Socio-Economic Development
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1. Good Governance: The Path to Socio-Economic Reform and Development in Indonesia

The crises that Indonesia has experienced since late 1997 are as much political as economic, and Indonesia has been forced to attempt to tackle them simultaneously. The country is struggling to create a rule-based economic system in place of the discretionary, corruption-ridden, patrimonial system that operated over the past three decades. It is also attempting to establish a pluralist democracy both to underpin its economic system and as a goal in itself.

Indonesia’s financial and economic collapse has led to a degree of introspection and a search for the causes of the crisis, as well as for obstacles to and strategies for recovery. The arenas, sectors, institutions and practices identified for reform or restructuring in the course of these consultative dialogues for socio-economic development include:

- The Letter of Intent signed by the government of Indonesia and the International Monetary Fund.
- The relationship between central and local government in the operation of regional autonomy.
- The relationship between foreign direct investment and local investment.
- The fiscal structure.
- Reform of the bureaucracy and public administration.
- The military and its business relations.
- Restructuring the private and quasi-private sector.
- Reform of labour relations.
- The role of corruption in undermining reform and development.

Economic recovery is a priority for Indonesia, and governance reform has been identified as the modality by which economic recovery and socio-economic development should be addressed. The focus on governance reform means a shift of emphasis in development policy away from the programmes of the past, which focused only on the economic aspects.
of governance, to one which examines economic and political measures simultaneously.

This approach is an advance on economics-centred approaches, but it has some limitations that must be addressed. The parameters of governance reform cannot be determined simply by combining checklists of economic and political measures. Good governance is most likely to be secured through mutually-reinforcing institutions and practices that support economic recovery and sustain growth, and these institutions and practices must be the end-product of public deliberation and participation, ending in a degree of consensus. The deliberative process is both a means and an end in itself, but it is not necessarily linear or time-efficient. Furthermore, the institutions of governance must take root and be sustained over time before their impact can be assessed.

An emphasis on governance in effect demands a complete overhaul of the whole approach to public policy formulation and social organization and radically new approaches to development policy. However, Indonesia is attempting to address these issues in a context of a weak political regime, a depreciating currency, rising sectarian and communal violence, erosion of central authority and greater demands from the regions for political autonomy or even secession.

Although three years have passed since the eruption of the crisis, Indonesia’s public policy must resolve key distributional conflicts. The first of these is with the investment community and is associated with asset sales and debt resolution. The second is between programmes and projects that directly affect the welfare of the community at large, in particularly the poor. The investment community is largely concerned with issues of fiscal and financial restructuring, the reform of the bureaucracy and judiciary and the handling of corruption. The broader community is also concerned with the restructuring of the judiciary and bureaucracy and with the boundaries of the state under regional autonomy. It is also particularly concerned with issues of poverty alleviation, the environment and natural resource management, labour relations, private-sector reforms and corruption.

In this transitional phase of reconstruction and reform, it is vital that the initial conditions established during the crisis are identified as the
baseline, and that movements along a revised analytical framework are tracked in such a way that cause can be linked with effect and policy instruments with results.

It is also necessary to highlight the point that the mechanisms of economic crisis and contagion may be different from the transmission channels of economic recovery.

Although “good governance” is now a popular reform concept, it remains a puzzle. Exactly how much institutions contribute to economic performance is still to be understood. It is not entirely clear either if good institutions in themselves drive growth, or whether this depends on the nature of one institution - the state - or on the interaction between the state and civil society. Unless the correlation between institutional design and development and economic performance can be established, many policy initiatives hitherto undertaken may not be fully relevant.

There does not seem to be a clearly identifiable optimum structure of governance that can serve as a universal model for developing countries. It is not even clear if different structures of governance are appropriate at different stages of development or whether these structures are linked to what the country can afford at that stage.

All practical approaches to introducing governance into the reform agenda proceed by inserting a checklist of desired attributes in the economic and political realm. However, without a strong theoretical structure that evaluates alternative combinations of the governance reform package and its application in a given context, the menu approach will remain nothing more than a list of good ideas. Undoubtedly this list of ideas will emerge in respect of this and other consultative dialogues on governance reform in Indonesia. But there will be attempts to anchor this inquiry within an evaluation of vital elements of the reform package.

This initial inquiry also encourages other discussions to continue the critical analysis and evaluation of the reform package within the context of social, economic and political transformation.

To lead to the development of mutually reinforcing institutions and sustainable practices, the reformed institutional structures must be rooted
in Indonesia’s political and economic context and must draw on the critical factors that led up to the crisis. This means that more attention must be given to understanding Indonesia’s national circumstances.

Despite the enthusiasm for governance reform, there are several sobering issues that should be kept in mind as they have implications for policy. There are limitations in both in scale and timing, and there is not always a clear analytical link between specific institutional arrangements and economic performance, as some institutions are both ends and instruments. It is also very important to sequence the reforms strategically and appropriately, as many institutions and processes are interdependent and reforms must be undertaken simultaneously if they are to bear results. There is a need to set manageable priorities, so as to avoid the danger of overloading the reform agenda. Another useful strategy is to lower expectations of the immediate gains that can be achieved through governance reform, and avoid linking reforms with conditionalities.

The revised institutional framework to support good governance can only be created and sustained on the basis of social consensus. To move out of this deep crisis towards lasting regeneration, growth and social cohesion, the institutional framework must be developed through deliberation and the participation of broad sections of the Indonesian political and economic community. This is an arena in which public-sector and private-sector co-operation and consultation is required. Such deliberations are the product of a democratic system grounded in the rule of law. This is a prerequisite for the transformation of Indonesia and cannot be regarded as a by-product of development.

While the acceptance of democracy is not widely contested after the fall of Soeharto, there is still a contest between models of democracy. There are signs that key actors in Indonesia may favour elitist democracy as opposed to a more deliberative and participatory democracy. Elitist democracy favours public control over the political process in the form of elections and the resolution of interests through group bargaining and interest mediation. Deliberative democracy, on the other hand, focuses on public participation in determining the common good and developing a social compact in relation to the structures and processes of government. It favours free speech, public discourse, transparency and access to information. Given the differences, it is important that planners and
policy-makers have a clear notion of what type of democratic state and what model of market economy their governance reforms are seeking to create.

Despite the introspection that followed the onset of the financial and economic crises, several unanswered questions continue to bedevil policy makers and must eventually be addressed at more length in other consultative forums. At present Indonesia is fighting on many fronts. Its struggles include coping with enormous private-sector debts and salvaging a banking sector that is burdened by defaulting creditors and a weak currency. The government needs to develop credible policies to secure investor confidence and to undertake the redistribution of assets within a framework that is transparent and fair. Much attention should also be directed at creating employment and the delivery of basic services at affordable prices, so as to secure the confidence of the public that these issues are being treated as a priority.

The rupiah remains weak despite the fact that all monetary and macroeconomic aggregates show positive developments. This raises questions as to whether the currency is weak due to political, economic and security uncertainties in the country, or due to other factors like the slackening of monetary controls and a lack of resolve on the part of the central bank in respect of monetary policy.

The question also remains as to whether Indonesia is in a continuing state of crisis because of a national failure to address the problems, or whether this is due as well to factors that would tax the effectiveness of even the most competent regulatory authorities. Clearly it is important that national policy-makers have a better understanding of these issues, especially of how financial markets operate and the implications of different financial policies and forms of intervention and restraint by government. There is a need to focus on both the design and the implementation of financial policy.

2. Indonesia’s Governance Agenda

The wish list of institutional improvements in Indonesia is indeed a long one. It implicitly recognises that economic and political governance are
entwined. The necessary improvements in political and economic practices range from cancelling flawed government contracts and improving procurement regulations to introducing regional autonomy, promoting community organizations and disbursing social safety net funds.

Indonesia’s political governance agenda includes the introduction of anti-corruption measures, the creation of autonomous institutions including a judicial service rooted in the rule of law, a reform of the civil service and decentralization of administrative authority to lower levels of government. It extends to addressing the optimal size of the state, the empowerment of civil society as an indispensable instrument of social equality and ensuring community contributions to good governance.

2.1 Challenges During the Transition

There is danger that when the state is weak during a transition, the power vacuum created will give rise to local elites who can openly engage in corrupt practices and undermine the state. At the same time, the fall of the Soeharto regime has unexpectedly opened the political space and in this interregnum there is much more debate, discussion and a general refusal by the public to docilely accept the views of their leadership. As a result, policies are being challenged and are more difficult to implement by executive fiat. Political leadership has to adjust to this new reality. Although it is sometimes viewed as an anarchic situation, in effect it represents the exercise of greater democracy in decision-making.

The economic collapse caused a rise in unemployment and poverty. Linked to this was the rise in poverty-related problems of malnutrition and hunger, an increase in health problems and a decline in school enrolment. These secondary problems have long-term and negative social and economic consequences.

The collapse also highlighted the vulnerability of large numbers of Indonesians, especially the urban population dependent on the industry-based sectors of the economy. Without steady employment, many people were unable to afford the basic necessities of life and they could not rely on the state to provide any social welfare protection. The intensity and scale of the devastation was mitigated by the fact that Indonesia’s population remains largely rural and agrarian, and the villages were able to absorb many people returning from the cities. This temporarily helped
to ameliorate the problem in urban areas, although it contributed to worsening conditions in rural areas.

Indonesia’s crisis is associated with deep structural problems that relate to the economic decision-making institutions and processes established during the New Order period. During that time, business was concentrated in the hands of a small elite of wealthy and well-connected individuals who depended on political patronage rather than on business acumen.

Business ventures did not operate on the basis of real market forces and the economy was driven by rentiers rather than by entrepreneurs. Corruption and barriers to trade prohibited the development of a broad-based entrepreneur class whose activities could generate employment, and Indonesia also suffered from the lack of a market based on diverse economic activities that could use resources efficiently. Instead, the entrepreneurial spirit was stifled by the blatant support given to favoured businessmen. In fact the hidden cost of doing business in Indonesia was too high to make it competitive.

The artificially restricted base of the Indonesian economy led to wide economic disparities between the wealthy and poor, and between rural and urban sectors. Economic disparities also manifested themselves regionally, creating serious social problems as inequalities were marked along the fault-lines of religious and ethnic cleavages, and between traditional village communities and transmigrant groupings. In addition, there were wide disparities in employment and income opportunities between men and women.

The positive aspect of the economic crisis was that it engendered political changes. It gave Indonesians a chance to reshape and redesign their economic and political infrastructure. This includes state institutions and policy-making procedures at the national and local level, as well as business practices. Such changes, if well-designed and successfully implemented, increase the prospects of broader participation in all aspects of the economy in Indonesia and will generate greater social inclusion and cohesion.

For Indonesia to move on from its economic crisis, it must take steps to
restore public confidence in the economy and its potential to realize stable growth. This will require developing and implementing an economic recovery plan along with a governance agenda. On the economic front it must seek to bring back capital while addressing the economic disparities between social groups to prevent alienation, marginalization and structural inequalities. Economic policy needs to be forward-looking and inclusive both at the national and the local level. Standard norms and procedures of good business practice, supported by the rule of law, must be introduced with effective penalties for non-compliance. Economic planning and decision-making must be carried out in an open and clean environment, free of corruption. This can only happen with increased political stability and economic certainty.

3. Guiding Principles for Socio-Economic Restructuring

3.1 A Blueprint for Reform

Unlike the other countries caught up in the Asian economic crisis that began in July 1997, Indonesia has shown fewer signs of sustained economic recovery. The root of the problem is with the development paradigm that was entrenched during the New Order and emphasized growth, “stability” and a government-dominated “command and control” structure for all economic development policies. There was little room for the public either to have input into the decision-making process, or to criticize it. What resulted was a concentration of power in economic decision-making without any mechanisms to counter poorly conceived policies or to address the rampant corruption that could undermine even the best of policies.

The monetary crisis removed the veil from the complex problems created by the New Order, prominent amongst which was the centralized and patrimonial nature of the state. All economic, social, and cultural linkages between institutions and organizations now need to be re-established to ensure a more equitable distribution of prosperity and an improvement in the quality of life of all people.

This restructuring requires a blueprint for Indonesian economic development that prioritizes people’s social needs as well as their economic needs.
This blueprint, while fundamentally reforming Indonesia’s economic structures and relations, must also be attuned with the demands for social and political reforms. The process and the substance of the economic reforms must be compatible with the principles of democracy. Economic governance in Indonesia should be based on the following principles:

**Recommendations:**

- Developing a broad economic base to secure social welfare.
- Prioritizing the improvement of living conditions and the welfare of vulnerable groups in society, including women and less privileged social groups, in order to eliminate structural poverty.
- Providing equal opportunities and equal access for the advancement for all Indonesians.
- Developing an economic paradigm that does not only focus on large-scale industry and trade but also fosters small and medium-sized business and focuses on the development of the agricultural and oceanic sectors, recognizing that the latter provide the livelihood for the majority of Indonesians.
- Eliminating poverty in the villages as well as the urban areas.
- Developing a balanced economic system that is open and transparent and eliminates corruption, collusion and nepotism, as well as the monopolistic and oligopolistic systems which provide protection and privilege only to a small political and economic elite.
- Developing an economic system that is not overly dependent on foreign loans. While Indonesia should not be isolated economically, it should maintain the integrity of the national economy.
- Creating an Indonesian economic development paradigm that places economic activity as a medium for advancing the nation’s welfare and not as an end in itself.
- Developing an economic system that addresses regional
Based on the above principles, the economic structure and system that is developed in the longer term should be based on further commitments to:

- Link economic development with the wider national development agenda. Economic development must be in tune with political, cultural and social life and strive to eliminate structural poverty as well as the culture of poverty that affects large segments of the population.
- Base economic development on the principles of sustainable development with emphasis on the efficient and sustainable use of natural resources.
- Take into account Indonesia’s strategic position as an archipelago state. There are strengths and weaknesses that emanate from this. It is necessary to ensure that Indonesian waters are used for the benefit of the whole Indonesian nation.
- Take into account Indonesia’s ethnic and religious diversity and demographic conditions, including the vertical and horizontal cleavages that divide society, and minimize the social and economic disparities within and between every group in society.
- Monitor the impact of economic development processes to prevent marginalization of any group, giving specific attention to the problems of equality and equity for women and other vulnerable groups in society.
- Support the agricultural sector and small to middle-scale industries to ensure their sustainability. The emphasis should be on fostering their self-reliance and not creating dependency on government.
- Focus on stimulating indigenous social and economic relations to stimulate greater self-sufficiency among communities.

### 3.2 Development Through the Rule of Law

To ensure sustainable long-term economic development, the economic blueprint must be implemented consistently and uniformly, under clear
regulations which stipulate the role of the state in the socio-economic life of the nation. Of vital importance to this endeavour is adherence to the principle of the supremacy of law.

There is still a tendency, which was rampant during the New Order era, to make arbitrary use of state-owned companies and the non-budgetary funds of government institutions, such as the state logistics board and the reforestation funds. This and other arbitrary practices must be checked.

**Recommendations:**

- Elimination of excessive intervention from the state in the market mechanism to prevent market distortions.
- Application of the rule of law, without any discrimination, to prevent exploitation and the unfair treatment of Indonesian employees.
- Equal and fair treatment of all economic subjects to give the same opportunities of success to all.
- Creation of a transparent process in awarding economic rights through licensing.
- Notwithstanding the recommendations that the state should not intervene to create market distortions, recognize that the State has a role to play in providing safety nets and support to vulnerable groups. Give special attention to vulnerable groups, such as the informal sector, through affirmative action programmes that will eventually “level the playing field”.

3.3 The Letter of Intent

Indonesia’s attempts to get out of the crisis have resulted in the signing of a Letter of Intent (LoI) agreement between the government and the International Monetary Fund (IMF). Until now, the LoI, a binding financial and institutional restructuring plan devised by the government
in conjunction with the IMF, is the only official blueprint for Indonesia’s economic recovery.

The centrality of the LoI cannot be underestimated. Not only does the implementation of the LoI bring the IMF to Indonesia, but it also affects the terms of all other international financial agreements with Indonesia. For example, agreement with the Consultative Group for Indonesia and the Paris Club are conditional upon successful implementation of the LoI. Given the weakness of policy decision-making in Indonesia, the LoI takes on great significance as it sets an agenda for reform, both in the economic and governance spheres, and is binding on the cabinet.

However, the LoI as it stands is not sufficiently comprehensive to tackle the wide range of social and economic problems that beset Indonesia. It prioritizes monetary recovery but does not focus on the wider economy. The cabinet and government signed another LoI in September 2000 and are politically committed to IMF reforms until at least the year 2002. What is needed, however, is a longer-term strategy for developing a strong Indonesian economy. It is essential that the Indonesian economy should not be trapped in a culture of dependency and the use of foreign loans as the basis for all economic development.

The IMF-supported LoI agreement has engendered some strains. It is seen as the product of an exclusive and isolated group of technocrats and bureaucrats, not the result of an inclusive and democratic process of negotiation. For a long-term blueprint for reform to be successful, it must result from participation by all components within society and be perceived as a national agenda based on national consensus.

The following steps need to be taken:

**Recommendations:**

- Develop a bottom-up process to generate input for the blueprint on economic development so that it will be relevant for every region in Indonesia.
- Develop an inclusive approach to economic planning to prevent the marginalization of any group, especially women and other vulnerable groups. Conduct consultations on the impact of
potential policies and organize public hearings before the final decision is made, especially on those aspects that concern the life and culture of the whole society.

- Invest in the development of a transparent socializing process, to ensure that the long-term blueprint for development is the product of national consensus and is akin to a social compact.

4. Democratizing Economic Activity in the Regions

Regional autonomy enables regions to optimize their economic, geographic and socio-cultural potentials. This development paradigm has the potential to decrease the disparities that have developed between regions and which today threaten the state with disintegration. There are two approaches towards dealing with regional autonomy. One is a federalist approach encouraging proactive regional government and the other is a unitarist approach with a proactive central government.

The first approach leaves it to regional government to identify strategies and handle all issues except those except those that impact on the integrity of the state and the nation. The second puts the onus of government and administration on the central government, except for certain defined issues that are to be handled by the regions.

Regional autonomy in Indonesia is determined by Laws No 22 and No 25 of 1999. Law No 22 shows signs of supporting the federalist approach. This is reflected, for example, in Chapter Seven, Article One which states: “Regional authority covers authority in all governmental fields, except authority in foreign politics, security, defence, justice, monetary and fiscal affairs, religion, and “other areas of authority”.

However, these last words indicate that regional authority is given with reservations. Article Two from the same chapter defines “other areas of authority” as including policies relating to national planning and macro-level national development, balancing budgets, the state administration system and state economic institutions, empowering human resources, natural resources and strategic high technology, conservation and national standardization.
The half-hearted dispensation of autonomy can also be seen from the essence of Law No 25/1999, which is not in accordance with Law No 22. The grants of relatively wide authority under Law No 22, are not backed up by basic changes to strengthen regional capabilities in respect of finances. It is an absolute precondition of effective regional autonomy that these two laws have a shared direction and support each other. Before they were submitted to parliament, the parties involved in designing the laws should have had discussions to ensure a compatible vision, and put both laws in harmony with each other from their inception to support the common objective of regional empowerment.

The complexities of the problem are more obvious at the implementation level. Autonomy is devolved to the kabupaten (regency) and kota (incorporated city) as mentioned in Chapter 11, Article 11: “The kabupaten and kota authorities covers all authority in government besides the exceptional authority in Chapter Seven, detailed in Chapter Nine”. The framework of decentralization that is developed on the basis of Laws 22 and 25 does not fulfil demands for wider autonomy at the provincial level.

4.1 Regional Autonomy in the Face of Global Competition

Regional autonomy was conceived of as opening the widest possible opportunities for regions to optimize their potentials. It presumes that each region will have one or more pre-eminent features that give it advantage, which could come from location or natural endowments and resources. However, to realize the benefits of these endowments, it is necessary to prepare regions to become active participants in the global market. This requires putting in place structures and processes which include guarantees of free movement of all production factors, goods and services in Indonesia, regulatory frameworks to prevent corruption at the regional level and political processes that guarantee autonomy to local inhabitants to determine their aspirations.

Recommendations:

- Guarantee free movement in all production factors, goods and services in Indonesia.
• Create political processes that guarantee autonomy to local inhabitants to determine their aspirations.

• Reconsider simultaneously Laws No 22 and 25 of 1999, together with the three new political laws, to genuinely build the pillars for autonomy, starting from the lowest to the highest level of government.

• Create laws that complement regional autonomy by controlling the powers of the central government.

• Regulate both principles and practices at the central and regional levels to ensure that regional autonomy does not create new forms of corruption, collusion and nepotism.

• Regulate principles and practices that foster regional co-operation in order to optimize resource management. Area borders should not hinder rational economic decisions.

• Introduce incentive systems to ensure flexibility in the operation of regional autonomy.

• To ensure that regional governments are not expected to be control agents. Their role should be that of a facilitator ensuring that weak minority groups are not marginalized, and that development does not degrade the environment.

4.2 Civil Society and Economic Decentralization

This is the age of reform and democratization in Indonesia and every reform measure will be effective when there is direct participation from civil society at the central and regional level. This participation must be reflected in the legislation too. Support from the international community, especially the donor community, is needed to guarantee the smooth running of the autonomy process. A centralist and top-down approach is counter-productive for decentralization and will defeat the objectives of the government.

To prevent upheavals and distortions, there is a need for preparations at the central and the regional level to develop strategies, policies, programmes and institutions. At the central level, this has been partially executed through the enactment of a series of legislative steps towards
democratization, namely Laws No 22 and 25 of 1999.

Approaches that directly decentralize to the lower level (kabupaten and kotamadya) may create, in the short term, more risks than benefits. One way to minimize these risks is for government to execute decentralization in stages, handing over authority and resources at the provincial level as well. This approach will require adjustments in the law. Therefore, while the revision and adjustment process is being executed, a comprehensive regulatory framework in the form of a Perpu (government regulation) is immediately needed to support decentralization. In fact this problem is addressed by establishing PP No 25/2000.

At the regional level, the expectations roused by decentralization are so high that numerous demands are created on the central government. This is natural considering that until now, the regions have not realized any political reforms yet and there is suspicion about the central government’s commitment.

The reform measures conceptualized by the centre have not been internalized and are still being executed within centralized structures. The government continues to decide and formulate policies and the regions only execute them.

Recommendations:

- Establish a legal framework that fulfils the aspiration for autonomy at the provincial level and take steps to implement decentralization in stages. This includes establishing a Perpu on autonomy at the provincial level, revising Laws No 22 and 25 and strengthening efforts to increase awareness of the laws among the general public and among central and regional parliaments.
- Develop a strategic plan to implement decentralization, taking into account the need to guarantee continuous delivery of services,

continued
implementation of a balance between regions and a consistent fiscal policy.

- Maintain the momentum for decentralization by ensuring that central government immediately take steps to execute decentralization, especially in *kotas* (cities) and *kabupatens* (regencies) which are able to handle such needs as education, health, agriculture, and the development of roads. This strategy will ensure that trust is maintained and also will give more time to prepare the handling of the technical challenge of decentralization.

- As developing autonomy from a super-centralized system is a very complex process and covers various political, legal, socio-cultural and economic dimensions, the process of devolving power demands coordination and cooperation from all cabinet ministers with responsibility for economic development, industry, social welfare and poverty relief, and security.

- Decentralization should be extended to the grassroots, avoiding new concentrations of economic power at the local elite level.

- Horizontal relationships among the regions should be enhanced through economic activity.

- Development activities should be defined at the local level.

- Value-added tax should be shifted from central government to regional government in stages.

5. Investment and Natural Resource Management: Establishing a New Relationship

5.1 Sustainable Use of Natural Resources

Indonesia is rich in natural resources and has long attracted mining, logging and other resource-exploitation industries. But because Indonesia’s economic growth is highly dependent on her natural resources, serious consideration needs to be given to adopting and implementing the concept of sustainable development, so as to ensure the preservation of natural resources for the benefit of present and future generations.

From the inception, Indonesia’s development strategies focused on the
intensive use of natural resources. But natural resource preservation, including preservation of the environment, has not been a serious concern in development planning. Economic growth during the New Order era consistently showed a high rate of around 6-7 per cent a year, but this did not include a calculation of the costs of natural resource extraction leading to depletion and environmental degradation.

Furthermore, national income was not adjusted on the basis of the depletion or degradation of natural capital such as water, land, air, minerals and wilderness areas, nor was the cost of pollution calculated. If national income or economic growth figures were calculated after the consideration of these costs, the achievements would not be considered as inspiring. Every forward step of this type of “economic development” is a backward step for natural resources and the environment.

Natural resource management must balance the concerns of fairness between generations and fairness within generations. It is very important that natural resources are managed with prudence so that they can be bequeathed to future generations. Renewable natural resources should be used optimally, maintaining capital stocks. Non-renewable natural resources should be used efficiently with efforts taken to find substitutes.

Policies on natural resource use and exploitation should be based on a broad vision that aims to create sustainable development. It is vital that planners bear in mind that the environment and natural resources are Indonesia’s legacy from the past and legacy to the future. Development plans and economic recovery programmes must prioritize these as strategic economic resources for careful management and exploitation.

To implement sustainable development, it is not possible to rely solely on market mechanisms. The market has inherent limitations and is particularly weak in respect of regulating public goods. The market has not hesitated in underpricing natural resources by excluding the element of depletion from its calculations. Industrial goods were also underpriced because the calculations did not include negative externalities.
such as pollution.

Because of this, government intervention is needed to handle those issues that the market fails to address. Government has the capacity to handle such negative externalities through implementing taxes on industries that produce toxic waste or to compensate for pollution and natural resource depletion.

The government also has a role in setting standards in the use and management of natural resources and the environment. The role of Bappedal, a government body that oversees the exploitation of Indonesia’s natural resources, needs to be more effective and the judicial system needs to be improved to be able to handle transgressions of environmental regulations more seriously, with stiff penalties adhering on the principle that “the polluter pays”.

A mechanism needs to be established whereby regular reviews of past natural resource exploitation contracts could be done to ensure adherence to environmental standards. Empowerment of stakeholders with environmental problems is also vital. These stakeholders are often community members who feel the impact of environmental problems.

Even the wider society can become stakeholders because of their interest in environmental preservation. Environmental non-governmental organizations play strategic roles as interest groups, drawing attention to the problems and identifying strategies for the responsible management of these resources.

Tropical rain forests are the lungs of the world and therefore national and international society has an interest in them. The government should take decisive and effective measures to eliminate illegal logging. A comprehensive review on the mechanism for awarding timber concessions should be carried out, since in the past this was not done transparently. All timber concession licenses that do not meet sustainable forest management standards, such as those defined by the eco-labelling institute of Indonesia, should be revoked.

A more prudent approach needs to be taken in the exploitation of marine resources. It is imperative to protect the waters of Indonesia from illegal
fishing by foreign fishing fleets, particularly in the eastern regions, so local maritime patrols should be strengthened. There should be better local monitoring of fishing and other uses of natural resources, including through a system of natural resource accounting.

**Recommendations:**

- The market is weak at pricing costs of natural resource extraction such as depletion, pollution or other environmental damage. The government should regulate these costs through measures such as taxation of toxic waste production, pollution or other negative externalities.
- The government has a role in setting standards for the extraction and management of natural resources. Bappedal needs to be made more effective and the judicial system strengthened so that transgressions of environmental laws are firmly handled and subject to steep fines.
- A mechanism should be created to regularly review natural resource exploitation contracts issued in the past, to make sure that they continue to meet environmental standards.
- The wider society, as well as local communities, are stakeholders in the environment. Environmental NGOs can play a useful role in drawing attention to problems and suggesting solutions.
- The government must stop all illegal logging, review the mechanism for issuing logging licences and revoke all licences that do not meet acceptable standards of environmental management, such as those defined by the eco-labelling institute of Indonesia.
- Efforts to monitor the use of natural resources should be stepped up and local maritime patrols increased to stop illegal fishing by foreign vessels, especially in eastern Indonesia.

**5.2 Empowering Environmentally-Friendly Local Investors**

Exploitation of natural resources during the New Order era was centralized, in that the central government in Jakarta determined the locations for
exploration and exploitation of natural resources and decided which investors were awarded the contracts. Not only was the local government estranged from the decision-making process, but also most of the contracts were granted to large investors, mostly joint-venture companies. Local investors and companies could not compete, and there was no level playing field for access to natural resources. In implementing regional autonomy through Law No 22/1999, efforts should be taken to ensure that a significant role is played by environmentally friendly investors.

Recommendations:

- Design an affirmative action programme to support environmentally friendly local investors and companies in gaining access to the sustainable use of natural resources.
- Ensure that a just tender process for investment projects can take place at the local level, open to all bidders.
- Local investment projects should adhere to the environmental and social impact assessment requirements, as defined by Bappedal, for their feasibility studies.
- Strict screening of investment proposals should be conducted, taking into careful consideration their environmental and social impacts.
- Empower local investors with the ability to adhere to the principles of corporate social responsibility as an asset and a form of leverage in competing against other investors.

6. The Fiscal Structure

The best indicator of the government’s commitment to reform would be the annual budget, known by the Indonesian abbreviation APBN. It is through the allocation of resources that the government’s sectoral priorities, as well as the strategic choices and plans that it develops, are best reflected.
During the New Order, the DPR had no role in influencing policy either through the formulation of legislation or through the allocation of resources. Even if DPR members wanted to play a more active role in the formulating of laws, they did not have the access to data and information on income and expenses. The draft APBN was never changed by the DPR. Budget increases and other changes introduced by the executive during the period were always agreed, and the DPR became a symbolic rubber-stamp institution, giving a constitutional basis for the execution of the government’s activities. There was little synchronization between the annual budget, a five-year medium term plan (Repelita) and the Broad Guidelines for State Policy (GBHN) as a long-term plan.

Today, the DPR has greater powers to question the executive in respect of the draft APBN and even to change aspects of it. However, what has to be avoided is deadlock as an outcome of budget discussions. According to the 1945 Constitution, if the DPR and government do not agree upon the draft APBN offered by the government, then the government must use the APBN from the previous year. This is unrealistic, because the APBN agreed upon is more than a total sum. It includes line-item expenditures as well.

There are often many inconsistencies reflected in budget allocation. For example, a strong commitment to advance education is often expressed in debates and plans but is not reflected in the amount allocated for education. Similarly, commitments to empower women in all aspects of life, especially in poor villages, are expressed but rarely backed up with resources.

The government must also re-examine the way it plans to finance its deficit. Previously the government relied on foreign loans. It now relies, however, on both foreign loans and domestic bonds. But by issuing local bonds, it has the effect of “crowding out” debt issues by private-sector borrowers.
Socio-Economic Development

Recommendations:

- Provide mechanisms to ensure that APBNs are passed. If a deadlock occurs when discussing the APBN, there needs to be a consensus on ways of resolving it. For example, references to the previous year’s budget should be permitted to secure approval for routine budgets, whereas development budgets should be discussed in detail until there is a complete and final agreement.
- Take measures to strengthen DPR members’ competence and capability in discussing APBN.
- Secure from the government a binding commitment that increased tax income will be spent equitably to deliver social justice.
- Prioritize the development of democratic public budgeting processes, for example by allowing multi-year budget planning and preparation. The current time constraints are detrimental to long-term planning and a timespan of 18 months would be more appropriate.
- To reduce the negative “crowding out” effect in the local capital market, the government must announce in advance a suitable timetable for issuing bonds, so as to allow the private sector to raise capital.

7. Restructuring the Bureaucracy to Support Socio-Economic Reforms

Indonesia has been identified as a country in which corruption is endemic, but previously, senior government officials refused to acknowledge this. Senior officials claimed instead that investor confidence was reflected in the high levels of growth and foreign investment, in an attempt to counter criticisms against the bureaucracy.

Nonetheless, the cost of corruption has been very high. Besides
undermining the institutions of government, and eroding the credibility and legitimacy of state actors, corruption has also had a tangible economic price.

The Indonesian bureaucracy today is overstaffed and grossly underpaid. Despite efforts at restructuring the bureaucracy from the New Order period until now, state employees’ productivity has not improved. Each state employee serves 50 people, a number which has been constant for more than 25 years. State employees’ official salaries have not been raised. The minimum salary for a state employee today is lower than the regional minimum salary stipulated by regulation.

Since 1983 the private sector’s role in the economy increased greatly with government efforts at deregulation. But the government did not do much to restructure the bureaucracy and make it a partner to the private sector. The government saw its role as providing an enabling environment for business, and recognised that it could only be accomplished through the bureaucracy, but the necessary transformation of the latter did not take place.

The government’s function in the economy has changed from providing direct services, such as the control and supply of public goods and selected private goods, to indirect functions such as policy formulation, facilitation and co-ordination. It has also limited its direct functions to the supply only of certain public goods. As a consequence of those changes, the bureaucracy’s structure became more decentralized and it now faces different expectations. These changes are reflected in an emphasis on key functions and on being more professional, transparent, supportive and fair.

Looking at the developed countries of East Asia, continuous growth through the private sector is supported by a strong, efficient and honest bureaucracy. There are three main indicators that a bureaucracy is honest and efficient:

- Recruitment and promotion based on achievement and through a competitive process.
- Adequate remuneration, whereby salary and incentives are competitive with those offered by the private sector.
- A clear career path.

In countries like South Korea, Japan and Singapore, competition for entry into the civil service is high and employees benefit from competitive salaries, often comparable with the private sector. Employees may gain scholarships for higher studies and training, further increasing the prestige of the sector and the quality of its human resources.

A clear career pattern is also an incentive to motivate first-division employees of the bureaucracy. For example in Indonesia, some state enterprises like *Perusahaan Listrik Negara* (PLN), the state electricity company, and Bank Indonesia, the central bank, pay salaries that are competitive with the private sector. A holder of an engineering degree who works for PLN will receive, after training, a salary of approximately Rp 800,000\(^1\) per month, which is better than in some private-sector companies. But positions are not ranked clearly, and staff feel undermined by the prospects of political intervention.

In countries such as Singapore there are mechanisms to promote integrity. Besides good salaries, disincentives for corruption exist through a strong penalty system. In Singapore, every act of corruption, no matter how small, will be penalized by expulsion from state employment. Furthermore, the government will publish the names of expelled employees, making it difficult for them to find alternative work. The case in Indonesia is very different.

Although the growth rate in the number of state employees has decreased from 6-8 per cent a year in the past to an average of 3-4 per cent a year now, there is still a mismatch between the bureaucracy’s needs and capacities. In some government institutions, changes in the government’s role in a given sector has created an excess of employed capacity, while there can still be a shortage of capacity at the implementation level. Some positions call for advanced education, but there are limited numbers of people with degrees who are willing to take these positions.

An example of mismatches between capacity and demand is the Trade and Industry Department, where there is now excess capacity because of deregulation. Yet the government is reluctant to reduce the number of
unnecessary state employees because it is not politically popular.

Data shows that the aggregate quality of state employees has tended to improve over time. The ratio of state employee with the minimum education level of SMA (high school) increased in 1991/92. But the quality of employees available to be trained as decision-makers and planners is poor and the numbers are low. Undergraduates from distinguished universities like the University of Indonesia and the Bandung Institute of Technology are reluctant to apply for positions as state employees. As a result, the undergraduates who apply are usually from second-class universities. Even where there are employees from first-class universities, they stay there only for a short period in order to meet the requirements of a scholarship. After they have finished their obligatory term, they will resign and work in the private sector. The reason for this is that the salary system is not competitive.

With economic deregulation at the end of the 1980s, salaries in the private sector increased dramatically while many incentives received by state employees were cut. As a result, state employee benefits and pay fell far behind those of the private sector. A new graduate is only paid Rp 125,000 per month in the state sector after eight months’ probation. In the private sector, a graduate can expect to obtain a minimum salary of Rp 350,000-800,000. The more senior the position, the wider this gap is.

As a result, it is difficult to recruit employees with high levels of competence and to ensure that they remain honest and incorruptible. In addition, the non-transparent recruitment system acts as a disincentive to public service employment. It is no secret that nepotism and bribery have infiltrated the recruitment system and pervade the system of promotions and lateral transfers to career positions that are considered “wet”, meaning that they offer many opportunities for making money illegally.

As a consequence of the declining quality of key state employees, many career positions are being filled with academic professionals. But this in turn hurts the universities as they lose lecturers. Besides, this type of
recruitment further erodes confidence in the bureaucracy as an institution in which it is possible to develop a career.

The bureaucracy is one of the major economic actors that facilitates the flow of market mechanisms. Structural reform of Indonesia’s bureaucracy must be initiated as a matter of priority. Reform requires more than initiatives to improve incentives in recruitment. It must also create a more conducive and transparent environment in which state employees can build their careers. Without reform in the public administration sector, the economic reforms that the government has planned will be ineffective.

7.1 The Future of Bureaucracy and Political Renewal

The bureaucracy is a service provider and must be demand-driven. This is not the case in Indonesia, where in the past the authorities have often corruptly given privileged access to entrepreneurs to exploit their economic interests, undermining the interests of consumers and society. The economy is disadvantaged and consumers suffer high losses as a result.

This kind of practice is common. Examples include the issuing of licenses in the trade of wheat flour, cloves, sugar, palm oil, rice and premix; in cases of toll roads, the former National Aircraft Industry (IPTN, now known as PT Dirgantara Indonesia), the commercial airline Sempati and Batam port, to name but a few.

Sub-optimal resource allocation distorts the economy and slowly weakens economic potential. This is reflected in Indonesia’s economic growth patterns, which are lower than countries in the region. The value of other economic losses from corruption and other forms of distortion can be calculated, and a conservative estimate would estimate it at trillions of rupiah. Sub-optimal resource allocation may also weaken the pillars of the economy by promoting “false” development and profit generation that has no real base. In addition, it stimulates an unequal and unfair distribution of income.

As Indonesia embarks on strengthening regional autonomy, the bureaucracy has a challenging role to play. It is imperative that it becomes a partner.
in this process and does not undermine it through corruption or by obstruction.

The bureaucracy is required to be an independent force. But merely improving the bureaucracy is not enough. More basic reforms are needed to ensure that other related institutions in society can also realize their potentials and function accordingly.

It is impossible to create a clean and authoritative government if institutions such as the bureaucracy and the military are intertwined in a distorted chain. Reform of the bureaucracy must be accompanied by a re-evaluation of the military’s role. Changes can be made incrementally, at the most appropriate time and in appropriate stages. But what is required most is commitment and political will to initiate such changes.

Recommendations:

- Rationalize and reform public administration to be efficient and effective. Salaries need to be increased for public servants so that incentives to fall prey to bribery and corruption are removed.
- Reduce the ratio of public servants to the general public to realistic levels. Re-train public administrators to be responsive to the new paradigm in Indonesia.
- Review the process of recruitment and promotion in the bureaucracy to ensure that merit and efficiency are the criteria for recruitment.
- Ensure that the bureaucracy becomes accountable to the public, as a service-oriented and demand-driven institution.
- Provide competitive salaries and ensure that recruits can develop meaningful careers within the bureaucracy.

8. The Military and its Role in Business

The involvement of the military in businesses has long roots in Indonesia, going back even before the declaration of independence. Officers of the PETA, an Indonesian military unit formed by the occupying Japanese during the Second World War, enjoyed levels of welfare that were not
very different from the officers of the Dutch colonial government that the Japanese replaced. This is not only because of their salaries, but also because the Japanese authorities developed an independent economic programme, providing capital and assets to the PETA corps for their own benefit.

The People’s Security Body (Badan Keamanan Rakyat or BKR) that was formed after independence also obtained special facilities and funds from rich ethnic Chinese and entrepreneurs. Following the creation of the Armed Forces (Angkatan Bersenjata) after the revolution era, there were fewer special treatments. But numerous rebellions and a shrinking of the government’s budget in 1952 forced regional military commanders to find their own funds to cover personnel and operational costs. The armed forces’ close involvement in businesses occurred when the government nationalized Dutch companies later that decade.

The impetus for military involvement in business during the New Order was the low budget allocated by the state for arms, expenses and soldiers’ welfare. The military’s “dual function” concept, which justified a social and political as well as a defence role, provided legitimacy for its involvement in various aspects of life, including business.

But in the course of these activities the military was responsible for uncontrolled excess, of which corruption was the most obvious by-product. Furthermore, the monies raised were not used for purely military purposes but to support a lavish way of life among military officers and strengthen political cliques within the military. The use of Pertamina (the state oil company) is one such negative example of the military’s off-budget activities.

Currently, the military’s business activities can be categorized into four groups: co-operatives (koperasi) with soldiers’ welfare as priority; business units; businesses run by non-profit institutions; and “influence and ease”, which practice is outside the military’s formal business structure. Rent-seeking became an acute disease in Indonesia’s economy during the New Order, and the four categories of military business practices contribute to this malaise. One example is the electricity business, where a military-backed project charges 50 per cent more per kilowatt-hour than projects managed by PLN, the state power company which were
agreed at the same time.

As an institution the armed forces was a powerful element of the authoritarian bureaucratic regime, yet it is possible that the grand strategy was not in the hands of the armed forces itself. This can be seen from certain military businesses which were developed in co-operation with powerful private-sector operators, including those from the family of then-president Soeharto. These include timber, civil aviation, aircraft maintenance in Batam, a holiday resort in Bintan, fish processing and many others.

The military’s influence over big business waned in the late 1970s as powerful civilian players became more influential. The involvement of the military and its senior officers, as well as retired officers, is still strong, but the motive was to retain their loyalty towards Soeharto. Some groups think the military was used as a front by other interests, as in cases of land reform, labour strikes and the use of assets controlled by the military, or used simply to guard big business in uncertain times.

A major task is to “purify” the military’s role and at the same time assign to it an appropriate position according to its function. In the context of globalization, more specialist expertise is required to run businesses efficiently and the military has its own tasks of protecting national security and defence.

The following recommendations are suggested:

**Recommendations:**

- Removing the military from business is as crucial as the reform of the bureaucracy for optimizing socio-economic reforms in Indonesia.
- Dismantling the monopoly positions maintained by the military through government regulations.
- Privatising military-owned enterprises, or ensuring that the public interest is represented in military-controlled funds and investments.
- Establishing mechanisms to ensure the military’s transition away from business.

9. **Encouraging Small and Medium Business Enterprises**

The Indonesian economy is characterized by large-scale industry and business, largely financed by international capital, and a large informal sector. What is lacking is a strong, locally-based industrial and service sector. This is so because there are many difficulties associated with establishing such enterprises.

The absence of such enterprises has created a distorted economy. People have either become dependents on, rather than active stakeholders in, the formal economy, or they work in the informal economy. The latter remains unregulated and is a risky arena both for managers and owners. It also receives little support from the government.

Indonesia remains committed to development through international capital and its obligations are outlined in the Letter of Intent signed between the government of Indonesia and the International Monetary Fund. While it is important for Indonesians to support the terms of Letter of Intent, it is important that Indonesia does not rely only on the volatile resource base of international capital.

There needs to be a rise in domestic investment and growth of small and medium-sized business enterprises. This will help reabsorb the unemployed into the workforce at a lower cost. It is important to look at options to improve the prospects of small and medium-sized business enterprises and to use them as creative vehicles by which to jump-start the generation of employment opportunities.

There are many obstacles to starting up a business. They include a tangled web of bureaucratic requirements that are also gateways for corruption and bribery, as well as production and export quotas that are, in effect, barriers to the operation of market mechanisms. It also remains difficult for small and medium enterprises to receive high-quality skills training
to improve their human capital.

These barriers have prevented the development of an entrepreneurial class free to establish their own enterprises. Small and medium enterprises are often viewed as unrewarding, non-profitable activities. However, entrepreneurial activity is needed to build up an economy with a diverse base. The inter-relationship between an entrepreneurial class and a diversified economy are strong, and they combine to create a more resilient national economy which is insulated from the vagaries of the international markets and has the ability to provide greater employment opportunities at lower costs.

9.1 Benefits of SMEs

The advantage of small and medium-sized business enterprises (SME) is that they suffer less from the operational rigidities that sometimes undermine large businesses. An SME can adapt to a change in market conditions, such as a fall in demand, at a far quicker speed than large enterprises. This is so because their overheads and fixed costs are lower. It is also easier for an SME to change suppliers for lower-cost supplies, as well as adjust to the change in quality. Production processes are usually quicker, and the return on capital is more rapid that it is from large operations. This can protect SMEs significantly from changes in currency valuations or interest rates. In addition, industrial unrest is rarely an issue for SMEs.

The strength and importance of SMEs was seen during krismon, Indonesia’s economic crisis, when small enterprises opened up to fill the demand created by the failures of large enterprises. The large enterprises were unable to adjust to market conditions. Credit given to SMEs rose sharply, especially by credit institutions such as Bank Rakyat Indonesia, a state bank which specializes in financing small business. Although there are no official figures for investment or new employment created by SMEs, there is strong circumstantial evidence indicating that small traders did benefit from these activities and significant entrepreneurial opportunities were created.

9.2 Challenges to SMEs
Although SMEs are able to survive the crisis better than large operations, there are innumerable problems associated with their start-up which include securing a plethora of licenses, dealing with import producer schemes and export quotas. For example:

- **Licenses**: SMEs require formal licenses recognized by the Ministry of Trade to operate in the industrial sector. It is necessary to obtain a total of 27 licenses whose cost is estimated at 10-15 per cent of operational costs. As a result, most entrepreneurs prefer to remain informal although they have to bear high hidden costs, paying for services and supplies they otherwise would not obtain.

- **Import Producer Schemes**: these dictate that to import certain commodities, the entrepreneur needs to be a producer and declare how much he or she will import. For a small business starting up, it is often not possible to make such declarations.

- **Export quotas**: these limit the amount of goods that can be produced in certain areas, whether or not there are producers or manufacturers of those goods.

To improve the situation for SMEs in Indonesia, help increase the size of the entrepreneurial class, encourage economic diversity and create employment opportunities, the government must take measures in several areas.

**Recommendations:**

- Reduce the burden of licenses on all enterprises. The current maze of regulations and licensing requirements is complicated, costly, time-consuming and detrimental to start-up. In effect, it acts as a barrier to entry into the market, and keeps firms and businesses in the informal sector.

- A short-term remedy to the problems of bureaucratic red tape is to establish “One-Stop Service Centres”. The aim is to simplify the cost and paperwork involved in obtaining all necessary permits and licenses, by making them available at one place.
and through one application process. However, this must be a temporary solution, as for business to be successful in the long run, bureaucratic requirements must as far as possible be eliminated.

- Reduce, with a view to removing, all levies that add to the hidden costs of production for SMEs. These can be legal or illegal, including for example the payment of local protection money. This can only be done in conjunction with stronger adherence to the rule of law in general in Indonesia.
- Improve competition. Tariffs and quotas, like licenses, act as barriers in the market. Where there is no overriding social rationale for retaining tariffs and quotas, they must be eliminated so as to create a more level playing field.
- Increase the availability of technical and managerial training skills

  continued

for SMEs. For the moment, such training is provided by the state as part of a regulated partnership programme, but they are often inefficient and the training inadequate. In the longer term, training should be provided by the private sector.

- Encourage close co-operation between the owners and managers of SMEs so that, as a sector, they will have stronger voice to promote their views and needs. This would complement the existing FORDA (regional forums) that have developed in the last three years.
- As agriculture is the largest sector in which SMEs are found, there is a need to develop an overall strategy for the food and agricultural sector. Protectionism is affecting this sector.
- The removal of all subsidies, especially fuel, must be accompanied by impact control schemes.
- There is a need to educate legislators about the problems of SMEs.

10. Labour Relations Reform

10.1 Law Enforcement

Indonesia has a large labour force within the formal sector as much foreign
direct investment has gone into the manufacturing sector and light industries. Competitive wages and a docile labour force have been the publicized attractions that have helped Indonesia to secure considerable investment in these sectors.

Although there are laws and regulations to determine labour relations in Indonesia, the government has never seriously monitored the implementation of policies and there are no mechanisms for law enforcement at any level, be it at the national level or at the lowest, local level. In the past, the government has tried to reform itself by ratifying international labour standards such as ILO conventions, but the reform process is limited to the policy-making stages alone. There is also a lack of socialization and co-ordination of policies, with national policies failing to be implemented at the local level. In practice, each level implements policies according to its own understanding.

**Recommendations:**

- Steps must be taken to re-affirm the rule of law, and this includes the labour laws.
- Prioritize law enforcement in the labour field. Violations should be considered as criminal acts and processed accordingly.
- Empower legal institutions to uphold labour laws.
- Create channels of communication between central and regional government leaders to ensure that labour violations are addressed.
- Use the media effectively to build awareness against the exploitation of labour.

10.2 Corruption, Collusion and Nepotism within Labour Relations

The working conditions and practices relating to labour relations are very poor. However, entrepreneurs are never held accountable and required to improve standards because they are able to bribe union officials, law enforcement officials and officials from the Department of Labour to report on labour conditions favourably.

Many entrepreneurs are pressured into using security personnel to provide additional security and mediate relations with their workers. These operations often reach 30 per cent of total production costs.

Clearly employer-labour relations need to be redefined. Much of the corruption stems from the unrealistically low wages that are paid to workers and security
personnel. Although it is difficult to re-align wages during this economic crisis, steps must be taken to address it as a matter of priority. Wages and working conditions should be negotiated between parties so that the problems can be addressed through consensus.

**Recommendations:**

- Eliminate corruption in labour relations that lead to the exploitation of workers.
- Ensure that workers are paid realistic, living wages.
- Develop a legal mechanism to protect workers rights’ more effectively.

### 10.3 Discrimination Between Women and Men Workers

Discrimination on grounds of gender continues to characterize labour relations in Indonesia. Facilities and even wages are accorded on grounds of gender and not based on the quality of work. The most common form of gender discrimination relates to wages, with women still considered as secondary earners, justifying lower wages than those received by men.

Furthermore, women workers suffer from additional gender-based discrimination, being subjected to pregnancy tests and the threats of dismissal if they take maternity leave or time off during menstrual cycles.

**Recommendations:**

- Wages should be based on the quality of work, not on gender.
- Women are also primary wage earners and arbitrary distinctions should not be based on gender.
- Gender-based discrimination based on women’s reproductive functions should be prohibited by law and the law enforced.

### 10.4 The Regional Minimum Wage

The regional minimum wage (UMR) is determined on the basis of meeting the basic physical needs of labour as “human beings” rather than their needs as “social beings”. The process of determining the level of UMR has been the subject of corruption and lacks transparency. The National Wages Council only involves one labour union, which is the government’s labour union, and determines rates without consulting other labour unions.

The price analysis used to determine these rates are not linked to real conditions. It is based on estimations drawn from prices in the main market, which are lower than in the local markets, where commodities have passed through a
long chain of distribution.

During the determination of the UMR, the government and the entrepreneurs isolate the workers from social interaction in order to depoliticize them. While the process occurs, workers are kept away from communications and social interaction, so that the economic regulations can be determined and presented to the workers for acceptance.

The UMR are often considered to be the “maximum” regional wage, and are based on various nonscientific and non-economic criteria.

**Recommendations:**

- The cost of daily needs must be based on realistic criteria and must be determined through a transparent and fair process.
- There must be a representative mechanism to have labour unions represented on the National Wage Council.
- The role of academicians in formulating wages of a company should be limited to an advisory capacity. Wage formulations should be based on the financial ability of a company and the standard index of daily needs.
- UMR must be based on the minimum fiscal capacity of the company and the minimum living cost for labour. Wages should thus be linked to the prosperity of the company. To ensure that this is realized, companies must provide information regarding their financial status to the workers and unions to negotiate proper wages.
- Government must formalize legislation to ensure minimum wages and the capacity to link wage increases with productivity.

**10.5 Strikes**

In Indonesia, strike action has not been recognized as a fundamental right of workers. Strike action is regarded as an act of hostility and violence, manifesting the selfishness of workers in articulating their demands. It is rarely considered as the last resort when demands are not fulfilled. “Peaceful” negotiation processes that normally benefit the entrepreneurs are regarded as the ideal.

**Recommendations:**

- Labour and business must enter into negotiations to resolve
contested issues.

- The right to strike should be recognized as integral to workers as the right to association and used judiciously.

### 10.6 Labour Dispute Settlement

At present, there is no time limit for resolving industrial disputes. Until now, the losing party has been able to appeal to the administrative court, which can take three years or more. During this time, the law does not protect the rights and obligations of both parties. This often means that the workers, who are financially weak, do not have any other option but to resign and find another job.

**Recommendations:**

- A labour court must be established to address labour issues efficiently and limit the duration of legal process between workers and entrepreneurs. The labour court should be able to make an independent, final and binding decision within a prescribed and reasonable period.

- During the dispute process, the entrepreneurs still have to fulfill their obligations towards the workers regardless of whether or not they want to hire those workers pending settlement of the case.

### 10.7 Child Labour

Given the poverty levels in Indonesia there are many children who are employed, notwithstanding international conventions securing the rights of the child and prohibiting child labour.

The government has ratified ILO conventions regulating the age limit for child workers and providing minimal standards to regulate work conditions for child workers. Nevertheless child workers are treated badly and lack welfare protection and access to education. Estimates indicate that there are about between four and 6.5 million on child workers in Indonesia who are mostly underpaid and working under the age limit, which is 15 years. They have no access to education and work more than the prescribed daily hours with some even exceeding a working day of 12 hours per day.

**Recommendations:**

- Child workers should only be allowed to work after school. The government and the entrepreneurs must ensure that these children receive an education.
Because of children’s physical abilities, their working hours must be limited to five to six hours per day.

As with women workers, child workers should get paid on the basis of the work they deliver.

11. An Open Policy-Making Process

Labour, social and economic relations must be conducted within the paradigm of democratization, which is the force that brought about a regime change and is the trend of the future. Labour relations should be developed and defined through laws that are drafted with the participation of the workers.

Recommendations:

- All government policies are for the benefit of the people. This stipulates that the government directly consults the people prior to drafting policies, to ensure that their inputs are included.
- Government’s role is that of a facilitator, not as an absolute regulator, and this should be reflected in national policies and programmes.

12. Collusion, Corruption and Nepotism

By the late 1990s KKN, the acronym for collusion, corruption and nepotism, became a key word to characterize many of the ills of the New Order regime of President Soeharto. In the sphere of economics, it referred to the malign influence of the excessive payments of money, either to win favours or concessions, or simply to be able to survive in business. It also referred to the personalized nature of the business world in Indonesia, where connections to the highest levels of the elite ruling group alone ensured economic success.

These practices had a very negative impact on the market. Privileged yet inefficient businesses prospered. It impeded the development of an entrepreneurial class and perceptions of business were very negative both nationally and internationally. The hidden costs of business were very high and further distorted valuations and budgets. It created an environment of corruption, which undermined all other legal institutions such as the judiciary, bureaucracy and government.

Indonesia ranks 85th equal out of 89 countries in the 2000 Transparency International Corruption Perceptions Index (CPI). Where “10” is the top score, Indonesia only achieved 1.7. The score relates to perceptions of the degree
of corruption as seen by business people, risk analysts and the general public. Corruption has contributed to poor financial regulation and impeded proper crisis management, and perceptions of corruption undermine investor confidence. KKN must be rooted out if the Indonesian economy is to develop. For this to happen, structures of economic decision-making must be transparent, with clear chains of command in all decision-making processes, including appointments. The damage caused to the country by KKN cannot be understated and must be high on the agenda of governance reform. When a country is branded as a haven for bribery and corruption, it does not become an attractive investment site for either international capital, or for domestic entrepreneurship.

The effect of KKN also impacts directly on the cost of goods and services, both in the public and private sector, as well as on the creation of opportunities for investment and the generation of employment.

To cleanse the economic system of market distortions, changes are needed at all levels. They are especially required at the highest levels of the political and bureaucratic establishment.

**Recommendations:**

- Review appointment procedures for all high-ranking officials, from first echelon civil servants to directors of boards of all state enterprises.
- Directors of all state-owned enterprises must be scrutinized by an independent commission.
- Institutions such as that of ombudsman must be strengthened, and empowered to carry out full investigations of complaints against the state.
- The state must provide incentives to all companies to keep good records and accounts so that an accurate picture of their income tax liability can be ascertained.
- Tax-collecting services must be reformed to ensure that they carry out their real and intended duties with integrity and fairness.
- As detailed in Section 7 above, the bureaucracy needs to be reformed to become effective and honest.

**Note**

1 The exchange rate on 3 October 2000 was 8730 rupiah to the US dollar.