory framework needs to be updated…You cannot interpret the laws one day this way and tomorrow you take a different approach. The laws must be implemented consistently”.\textsuperscript{125} Yet there has even been ambiguity over this point in regard to the legal system since decentralisation, as local officials utilise financial resources to influence and bribe local legislators.\textsuperscript{126} Uncertainty in the judicial system has been of increasing concern to foreign investors, as the end of the New Order also saw a surge of lawsuits involving foreign business. As Van der Eng notes, favourable court decisions can no longer be secured by an unofficial guarantee as there is no longer an ultimate guarantor to ensure the agreement is upheld.\textsuperscript{127}

While the civil service in Indonesia has a reputation for being inherently corrupt, the judicial system is a case where we see corruption being exercised also out of fear. This was exemplified with the Tommy Suharto case, where a supreme court judge was murdered after he refused an ‘offer’ made by Tommy. This indicated to the other members of the judicial system that non-compliance with the demands of the politically well-connected would have serious ramifications. Judges often face the decision of accepting a bribe and judging in a particular favour, or not accepting a bribe but still delivering a pre-agreed upon verdict.\textsuperscript{128} While the laws do work sometimes, when they

\textsuperscript{124} Interview with Australian lawyer working in Jakarta, Jakarta, September 2005.
\textsuperscript{125} Interview, National Businessperson, Jakarta, September 2005.
\textsuperscript{126} J. Hanna, ‘Local Civil-Military Relations During the First Phase of Democratic Transition’, p. 82
\textsuperscript{127} P. van der Eng, ‘Business in Indonesia’, p. 11.
\textsuperscript{128} Interview with Australian lawyer working in Jakarta, Jakarta, September 2005.
fail they are glaring examples to the community, who already lack confidence in the judicial system. The impact of the arbitrary nature of decision making by the judicial system can be seen particularly in the mining sector, in the cases of attempted contract cancellation by the state-owned electric power company PLN, and the individual cases of insurance company Prudential Life Assurance and chemical manufacturing company Tri Polya.

As per IMF requirements, government expenditure contracted sharply in response to the financial crisis. The energy sector was affected significantly by this change. Because of a problematic power deficit in Indonesia in the 1980s and early 1990s, the state-owned power company, PLN, set up 26 power generation agreements with private companies between 1990 and 1997. However, between 1997-1998 PLN, cancelled, postponed, or flagged for review all of the 26 power generation agreements. At the time, foreign investors were major partners in most of the agreements.¹²⁹ From the outset, the decisions that were made by the Indonesian government and PLN were confusing and there was frequent miscommunication between PLN, the foreign investors and the press. In June 1998, after the cancellation of a contract with national company PT Cikarang Listrindo, reports emerged that PLN was going to alter or cancel contracts with Energy Equity Corp. (Australia), PowerGen PLC (Britain), El Paso Energy Corp (US) and Uncol Corp (US). Yet despite the fact that contracts were eventually cancelled, they were initially denied by each individual company, as PLN had not indicated that it would be taking any such action.¹³⁰ The justification for the cancellation or review of the agreements rested on the premise that the initial negotiations between the foreign companies and PLN were undertaken with the Suharto government, and that the agreed upon rates which PLN was to pay for the supply of power were tremendously inflated. This problem was further compounded by the massive exchange rate depreciation from 1998 onwards as the Indonesian consumers paid for their power in rupiah, yet PLN had agreed to pay the foreign partners in US dollars.

By 1999, the resolution of the PLN related cases were considered amongst the most important issues if foreign investor confidence was to be restored. An article in *Business Asia* warned in regards to the power debacle that "Indonesia cannot afford to undermine the confidence of foreign investors". Yet conflict between foreign investors and PLN continued, exacerbated by a government that encouraged both parties to settle out of court. In 2000, PLN moved to take one of its contractors Paton Energy (owned by Mitsui & Co. and GE Capital) to court after a corruption audit was carried out, but was forced to drop the case by then President Gus Dur. Eventually, the US government and the Overseas Private Investment Corp became involved in the issue, and while some foreign companies received partial payouts or were able to renegotiate their contracts on desirable terms, others did not. Indeed, the drawn out nature of the debacle as well as the arbitrary application of the law by the judicial system confirmed in the minds of many foreign investors that Indonesia’s business climate was far too unstable to consider investing and operating enterprises.

The treatment of foreign business in Indonesia’s mining industry also served as a reminder to foreign investors that the judicial system would not provide the necessary protection to do business in the country. One of the most significant cases was in 2002, involving the eventual sale of the jointly-owned Kaltim Prima Coal (KPC) by its foreign investors Rio Tinto and BP. This case had a particular impact on the foreign investment community as it involved two large multinational players that reportedly “thought they were experienced enough to take care of themselves, but they were still outmanoeuvred in a country where corruption, shifting political priorities and an unreliable legal system make it difficult to do business”. Under an initial agreement, the Indonesian state was supposed to buy back 51 per cent of KPC from Rio Tinto and BP for a price of $420 million. Yet the government’s refusal to uphold the original arrangement, and the intervention of the East Kalimantan regional governments necessitated countless rounds of negotiations with Rio Tinto and BP. In response to the inadequate application of law and the futile negotiations with the governments, Rio Tinto and BP sold the whole

holding for $500 million to a local company.\textsuperscript{136} The high level of uncertainty and subsequent reluctance by foreign investors to do business in Indonesia’s otherwise resource rich mining industry saw the sector stagnate considerably.\textsuperscript{137} 

In 2004, Prudential Life Assurance, a subsidiary of Prudential Assurance Company (UK) was declared bankrupt by the Commercial Court and was ordered to pay $400,000 to the plaintiff, a former agent for the company. The decision to declare Prudential Life Assurance bankrupt was somewhat confusing as the company had assets worth US$183 and had received $108.7 in premiums in 2003 according to FDI Magazine.\textsuperscript{138} As with a very similar case involving financial company Manulife (Canada) in 2002, the Prudential Assurance bankruptcy decision was overturned, however the incident sent ripples through an already weak foreign investment community and chairman of the Indonesian Insurance Council, Hotbonar Sinaga commented that “he believed several foreign investors had planned to enter the Indonesian insurance market but had put their plans on hold as a result of the Prudential case”.\textsuperscript{139} In a counter-law suit, PT Tri Polyta Indonesia, in which Prago Pangetsu was the major stakeholder, was relieved of payments to creditors of $310 million due to an obscure law that rendered the initial bond illegal.\textsuperscript{140} Marks concludes that the Tri Polyta case “underlines that legal certainty is a public good, and as such is subject to free riding”,\textsuperscript{141} as can be said for the Prudential Life Assurance case. In such a climate of increasing uncertainty, foreign investors are choosing to relocate their capital to stable investment locations such as China and Malaysia. Of course there are numerous examples where we see that the system does in fact work, but there are also many cases where corruption has played a part. These present themselves as glaring examples both within and outside Indonesia, particularly for prospective foreign investors, that the state of the judicial system is a major, if not primary, deterrent.

\textsuperscript{136} Anonymous, ‘Still Living Dangerously; Indonesia’, p. 79.
\textsuperscript{141} S. V. Marks, ‘Survey of Recent Developments’, p. 172.
7.4 Conclusion

In this chapter we have seen the implications of the IMF demands that were documented in Chapter Five. The domestic political tensions and conflict associated with Indonesia’s democratic transition in an immediate post-crisis environment resulted in an unstable economic situation that should only have been temporary. Against this already tenuous backdrop, the presidents’ struggle to assert their authority over competing factions became increasingly difficult as their bases of power were diffused due to IMF-demanded reforms. The government encountered difficulty in gaining popular support and legitimacy as the economy remained at best sluggish due to the IMF-instigated ‘liberalisation’ measures and a retraction of state regulation in some areas of the economy. Thus the failure of the IMF program and the poor condition of Indonesia’s economy contributed to the further erosion of already waning levels of popular support for the political regime. As a result, the government lacked the authority necessary to direct economic steering and engender a degree of national cultural, political and economic cohesiveness. This is best demonstrated by the decentralisation strategy, that has been thoroughly addressed in this chapter and chapter Five, which resulted in a dislocation of power between the central and regional government, and local economies were thus hijacked by local vested interests. The central government had little control over the patronage networks that emerged in regional Indonesia, as they were often reinforced by both the local governments with the support of the military. The uncertainty that was associated with this new dispersion of power was un conducive to already ambivalent foreign investment sentiment, as it became virtually impossible for foreigners to do business outside of Jakarta. Foreign investment was deterred by the effects of regional autonomy even in the extractive industries, despite their being insulated from the negative currency sentiment surrounding the ailing rupiah to which other sectors were subject.142

The lessons learnt from the disastrous effects of the IMF reforms in Indonesia throw up broader questions about the role of the IMF and the suitability of its programs, which are neo-liberal in construction and have indeed not only failed in Indonesia but in many developing countries around the world. In light of the changes that occurred in

142 Oil & Gas business is carried out in US dollars.
Indonesia as a result of the IMF-directed program based upon neo-liberal principles, it is necessary in the next chapter to examine both the changes that have occurred in post-IMF Indonesia and the role of the IMF in its capacity as a major international financial institution.