



HISTORY IN THE MAKING

A SYSTEMIC TRANSITION IN INDONESIA

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History in the making

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I. Introduction

The purpose of this paper is to take stock of the current development situation in Indonesia. The causal and operational inter-correlation between different elements of the transition being attempted in Indonesia: democratic governance and consolidation, peaceful conflict resolution and economic reform demand a new approach towards an examination of the dynamics of the transition process.

The essence of this approach lies in focusing more on the interlinkages between these complementary elements of the reform agenda and relatively less on a single area of policy. This merely reflects the realisation that what began as the most severe economic crisis in the post-independence period in Indonesia soon spilled over into an agenda for total transformation of Indonesian society and politics. With the fall of the New Order government following the student riots of May 1998, the Indonesian problematique moved from effecting an economic recovery to managing a systemic transition. As a consequence, the task before Indonesian policy makers and institutions is to undertake social reorganisation on a scale triggered by historic crises, comparable more to the situation in Europe and USA in the grip of the Great Depression or in the former USSR after the fall of the Berlin Wall. Such a transition both in magnitude and depth goes well beyond that contained in standard structural adjustment programmes familiar in so many developing countries since the mid 1980s.

Systemic reforms by their very nature are rare phenomenon. They are history in the making. The opportunity for total reform comes once in a lifetime if at all. Indonesia is no different. The current transition is only its second attempt after independence to establish a pluralist democracy. It is sparked by an economic crisis,

which bears easy resemblance to the disastrous economic situation in the early 1960s. It takes place against the backdrop of frustrated expectation of a whole generation, which has seen its future prospects tumble, and its life plunged into uncertainty. Forty percent of these live in cities compared to less than a tenth just after independence. Issues of great merit and national importance: the relation between state and person, between town and country, between centre and region, between state and religion, between the military and the civilian, commonplace in the first phase of democracy in the early 1950s have now returned with even greater force to the public arena.

This is the great canvass on which Indonesian policy makers must write and by which all of us, donor and recipient alike, will be judged. Transition in Indonesia today is not merely a matter of sectoral strategies, efficient accounting or budgetary allocation. These are all important. But by themselves they miss the essence of the transition now taking place. At the heart of the Indonesian transition lies the challenge of seizing a unique historical chance to fashion anew approaches, policies and practices which will stand the test of time in a changing world characterised by the near universal winds of globalisation and decentralisation and democracy.

Such transitions do not move in straight lines. The past is not a good guide to the future. Historically discontinuous processes do not lend themselves to easy theorising. To a large extent we learn as we go along. With the end of the Cold War this is easier than it used to be. Ideological positions are less polarised. There is a general admission by governments and development agencies alike that we do not know everything. The World Development Report 2000 makes the important point that "a deeper understanding of development involves a recognition that sweeping beliefs are often incomplete, that layers of complexity are buried not far beneath the surface, and that wisdom is often contingent on the particular conditions of time and place."

Understanding the main currents of the Indonesian transition, preventing it from slipping into violent dissension, discouraging it from a retreat into a new form of authoritarianism, and through it all protecting the interest of the poor and the excluded is the great development challenge of the day. Such endeavours are achieved rarely if ever under the overarching prescription of a single philosophy or

by a single agency or organisation. There are advances and reversals, detours and blind alleys. The glass of the transition seen at different times is either half-full or half-empty, depending on the timing of the observation and the predilections of the viewer. Interpreting the trends and identifying the moving forces of such a fundamental social overhaul is therefore a matter of balance. Partnerships, in such a context, have a role much larger than the conservation of finance and personnel. They provide a collective mind through which the twists and turns of the juggernaut of such historically specific transitions can be witnessed and interpreted. They constitute a lens through which feasible policy choices can be examined, evaluated and resolved.

A frequent question in the wake of the Asian economic crisis is why Indonesia has not recovered at the same pace as Korea or Malaysia or Thailand. The answer is usually couched in terms of the failure of political will, in the almost organic corruption, which is said to permeate Indonesian society, and in the appropriateness of governing institutions. These limited responses suit the mood of early days of the crisis when all crises affected countries seemed to be linked by the invisible web of currency markets and contagion. Seen in a more contemporary light, the Indonesian recovery is slower than in other countries of the region because economic recovery is just one of the indicators of the Indonesian transition.

Like must be compared with like. Other countries have taken decades to establish electoral democracies, rein in the military, manage conflicting political and economic claims, achieve macroeconomic balance and open markets. The myopia of partial comparisons only encourages the retreat into simple concepts and assertions. Only relevant comparisons can illuminate the path of a lasting and peaceful transition.

II. The Indonesian transition: history and perspective

Using historical data to predict future changes in prices and quantities in times of systemic transition is fraught with difficulty. The results often prove unreliable. Continuous downward revisions of the projected growth rates of GDP in the first two years of the crisis, wide variations in poverty projections and the almost

impossible forecasts of future private sector investments have all been singular examples of the such forecasting problems. Data collection is expensive. Statistical agencies face budgetary cuts. People move across cities and provinces. Households are sensitive to questions of social stress and adjustment. The importance of macroeconomic trends might be exaggerated in a bid to dampen negative investor expectations about the future.

Nevertheless, times of transition need an anchor in history and in the experience of other countries in similar situations. Over-ambition in institutional change might be as fatal for the credibility of a reform program as setting the targets too low. The Balcerowicz thesis of the early phase of transitions as a period free from political constraints, since the public is willing to accept anything, assumes a group of reformers with a very clear idea of what is needed. This might be relevant to countries, such as Poland, where power is transferred to former dissident parties and movements at the start of the transition. It is unlikely to work when effective party formation is part of the transition it self.

In the case of Indonesia, the political task is not only to give direction to the transition process but to discourage the general public from exchanging one set of unreasonable expectations, that everything was bad under the ancien regime, for another: that peace and prosperity will return just with a change of government.

Indonesian studies of the transition tend to focus on the immediate in a bid to attend to the urgent. There is a spirit of pragmatism which permeates economic, social and legal writings during the course of the transition. In this headlong flight to current reason both the past and the future are at times blurred in the background. The past, because there is more than a passing element of déjà vu in the current Indonesian situation. The future because its implications are yet to be clearly understood and just because it appears distant.

Echoes of past crises and failed transitions

Although Indonesia did experience two episodes of economic instability, 1974-79 and 1980-82 linked to shifts in international oil prices, and one of structural

adjustment, 1983-90, the current crisis bears comparison with the economic situation of the early 1960s. The year 1998 registered the largest output fall in post-independence economic history (Table 1), while the collapse of the stock market was comparable to the situation in the United Kingdom and the United States between 1930 and 1934 (Figure 1).

It can even be argued that in some ways the impact of the current economic crisis was even greater than that of the mid 1960s. This is because rural crisis coping mechanisms are likely to have been much more robust than now given the dramatic increase in the urban population since the early 1970s. The present crisis also occurred unexpected, following a period of sustained growth and rising household expectations. In contrast, by the time the New Order took over Indonesia had already undergone a prolonged phase of economic stagnation and low public expectations with regard to a rise in economic prosperity.

In the political sphere, pluralist democracy is being tried for the second time. The first experiment which lasted from just after Independence till the advent of 'guided democracy' in 1959 ended first in constriction and then in dissolution six years later. Social violence, much interpreted as a new affliction in the post-Suharto era, at times encouraging a wistful longing for the order of the New Order, is a familiar characteristic of earlier troubled times. It was never far below the surface in the Old Order under Sukarno. The New Order was borne in an orgy of partisan killing the memory of which still haunts most Indonesians of that generation.

The passionate debates of today on regional decentralisation resonate the equally vigorous views on the need to balance the demands of national integration and nation building with fairness for the provinces. Current speculations about the desirability of a federal political structure in a country so diverse as Indonesia resonates the first experiment with a confederate polity in the closing days of Dutch rule. The anti-foreign business sentiments of some segments of the Indonesian population find a parallel not only in the nationalisation of Dutch enterprises in the 1950's, but also in the periodic outbreak of violent resentment towards the ethnic Chinese Indonesians.

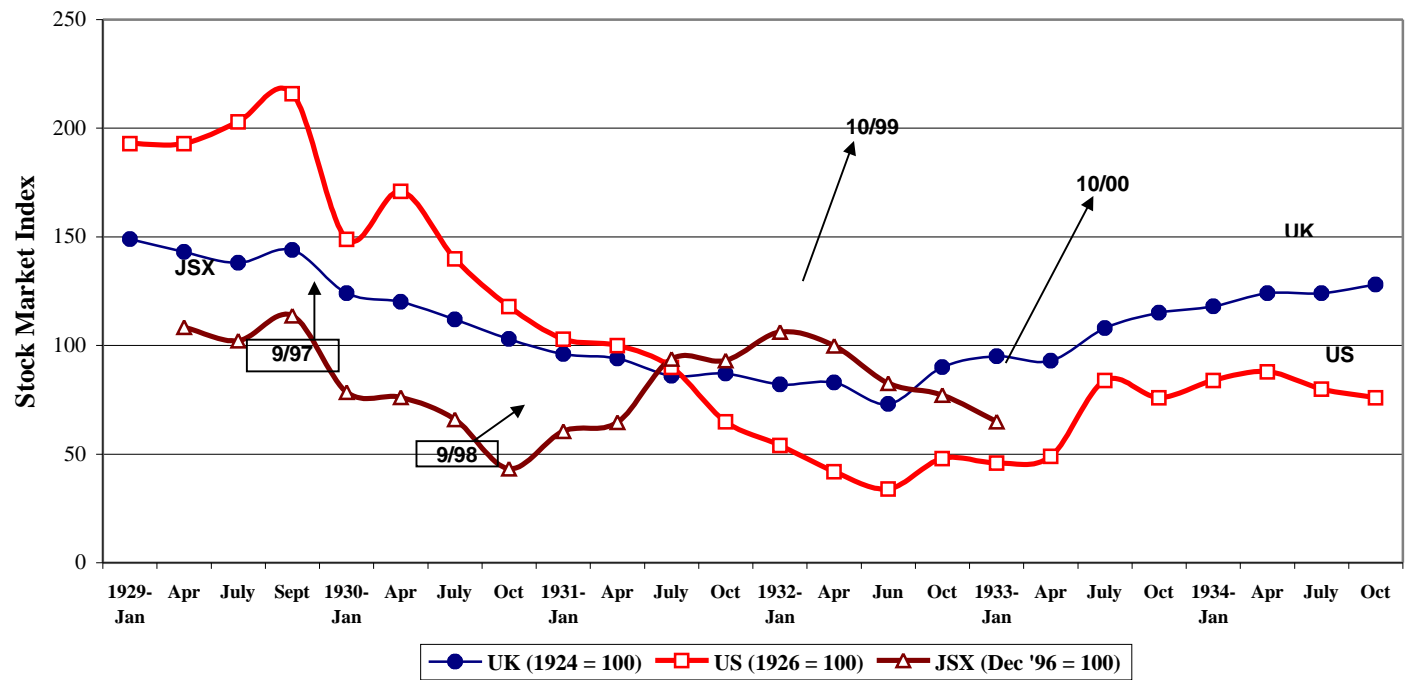
Table 1: Long -term real GDP growth 1951 - 99

Year	Growth	Year	Growth	Year	Growth	Year	Growth	Year	Growth
1950	-	1960	2	1970	6.5	1980	7.9	1990	7.24
1951	6.3	1961	5.7	1971	7	1981	7.4	1991	6.95
1952	3.1	1962	1.8	1972	9.4	1982	-0.3	1992	6.46
1953	6.5	1963	-2.2	1973	11.3	1983	3.3	1993	6.50
1954	6.9	1964	3.5	1974	7.6	1984	6	1994	7.54
1955	5.8	1965	1.1	1975	5	1985	2.4	1995	8.22
1956	2.6	1966	2.3	1976	6.9	1986	4	1996	7.82
1957	7.1	1967	2.3	1977	8.9	1987	3.9	1997	4.70
1958	-4.1	1968	11.1	1978	7.7	1988	5.7	1998	-13.20
1959	2.4	1969	7.1	1979	6.3	1989	7.4	1999	0.23
								2000	4.8

Note: 1960-65 from 1960 weights, 1966-77 from 1973 weights, 1978-93 from 1983 weights and 1994-99 from 1993 weights.

Source: Woo, Glassburner and Nasution (1994) and CBS

Figure 1: Stock Market Crash during the Great Depression, 1929-39



Note: Based on quarterly basis, Jan '29 until Oct '34 for US and UK, and Jan '97 until Oct '2000 for JSX (Jakarta)
 Source: UK and US stock market index from Kindleberger (1986) and JSX index calculated from BI

Such history is critical not in the refinement of economic forecasts but to an appreciation of the public mood and to an understanding of the role of expectations in turning economic crisis into social transformation. It is essential to a realisation that the end of a thirty year period in Indonesian history resulted in an evaporation of the social consensus or glue that is necessary, as Stiglitz reminds us, to the sustained economic development in any society. Social revolutions, and the transformations that accompany them, are caused not merely by an exacerbation of poverty. The key is to be found in the impact of sudden shifts in the pace of economic change or speed of modernisation on emergent social forces, be it an educated middle class, newly enriched farmers, or a vocal urban working population.

The future is not what it used to be

In the concerns of the present, the future is also often forgotten. The transition takes place in a rapidly changing world in which globalisation and decentralisation are powerful currents, neither easily denied nor ignored. There are other overarching currents too. Most important of all is the recognition that democracy as a political system is not merely a luxury for the rich industrial nations but a system of universal applicability. The 20th Century has been hailed as the 'democratic century'. Some have seen the arrival of democracy as a universal political system as the greatest achievement of the last century, a singular feat given the explosion of science and technology, which the 20th century exemplified.

With democracy has come the recognition of civic and human rights as a 'moral' right and not just as an efficient system for containing conflict and promoting economic growth. Freedom, rights and entitlements are no longer mere slogans to facilitate social engineering by a Weberian bureaucracy but a statement of non-negotiable values, a choice not only between provision and abrogation of rights, but a choice between right and wrong.

The flowering of 20th century democracy implies a core belief in the universality of civic rights, a view underscored by the Human Development Report 2000. Equality of status is a fundamental condition of democracy, a sentiment which permeates through our concern for the tortured, the discriminated, the poor and the excluded. The calculus of utilitarianism, used to weigh changes in marginal benefits to one group against the loss to another is a good tool for the pricing of commodities but is ignoble as an approach to social policy. Dahrendorf drives home the point thus:

“Entry tickets open doors but for those who do not have them these doors remain closed. In that sense, entitlements draw lines and constitute barriers. This means that in principle there is nothing gradual about them; half an entry ticket is no entry ticket. Rights of access may be more or less widely available, but as such they are clearly defined. Entitlements grow in steps rather than in linear fashion. There is in fact a sense in which they do not ‘grow’ or ‘decline’ at all, but are established or removed, given or taken away”

In Indonesia, the prolonged economic crisis and the outbreaks of social violence are gradually bringing home the realisation that Indonesia must manage a number of complementary transitions at the same time. It must recover from its worst crisis in half a century. It must do so while creating a revised system of government. New opportunities for the growth of civil society need to be provided. It must pay heed to the tide of popular expectations relating to both clean government and future prosperity from a reform minded public. It must ensure that disappointed expectations do not boil over into violent conflict, thus setting back the task of democratic consolidation.

Moreover, Indonesia has to do all this against a background of continuous integration of the global economy, bringing greater competition, potentially rising levels of economic inequality and diminished policy space for national governments. This space would also be redefined by decentralisation of political and economic power, itself symbolic of a righting of past ethnic and cultural grievances

Despite the historical parallels, this is a quite different canvas from the one Indonesia inherited in the late 1960s. In the political arena, the public mood is one of freedom and democracy, not of authoritarian discipline. Military rule as a system of

government has lost legitimacy. The cold war has ended. The balance of powers between different functions of the state is changing in favour of the legislature; increasing sharply the influence of public sentiment on public policy. Constitutional practice if not constitutional theory, is being changed on the ground. The same process of political de-concentration is underway in the regions. Local cultural and economic aspirations are openly exhibited in open conflict and in open demonstrations demanding accelerated decentralisation.

The economy has reached a particular threshold of industrialisation and diversity of output. Forty per cent of Indonesia's population or over 80 million people have made a new home in its cities. The majority of the population is literate and can be influenced by the popular press and media. A substantial segment of the urban population is in the formal labour force. The sharp increase in labour unrest in recent months shows that labour discontent is now being expressed in more organised forms than possible before. With the collapse of domestic industry during the crisis, the ownership structure of Indonesia's financial and industrial sectors is being redefined. The rapid substitution of private capital flows by external development assistance limits the range of policy choice and opens up Indonesian government decisions to external as well as domestic scrutiny.

The advent of democracy, as well as Indonesia's greater reliance on foreign aid, means that the days of expenditure allocation by dictatorship and decree are over. Competing claims cannot be settled by appeal to a single ruler. They must be fought for in the court of public opinion. Alternative options and reasons for policy choices are now the subject of detailed examination by Parliamentary Commissions, by regional governments and the newly empowered media.

Reworking Indonesia's miracle is therefore going to be much more difficult than simply regenerating its economy. This is partly because the public resources for containing latent social conflict, (such as oil windfalls, public subsidies for food and fuel, and INPRES grants) are much more limited. It is also partly because expectations have risen. It is difficult to defend the relatively low levels of public spending on social sectors in Indonesia compared to neighbouring countries while at the same time engaging in a wholesale bail out of large companies and banks. The

popular mood is captured in the following quotations from the Indonesian Bulletin of Economic Studies as follows:

“It is not surprising that the DPR responds to public pressure in opposition to increases in prices. The public are well aware that they will be called upon for years to come to bear the enormous costs of bailing out the banking system, whether in the form of higher taxes or reduced provision of government services. They also vaguely comprehend that many of the individuals who are responsible for these costs remain very well off. They correctly infer from this that an enormous wealth transfer is now in progress at their expense – whether to cover losses that should have been borne by those who undertook unsound investments, or to cover wilful default on a grand scale facilitated by a corrupt legal system. It is hardly surprising that members of the public resist paying more for fuel, electricity and public transport in such circumstances”¹

The future therefore cannot just be a reiteration of the past. Central to reworking the Indonesian miracle in the democratic polity of the future is the creation of a new social cohesion based on a set of rights based civic entitlements. Doing so is part of the regime shift designed to convince the ordinary citizen has an inherent stake in liberal democracy.

The art of managing a successful systemic transition is to be able to combine and channel mutually reinforcing strands of policy while at the same time generating a gradual rebuilding of social capital needed to bring credibility to the reform programme. It is difficult and uncertain art. There are no schools for the managers of transitions. The memory of the past, the expectations of the future and the economics of the present form the ever-changing kaleidoscope of the transition. Under these conditions, it is easy to oscillate between moods of optimism and pessimism. The Indonesian reform experience is an excellent example of this tendency, with both the domestic public and the foreign observer taking turns to first praise and then castigate Indonesian policy makers in their commitment either to pluralist democracy or a rules based market economy. To arrive at a balanced and informed view of the Indonesian management of the transition, awareness of historical precedent must be combined with an appreciation of the situation at the present.

III. The economic consequences of the crisis

When the present crisis hit Indonesia in late 1997, it was swift, unexpected, and devastating. All attention was focused on the immediate task of keeping the economy afloat. In the first, currency-collapse phase of the crisis, this meant an exclusive concern with macroeconomics. The currency depreciation had to be halted. The danger of runaway inflation had to be stopped in its tracks. This meant seeking out enormous amounts externally financed balance of payments support, mediated and monitored by the IMF.

As the macroeconomy was brought to heel, through rather draconian fiscal adjustment in the first year of the crisis, other problems of a more structural nature emerged. Recovery required a credible and viable banking sector. Indonesian banks lay saddled with bad debt. Their major clients, large conglomerates, faced mounting losses as the exchange rate plummeted. They had, in the years preceding the crisis, unwisely borrowed short in dollars and lent long in rupiah. These losses, made worse by the crash of the domestic market, rendered most debtors and associated creditor banks nominally bankrupt. Faced with such generic bankruptcy, structural reform moved to the cutting edge of policy. From the second half of 1998, bank recapitalisation and corporate restructuring became the order of the day.

Then came the political implosion. The performance of successive New Order governments could now be publicly assessed and criticised. This examination of past history revealed the fine inter-weaving of politics and economics under the ancien regime. Successful businesses had thrived on a three way collusion between the business entity, connected bank and the state functionary, under the instruction of a small and privileged political elite. As the result, standard rules of disclosure and due-diligence were turned into mere procedural formalities. Monopolies flourished. Potential competitors and recalcitrant workers faced the full force of political disfavour, legal sanction and old usage. These techniques, part of the armoury of authoritarian dominance, had matured over the long the years of the New Order.

¹ See Survey of Recent Developments by Ross Macleod, BIES, Vol 36, no 2, p.13.

Under such a political system, with no channels of complaint and robbed of the opportunities to establish wage bargaining structures, even urban consumers remained pliant and uncomplaining. In any case, channels of protest remained circumscribed. Golkar the government party was depicted as a Banyan tree of inter-dependent interest groups. Opposition parties, limited to two, were closely monitored and survived under fiat. The legal system had become a willing accomplice in narrowing the boundaries between public interest and private gain.

When the crisis struck in 1997, virtually every one in Indonesia seemed to be in private business. Every public function seemed to have been de facto privatised. The military and police generated over 70% of its revenue from non-budgetary sources. Civil servants and judges, doctors and teachers, the guardians of law and order, district heads and civil contractors had all combined to a hollowing out of government. Such pervasive rent seeking made the Indonesian State even smaller than it appeared in the official budget figures. Allowing for a 30% leakage in public expenditure reduced the Indonesian public expenditure to GDP ratio at the start of the crisis to around 13%. This was around one third of the average for OECD countries. As the enormity of the governance problem dawned, sometime in mid 1999, reform of institutions and the induction of good governance practices became the new development catchword.

The suddenness of the crisis meant not only a learning-by-doing approach to public policy. It also resulted in rapid stocktaking of the damage wrought by the financial storm. For the economic sectors this was reasonably obvious. It was signalled by the sharp fall of GDP, by the virtual halt of construction and by significant excess capacity in the manufacturing sectors. Assessing the social impact was, however, quite another matter.

Evaluating the social consequences of the crisis depended not just on knowing how the collapse of the production affected employment, wages and prices. This would have been hard enough in normal circumstances given that much of the population remained outside formal wage employment. There were other complications. Weekly working hours varied considerably. Different segments of the population consumed different baskets of commodities.

Even more critical was the fact that in a situation of economic distress, the social impact depended as much in knowing the various coping mechanisms actually employed by different households. These mechanisms themselves differed significantly across different regions and households. Sale of ornaments was often the first line of defence. Pawning consumer durables came next. Many migrated. Most returned and migrated again. In poor rural families dependency ratios increased. More and more people shared work on tiny family plots.

The urgent rush to assess the damage in the immediate aftermath of the outbreak of the crisis produced a large number of both macroeconomic, sectoral and social impact assessments. They were driven by the immediate concern of policymaking providing optimism to investors and assistance to the most impoverished households. They were thus unable to locate either the crisis or its social and political implications within the current of structural change already beginning to sweep the country from the beginning of the 1990s. Such analyses of the social impact of the crisis were therefore of little help in predicting what would actually happen to these underlying structural tendencies as Indonesia recovered from its prolonged recession. By the time such recovery occurred, the international economy would have become even more fiercely competitive.

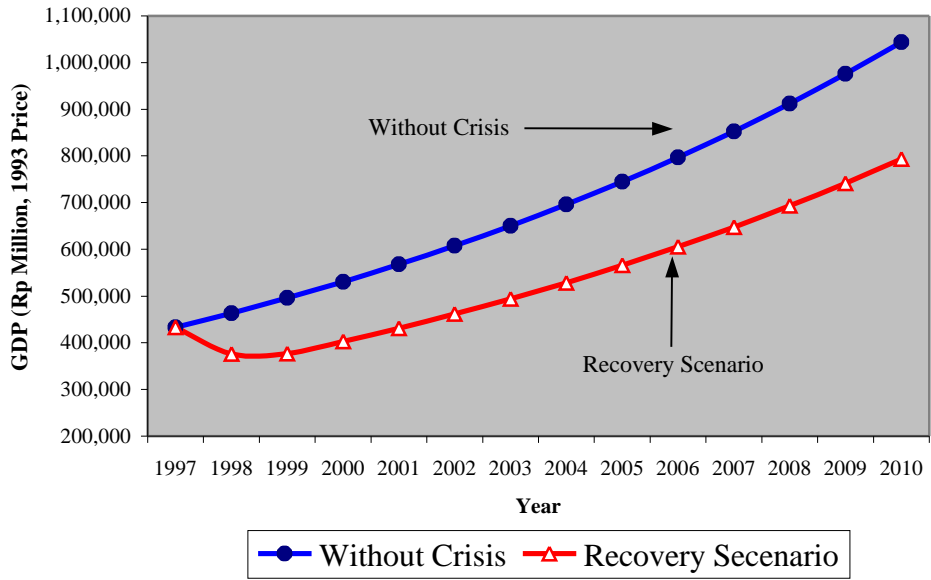
Studies of the social impact of the Indonesian crisis were not designed to raise other pertinent questions too. What impact, for instance, would the institutional changes, themselves dictated by the advent of democracy and new political freedoms, would have on public expectations. What new constraints would such changed expectations place on future social development policy?

Immediate issues of great moment: debt and bankruptcy, the confidence of investors, swings in the rupiah's fortunes, the surge or otherwise in unemployment, the numbers above and below the poverty line, and fiscal implications of decentralisation (as conceived in Laws 22 and 25 of 1999), the prosecution of the rich but corrupt, dominated economic and social enquiry after 1997. Crisis, not continuity, drove these assessments.

The effect on growth

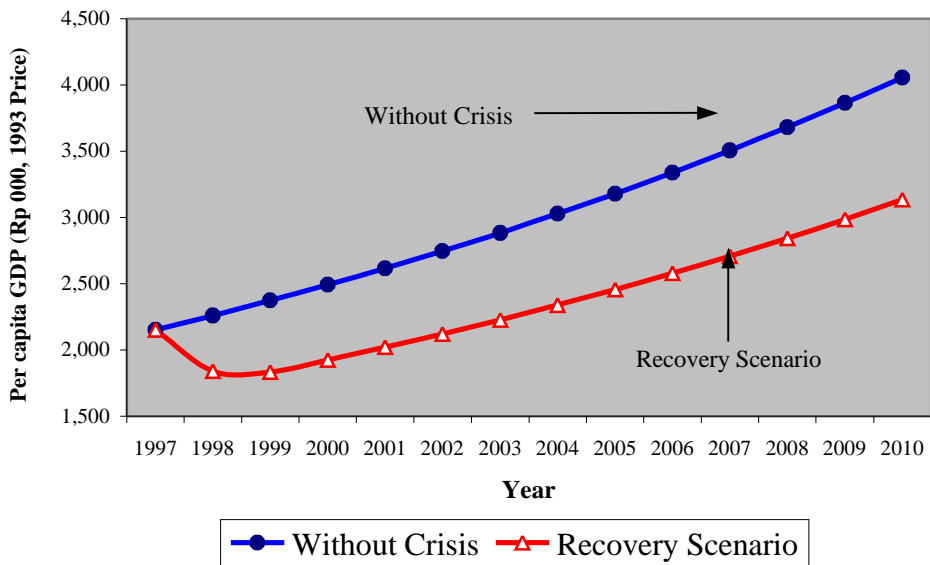
Indonesia was by far the worst affected economy during the economic and financial turmoil that swept the East Asian region in the late 1990s. The economy contracted by more than 13 per cent in 1998, about twice that of Malaysia and Thailand. The GDP per capita in real terms (in 1993 prices) fell from Rp. 2.2 million in 1997 to Rp. 1.8 million in 1998. This represented about 14.5 per cent decline in per capita GDP in just one year in an economy which was growing at an annual average rate of approximately 7 per cent (4.5 per cent per capita income growth rate) since 1967. The sharp decline in 1998 has cost the economy about 3 years of growth. The graphic impact of this crisis on the future path of the Indonesian economy is captured in [Figures 2 and 3](#). They show the projected trajectories of real GDP and real GDP per capita assuming that the economy was growing at an average annual rate of 7 per cent achieved prior to the crisis (1990-1997). Under the most optimistic scenario that the economy grows at the pre-crisis average annual rate, the projections show that the economy will be permanently below its potential. That is, it would have taken much fewer years to achieve any level of income had there been no crisis at all.

**Figure 2: GDP Growth Scenario
At 7 % Growth Rate (1990-97 performance)**



Source: Calculated from CBS data

**Figure 3: Per capita GDP Growth Scenario
At 5 % Growth Rate (1991-97 performance)**



Source: Calculated from CBS data

The crisis-induced economic contraction in Indonesia ‘...was larger than that which occurred in any years of the great depression in the United Kingdom, and was equivalent to two-thirds of the aggregate decline in the years 1929-32’ (Hill, 1999, p. 25, emphasis in original). The financial and construction sectors were the worst affected, contracting by about 39 per cent. Household consumption expenditure fell by nearly 3 per cent while government consumption dropped by 14.5 per cent. The decline in gross capital formation between 1997 and 1998 was about 41 per cent and that in changes in stock was 137 per cent.² This meant a significant weakening of the country’s future growth potential.

1998 was by far the worst year of the crisis. Growth recovered to around 0% in 1999 and is estimated to be around 3-4% for 2000. The World Bank reports that the recovery in 2000 is also broader based with all sectors except agriculture registering growth of output. Fixed investment is now growing faster than consumption. Both import and exports rose in 2000, the former supporting the view that recovery for the first time since the crisis is fuelled by fixed investment. High levels of excess capacity however, make precise evaluation of this investment impetus difficult.

The real problem in predicting the recovery is to assess where the new trend will settle. Forecasting investment flows in the next few years remains an exercise in faith. This is because it is difficult to make assumptions regarding future lending by the banking system. Moreover, while it is obvious that the currency and time mismatches of the past external borrowing on the private capital market are unlikely to be repeated in the future, it is difficult to predict how the composition of private capital flows will change with shifting perceptions about the robustness of the reform programme. Social instability and the uncertainties surrounding the business consequences of regional decentralisation mean that forecasting even direct foreign investment in the near future will not be easy.

² World Bank (2000) Indonesia: Accelerating Recovery in Uncertain Times.

IV. The social consequence of the crisis

Measured unemployment and wages

It is interesting that in Indonesia the measured unemployment rate, however, did not rise dramatically in the course of the crisis, despite such a severe output shock. This was perhaps due to the fact that in the absence of a social security or unemployment benefit scheme, those who lost employment in the formal and urban sector returned to the informal and rural sector. Estimates show that about 1 million people were added to the agricultural sector, which had been earlier declining over time. The sudden movement of a huge number of unemployed to the agricultural and informal sectors had negative repercussions on the agricultural wages and earnings of those operating in the informal sector and petty traders. Thus, although measured unemployment did not rise due to the crisis, the growth of nominal earnings was subdued.³

Added to this was the sudden rise of price inflation from about 6 per cent in 1997 to 58.5 per cent in 1998. With a slower growth in nominal wages, the surge in inflation meant a sharp decline (about 34 per cent) in real wages. In some parts of the country, the decline in real wage was very steep. For example, the real wage of industrial workers in Jakarta declined by about 45 per cent and that in the Surabaya area by more than 40 per cent. ⁴ The collapse in real wage was mirrored by a sharp increase in poverty.

Incidence and severity of poverty

Despite variations in estimates of poverty between various studies, there is general agreement that absolute poverty rose rapidly in the initial phase of the crisis. ⁵ The Central Bureau of Statistics (CBS) estimates show that the incidence of poverty rose from 19 per cent in February 1996 to 37 per cent in September 1998 at the height of the crisis. The increase in poverty in the urban areas was more marked than in

³ See Papanek (1999).

⁴ Papanek (1999, p. 3).

⁵ See Dhanani and Islam (2000, pp. 11-12) for details.

rural areas. The CBS measure of the poverty line is consumption-based, and hence is sensitive to the loss of purchasing power due to both inflation and recession. Once inflation was brought under control, the incidence of poverty declined to 23 per cent in February 1999 (see Table 2). But the incidence of poverty is likely to remain high so long as people at the bottom end do not find employment on a durable basis.

Poverty measured in terms of capability deprivations does not appear to have been affected by the crisis. For example, access to housing, safe water and basic health care and school enrolment did not change much during the crisis.⁶ However, it is too early to offer an assessment of the long-term consequences of the crisis on such aspects as health and education as it takes time for these effects to surface. If the incidence of poverty remains high, its long-term effects on basic health and education will be quite adverse.

Table 2: Transient poverty, 1996 – 1999 (% of population)

	1996 Feb	1997 Feb	1998 Feb	1998 Sep	1998 Dec	1999 Feb	1999 Aug
CBS ¹							
Urban	15.6	-	-	32.4	21.9	20.0	15.1
<u>Rural</u>	21.3	-	-	40.2	25.3	24.7	20.2
Urban + Rural	19.2			37.2	24.2	22.9	18.2
Author's Estimates							
Urban	18.0	16.2	23.6	30.2	29.8	33.0	25.6
<u>Rural</u>	41.9	37.6	48.6	52.2	51.1	55.0	43.3
Urban + Rural	33.3	29.7	39.3	43.6	42.8	46.3	36.3

Sources and Notes:

UNSFIR (2000), paper by Dhanani and Islam (Appendix)

However, the generally optimistic picture with respect to the fall in the incidence of poverty as inflation eased and recovery began needs to be qualified. Disaggregation of income distribution across households above and below the poverty line reveals quite another story. Relevant data is depicted in [Figure 4](#). Decomposition of the aggregate Gini coefficient, a common measure of inequality, across rural and urban areas and above and below the poverty line, shows two distinct trends. Income inequality above the poverty line in both rural and urban

⁶ See Dhanani and Islam (2000).

areas fell before and during the crisis. For households below the poverty line, however, it rose sharply.

The implication is the poorest of the poor households actually became worse off during the crisis. This is consistent with the finding that the poverty severity index registered a sharp increase during the early phase of the crisis. The Central Bureau of Statistics using a measure of the severity of poverty called P2, estimated this to have risen from 0.8 to 0.9 in urban areas and from 1.0 to 1.5 in rural areas between February 1997 and February 1999 (Figure 5). This is also supported by the observation that between February 1996 and 1999, the proportion of people falling below 65% of the poverty line increased by 66% compared to 48% for total households below the official poverty line. (Table 3) ⁷

⁷ Quoted in UNSFIR (2000), paper by Dhanani and Islam, p.13.

Table 3: Population below selected poverty Lines, 1996 – 1999 (millions of People, headcount ratio method)

	CBS Poverty Line				Authors' Poverty Line			
	Feb 96	Feb 99	Change million	%	Feb 96	Feb 99	Change million	%
<u>Below 65% of poverty line</u>	5.63	9.36	3.73	66	16.81	29.03	12.22	73
Urban	1.80	3.11	1.31	73	2.05	6.28	4.23	107
Rural	3.83	6.25	2.42	63	14.76	22.76	7.99	54
<u>Below 80% of poverty line</u>	17.86	26.33	8.47	47	34.86	56.95	22.08	63
Urban	5.06	8.98	3.92	78	5.97	14.72	8.75	147
Rural	12.80	17.35	4.55	36	28.89	42.23	13.33	46
<u>Below total poverty line</u>	37.66	55.78	18.12	48	65.12	94.86	29.74	46
Urban	11.09	19.12	8.04	73	12.67	26.62	13.95	110
Rural	26.57	36.65	10.08	38	52.44	68.24	15.79	30

Source: UNSFIR (2000), paper by Dhanani and Islam

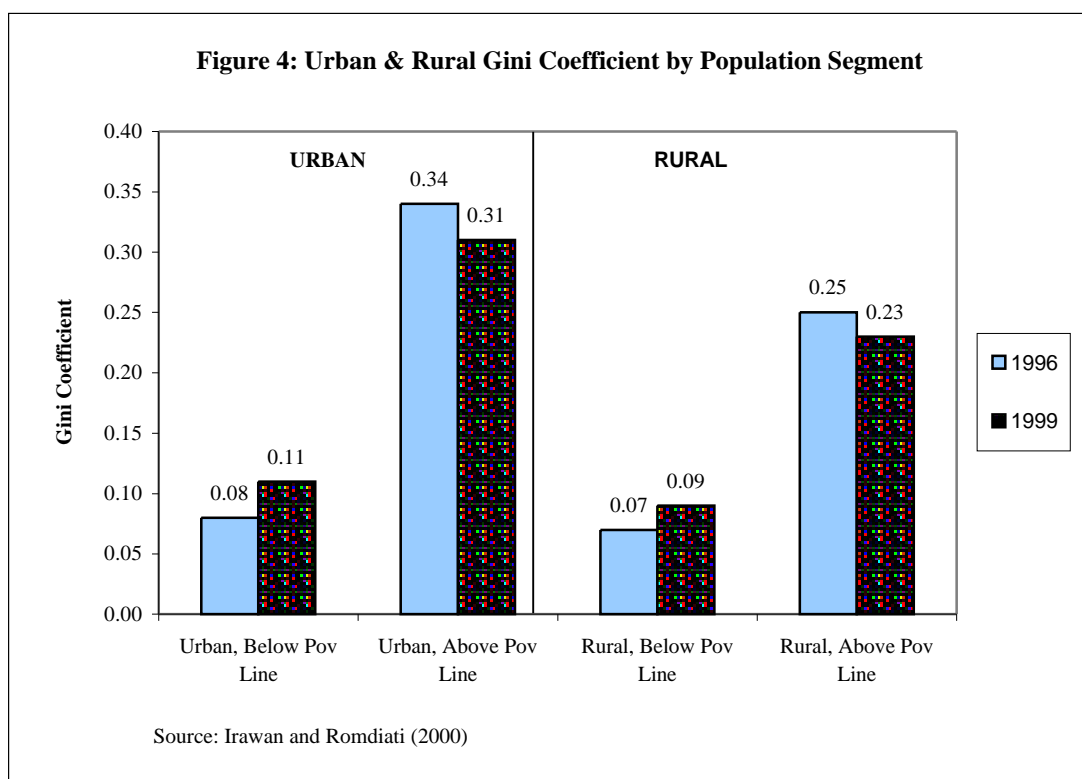
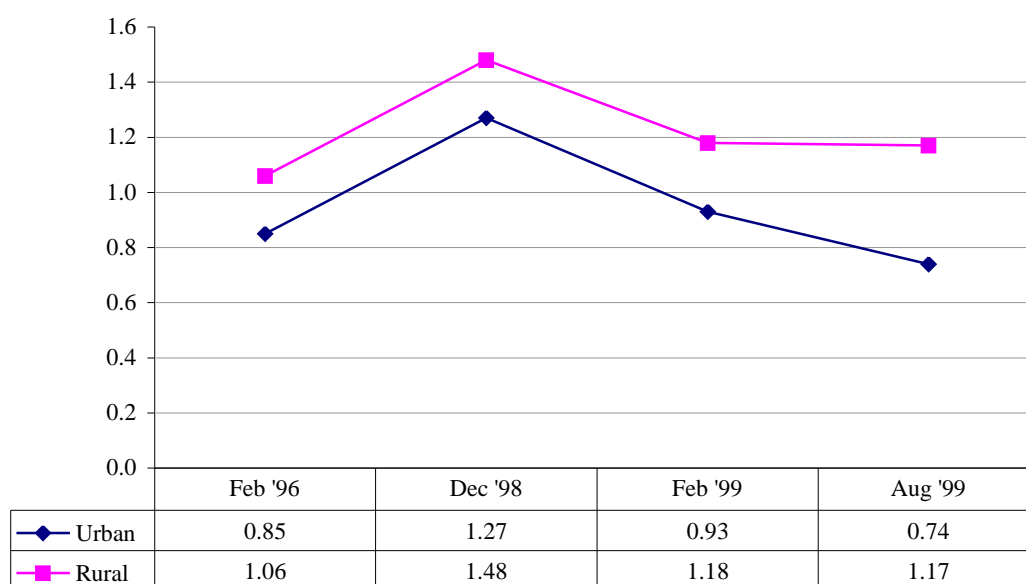


Figure 5: Trends in Poverty Severity Index (P2), 1996-1999



Source: UNSFIR (2000), paper by Dhanani and Islam

Attempts to measure the impact of the crisis on the poor have also been accompanied by debates over the best way to define and measure poverty. Some, such as the World Bank now refer to “vulnerability to poverty”. This reflects the fact that even households normally above the poverty line are likely to fall below it at sometime or another due to specific income or health related shocks. This concept is more in line with non-income concepts of poverty, which emphasise the importance of such factors as health, education and social protection for the poor on a continuing basis. Sustainable poverty reduction using the vulnerability criterion therefore requires a more comprehensive approach to the problem than the creation of a social safety net in times of crisis. The issue is of overwhelming importance for Indonesia since as much as 50% of all Indonesian households are expected to remain vulnerable to poverty in the foreseeable future.

Inequality and poverty

Changes in the degree of income or consumption inequality as a result of the economic crisis are crucial to the reworking of the Indonesian economic miracle. The reasoning is simple. Changes in poverty are negatively correlated with growth of per

capita income. They are positively correlated with a rise in economic inequality. Thus while growth is widely accepted as being good for the poor, it is also argued that "inequality is bad for the poor"⁸. An increase in inequality can therefore diminish the poverty reducing impact of economic growth. Recent research supports a strong relationship between growth and poverty with an elasticity of 0.87, computed using data for 72 countries. The same data found a much greater relationship between poverty and inequality, with an elasticity of 2.47. Similar calculations for Indonesia are presently unavailable. Yet, the Indonesian experience between 1987-96 would tend to support the same conclusion. During that period inequality rose and might have contributed to the slowing of the rate at which consumption poverty fell during the 1990s relative to previous decades.⁹

For any given rate of growth, continued reduction of consumption poverty will therefore depend on changes in the underlying pattern of income distribution. What happens to inequality is therefore central to policies aimed at reducing poverty.

Human capital during the crisis

Interpreting the effect of the crisis on human capital is not as easy as it might seem. These effects usually operate with a time lag. They require an estimation of the relative contribution of private and public investment in human capital and how these are likely to have changed during the course of the crisis. Changes in the quality of human capital provision have to be set besides variations in quantity. Shifts in public expenditure relating to human capital have to be examined alongside movements in complementary public services, such as investment in schools, hospitals and transportation.

⁸ UNSFIR Policy note by Islam and Tadjoeidin, November 16, 2000.

⁹ See Booth (2000) for an elaboration of this argument.

Education and health indicators

Despite these real income falls, the adverse impacts of crisis-induced poverty on non-income components of human development, such as the over-all school enrolment ratio or dropout rates, do not seem to be very stark in the short-run. Part of the reason seems to have been the success of the scholarship programme under which some 4 million students were provided assistance.

However, if one looks at the impact the crisis on the poorer and vulnerable sections of the community, a different picture emerges. For example, in poorer areas of Jakarta, enrolment of boys at grade one in primary schools dropped by 8.3 per cent and in the secondary schools by 14.4 per cent. The enrolment of girls in the secondary school fell by 19.4 per cent.¹⁰ The World Bank ¹¹also reports that the crisis-induced poverty has affected women and children more adversely than men.

Ministry of Education data also paints a dismal picture of the situation in the education sector. Ministry of education data shows that numbers of primary school teachers stood still after 1993/94 and has fallen during the crisis years. The number of teachers per primary school fell from around 8 in the years 1992/93 to 1995/96 to 7 after 1995/96. It was constant at around 20 to 21 in the Junior Secondary schools.

There is also evidence that part of the reason for low dropout rates was the willingness of mothers to undergo nutritional deprivation in order to keep children in school. This was in addition to the standard household coping mechanisms of selling assets. These have a clear finite end and would have weakened as the crisis continued.

Many women in the middle class who were once housewives were forced to look for jobs in household trade, massage or domestic service. There has also been an

¹⁰ World Bank (1999), "Impact of Economic Crisis on Basic Education in Indonesia", Watching Brief, Issue 2, January 1999, East Asia and Pacific Region.

¹¹ World Bank (2000d), Indonesia: Macroeconomic Update, released on September 18, 2000, available on the net:
<http://wbln0018.worldbank.org/eap/eap.nsf/CountryOffice/Indonesia>.

increase in prostitution. According to Jakarta based foundation, Yayasan Kusuma Burana, the red light districts absorbed 50 to 100 new comers every month in 1998.¹² There has been some increases in both female unemployment rate and child labour.¹³

Other studies also show disturbing findings which may have long-term negative consequences. For example, ILFS survey found that the proportion of adults using health services (puskesmas) fell from 7.4 per cent in the month prior to the crisis to 5.6 percent during 1998. The Survey also revealed that the proportion of children visiting public heath centres (posyandu) dropped from 26 per cent to 20 per cent and that of children under five years of age from 47 per cent to 28 per cent. This can be interpreted¹⁴ as a reflection of the drop in quality of services due to cuts in public expenditure rather than just of declines in affordability.

There is also growing evidence of the negative impact of the crisis on nutrition. For example, UNICEF assisted research shows that the prevalence of micro-nutrient deficiencies and wasting increased markedly in rural Central Java between 1995-96 and early 1999. The prevalence of wasting among children was found to be very high in early 1999 in the urban slums of Jakarta, Surabaya and Makassar. The prevalence of anaemia and night-blindness among children and mothers in both rural Central Java and the city slums also increased during the crisis and in the first half of 1999.¹⁵

Public coping mechanisms in education and health

These household coping mechanisms find a parallel in the coping mechanisms of government. The painful combination of a sharp fall in revenue and an explosion of debt service expenditure have had a serious impact on public expenditure on education and health. The World Bank's review of public spending in Indonesia in April 2000 reports that total realised public spending on education has declined both as a share of total government expenditures (7.7% in FY1996/97 to

¹² World Bank (1999), Gender Dimensions of the East Asian Crisis

¹³ See UNDP (1998).

¹⁴ See Stalker (2000)

3.9% in FY1997/980 and as a share of GDP (1.4% in FY1996/97 to 0.7% in FY1997/98). In the case of health, total realised health expenditures fell by 8% in real terms in FY 1997/98 and a further 12% in FY 1998/99.

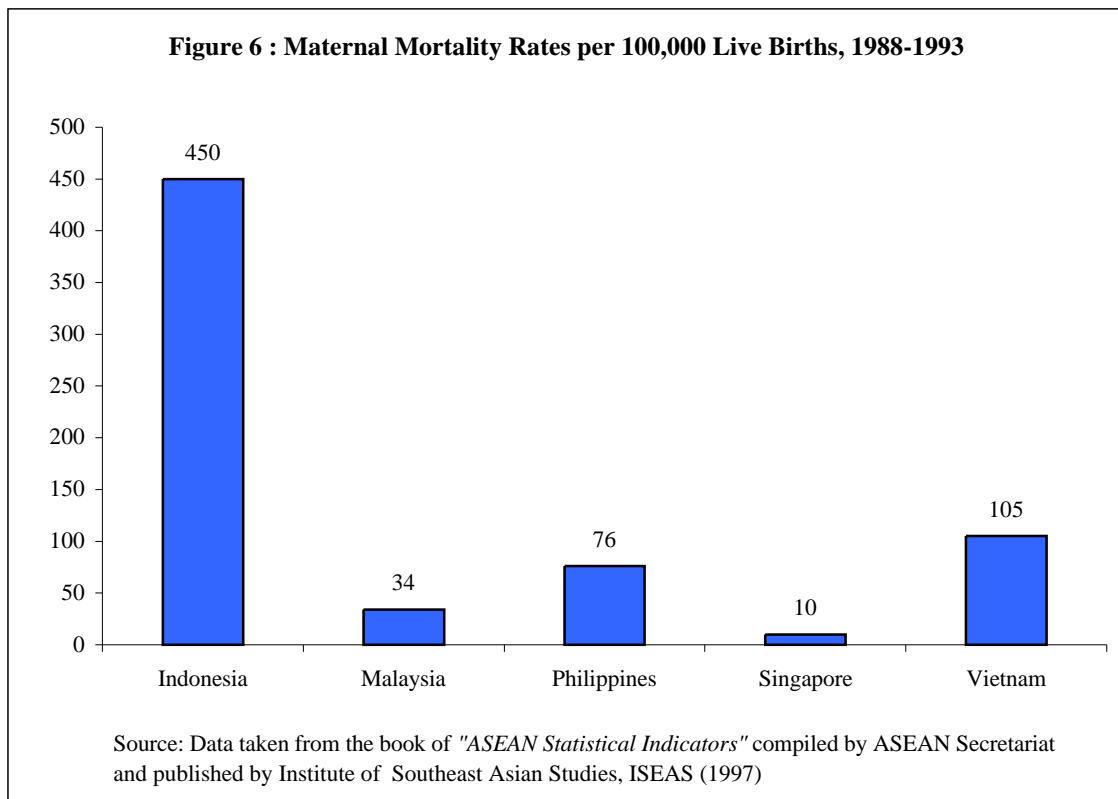
Private and public coping mechanisms in the field of health and education do not have symmetrical consequences. In the case of the former, minimum levels of expenditure are maintained at the cost of other consumption and by dissaving through asset sales. The result is a lower school dropout rate or incidence of serious illness than would otherwise have been the case. A fall in public development expenditure will reduce future access to education and health facilities as the per capita expenditure on these sectors and, the corresponding coverage per person, diminishes. A contraction of routine expenditure will affect both coverage and quality of service as schools and clinics suffer from shortage of essential materials, personnel are cut back and nominal wage increases lag behind inflation. Schemes such as scholarship programmes or social safety net related employment provision are very short-term methods of supporting essentially household coping mechanisms.

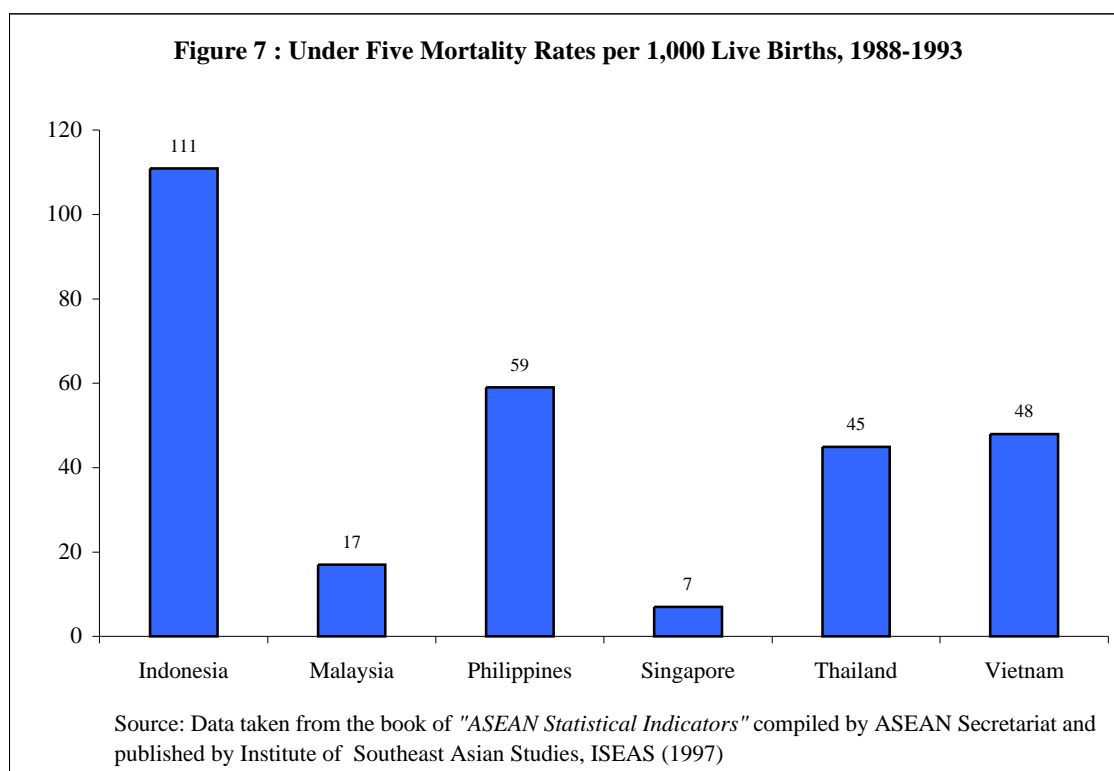
Public and private, household, resource allocation for human capital are in the final analysis not merely substitutes for each other. They play very different roles. While privately supplied services of public goods such as human capital is the practice in almost all countries, the responsibility of the state in providing basic education and health services goes beyond the calculus of the market. It is rooted in the civil rights based entitlements, which go to form the essence of democracy and the recognition of human rights, freedoms, and capabilities.

A rights based approach to development implies that some core values are non-negotiable. The right to a reasonably healthy life is one such value. [Figures 6 and 7](#) show just why a correction of public expenditure priorities to protect a minimum core for basic services in health and education is needed. Over a five-year period (1988-93) just before the growth momentum began to show signs of slowing down, maternal mortality in Indonesia stood at 450 per 100,000 live births. This was over 4

¹⁵ Helen Keller International (1999), cited in Dhanani and Islam (2000, p. 14).

times the figure for Vietnam, a much poorer country, and 13 times that in Malaysia. Under-five infant mortality was 111 in Indonesia compared to 48 in Vietnam and 17 in Malaysia. In Indonesia under crisis, the drop in realised public expenditures in health has to be seen in the context of such a dismal record of health outcomes.





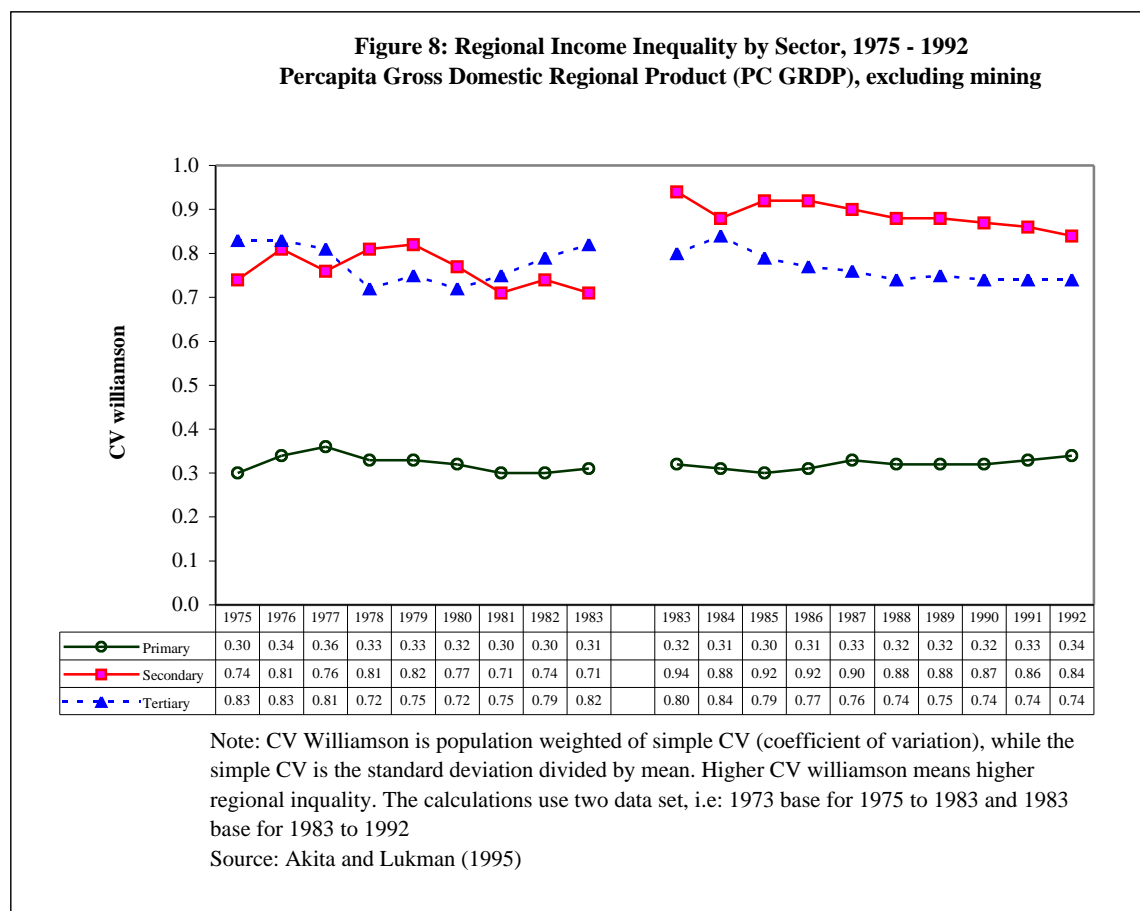
Economic inequality during the crisis: what remains of Indonesia's favourable initial conditions

What do these different studies of the social impact of the crisis on Indonesian society imply for changes in income distribution and human capital formation at the start of recovery? Has the crisis seriously undermined the two elements of Indonesia's economic miracle which might provide favourable initial conditions for a sustained reworking of its past achievements? When the dust on the myriad of studies on the social consequences of the crisis has settled, answers to the above questions are needed in arriving at a realistic view of the character, strength and sustainability of the recovery now underway in Indonesia. The emerging consensus on the above issues are summarised below.

SUSENAS data lead to the rather counter-intuitive conclusion that inequality in household expenditure has remained either stable or even declined in the course of the crisis. A possible explanation is that the bankruptcy of the urban industrial economy led to a compression of the upper end of the distribution. Hence, higher

income deciles experienced a sharper decline in expenditure relative to lower ones. As a result, Gini coefficients for household expenditure actually registered an overall fall from 0.36 in 1996 to 0.32 in 1998 and 0.33 in 1999.

On the other hand, inter-provincial disparity has remained remarkably stable during the crisis years. The CV Williamson index as 0.33 in 1993 and has risen to 0.35 in 1996. By 1999, at 0.32¹⁶ it had slightly moved from the pre-crisis peak. At first sight, this is a rather surprising result. The collapse of the industrial sector might have been expected to translate into lower inter-provincial inequality, if only because a high weight of the secondary sector would translate into higher inter-provincial variability in per capita income and expenditure. (Figure 8)



¹⁶ UNSFIR's staff estimation based on provincial average monthly non-adjusted per capita expenditure.

Table 4: Indonesia: Gini ratio of household expenditure across provinces,
1976 - 1999

No	Province	Gini Ratio				
		1976	1990	1993	1996	1999
1	Aceh	0.296	0.223	0.293	0.259	0.266
2	North Sumatra	0.276	0.248	0.295	0.301	0.269
3	West Sumatra	0.268	0.269	0.305	0.278	0.254
4	Riau	0.342	0.256	0.266	0.300	0.272
5	Jambi	0.289	0.228	0.242	0.246	0.255
6	South Sumatra	0.306	0.273	0.297	0.300	0.268
7	Bengkulu	0.306	0.259	0.281	0.273	0.275
8	Lampung	0.332	0.272	0.264	0.276	0.290
9	Jakarta		0.305	0.423	0.363	0.461
10	West Java	0.298	0.315	0.299	0.356	0.294
11	Central Java	0.314	0.286	0.295	0.291	0.266
12	Yogyakarta	0.372	0.353	0.331	0.378	0.336
13	East Java	0.334	0.300	0.325	0.311	0.291
14	Bali	0.227	0.297	0.315	0.309	0.281
15	West Nusa Tenggara	0.309	0.299	0.274	0.286	0.252
16	East Nusa Tenggara	0.375	0.296	0.254	0.296	0.283
17	West Kalimantan	0.318	0.284	0.302	0.300	0.269
18	Central Kalimantan	0.271	0.250	0.259	0.271	0.266
19	South Kalimantan	0.289	0.250	0.274	0.292	0.270
20	East Kalimantan	0.235	0.296	0.313	0.318	0.294
21	North Sulawesi	0.413	0.281	0.291	0.344	0.278
22	Central Sulawesi	0.377	0.270	0.287	0.302	0.296
23	South Sulawesi	0.354	0.296	0.273	0.323	0.282
24	Southeast Sulawesi	0.341	0.302	0.272	0.311	0.281
25	Maluku	0.375	0.269	0.300	0.269	0.288
26	Irian Jaya	-	0.328	0.363	0.386	0.437
Indonesia		0.353	0.321	0.335	0.356	0.352
Coeff. of variation (Std/Mean)		0.15	0.11	0.12	0.12	0.17
Coeff. of variation (Std/Mode)		0.16	0.10	0.12	0.12	0.19

Note: Figures represent Gini coefficient for household expenditure derived from Susenas

Sources: 1976 data from Islam and Hughes (1986), 1999 data from IHS (2000) and the rest from CBS

The constancy of the overall inter-provincial disparity during the crisis is, however, less of a puzzle when it is remembered that inequality decomposition for Indonesia shows that within sector inequality far outweighs between sector inequalities. This and the fact that much of the industrial sector is located in a single island, Java, would imply that the crisis did not witness a sharp change in the sectoral composition of regional GDP in the first two years of the crisis. Further evidence for this view is provided by the slow export growth till the second half of the year 2000. Since export growth, aided by currency depreciation, was expected to be located in natural resource intensive industries outside Java, there were few countervailing factors to the industrial decline in Java.

Some support to this hypothesis is contained in Table 4. East, West and Central Java all registered a decline in Gini coefficients with the largest decline occurring in West Java. On the other hand, Jakarta's Gini coefficient registered a dramatic increase from 0.36 to 0.46 between 1996 and 1999, although one would have expected the industrial collapse to have a significant expenditure reducing impact on higher expenditure brackets. One explanation could be the sharp fall in real wages of industrial workers such as to actually widen the income distribution spreads. Another could be in migration from surrounding cities to Jakarta which would have increased dependency ratios in Jakarta relative to other urban centres.

Despite these remaining conundrums, the overall picture with respect to income distribution trends in Indonesia is depicted in [Figure 9](#). The Lorenz curves shown there relate to district level data on per capita Gross Domestic Regional Product. Two conclusions emerge. First, inter-district inequality in Indonesia still remains relatively low at 0.41. Second, this drops significantly to 0.36 if oil and gas districts are dropped. If on the other hand 13 of the richest districts are eliminated the inter-district inequality falls to a very low level of 0.26. The implication is that even in the aftermath of the crisis Indonesia retains the favourable initial conditions it started at the beginning of its economic miracle in the mid-1960s and which it was able to largely maintain in subsequent years.

V. Social conflict as a crisis of expectations

Economic and social data show that economy is recovering. More slowly than it might, but steadily recovering nevertheless. This might be a reflection of some innate resilience of its people and its enterprises. It might equally be the result of a recovery of small and medium firms unencumbered by dollar denominated debt. It could be assisted by a recovery in neighbouring countries, a prolonged boom in the economy of the United States and a generally optimistic picture of global trading conditions. It is difficult to assign weights to each of these influences, but the general mood is that the worst of the crisis is over. Although somewhat of a relief to the Indonesian policy makers, it is only one of the important questions of the transition.

A critical issue in an understanding of the dynamics of the transition is the causes and cures of social conflict now raging in Indonesia. A simple linking of movements in economic and social indicators and the outbreak of violent social conflict will yield little by way of explanation. The economy is recovering. Poverty has fallen from its peak. School drop out rates are under control. The health situation is dire, but it has always been that way. In any case, under-nutrition and sickness is not the stuff of riots and conflict.

The statistics on social violence and conflict are notoriously unreliable. Definition is part of the problem. Criminality must not be confused with social conflict. Small outbreaks of frustration and stress should not be exaggerated and classified as major outbreaks of social conflict. Centrally orchestrated instances of violence designed to show the government in a poor light should not be classified as outbreaks of spontaneous resentment.

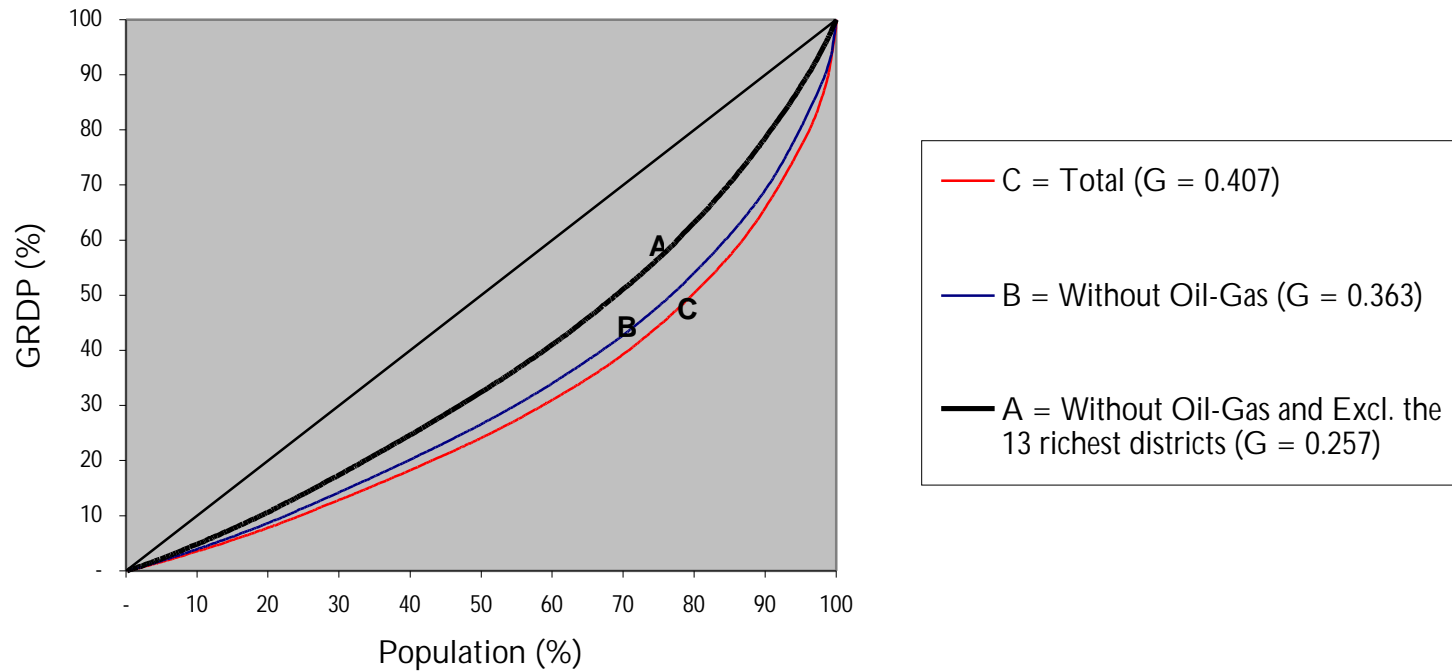
Despite these qualifications, the overall evidence points to an escalation of social conflict in this current transition to democracy relative to earlier periods (Table 5). Even allowing for a much expanded reporting of such instances of social violence due to the press freedom, the increase in the scale of social violence cannot be wished away as a statistical sleight of hand. Tables 5 and 6 provide a very tentative indicator of the scale of social conflict in the period of reformasi.

An increase in the incidence of social conflict in Indonesia, as elsewhere, is unlikely to be a direct reflection of the increase in poverty and destitution. These are contributing factors perhaps but hardly ever direct triggers. According to Huntington, the answer lies more in changes in expectations and in sudden shifts of the relative welfare positions of different groups. The roots of this conflict lie in the crumbling of old entitlements and expectations without the establishment of the new. They also rise in an attempt to right past wrongs.

Besides the obvious two-way link between the containment of social conflict and political stability, such conflict has significant economic costs. BAPPENAS estimates that the impact of social unrest on the economy of Aceh and Maluku was considerable. In Aceh the regional GDP contracted by 4.3% at a time when the national economy registered slightly positive growth. In Maluku, in the same year the regional GDP fell by 26.9%. In addition, domestic and foreign investment approvals also fell drastically in both provinces.¹⁷

¹⁷ National Development Planning Agency (2001), "The Indonesian Economy in the Year 2001: Prospects and Policies", p.24.

Figure 9: Lorenz Curve of Inter Districts Percapita GRDP,
at 93 price, 1998



Note: The figure indicates low regional Inequality of Inter districts Percapita GRDP (Gross Domestic Regional Product) if oil and gas products and output of the 13 richest districts (industry, trade, services and tourism enclave regions) are excluded from the analysis. This calculations use total 291 districts (excluding East Timor) that consist of 231 kabupaten and 60 kota.

Source: Tadjoeuddin, et. al. (2000)

Table 5: Social violence by category

Category of Social Violence	Regime						Total	
	Old Order (1945-65)		New Order (1965-98)		'Reformasi' Order (1998-99)			
	Freq.	%	Freq.	%	Freq.	%	Freq.	%
Community Vs Community ^a	30	46	72	46	97	74	199	56
Community to the State ^b	0	0	35	22	22	17	57	16
The State to Community ^c	0	0	34	22	6	5	40	11
State Vs State ^d	27	42	1	1	0	0	28	8
Mix	8	12	16	10	6	5	30	8
Total	65	100	158	100	131	100	354	100

Note:

^a Conflicts or violence between community groups (e.g. between ethnic groups, village, social class, indigenous vs. migrant, etc, for instance examples are present social conflicts in Moluccas and West Kalimantan).

^b Violence done by community to state institutions, e.g. the police office, parliament office, court office or other symbols of the state.

^c Violence done by state institutions (e.g. police, army) or other symbols of the state to community, e.g. implementation of DOM (military operation zone) in Aceh and Papua during 1990 – 1998

^d Conflict between state (centre) and state (regions) e.g. series of regional rebellions or separatism in 1950s (PRRI/Permesta in Sumatra and Sulawesi, NII (Indonesian Islamic State) in West Java, South Sulawesi and Aceh, etc).

Source: Djajadi (2000)

Table 6: Social violence since independence by type of violence and regime

Type of Violence	Regime						Total	
	Old Order (1945-65)		New Order (1965-98)		'Reformasi' Order (1998-99)			
	Freq.	%	Freq.	%	Freq.	%	Freq.	%
Riots	28	43	65	40	14	10	107	29
Damage	0	0	21	13	31	22	52	14
Engage in a gang fight	3	5	17	11	21	15	41	11
Military Operation	2	3	27	17	5	4	34	9
Internal War	2	3	2	1	20	14	24	7
Murder	12	18	2	1	9	6	23	6
Plundering	0	0	1	1	19	14	20	5
Coup	15	23	2	1	0	0	17	5
Sabotage	0	0	9	6	5	4	14	4
Others	3	5	15	9	16	11	34	9
Total	65	100	161	100	140	100	366	100

Source: Djajadi (2000)

VI. Conflict resolution and the consolidation of democracy

Social conflicts are traumatic events. They bring out the worst and the best in human nature. They demand an urgency of response. They focus attention on supplies and logistics, on counting the damage, on assessing the needs of post-conflict reconstruction. Until very recently, social conflicts, along with natural disasters and open war, were the almost exclusive subject for humanitarian concern and assistance.

Historic transitions bring an added dimension to the containment and resolution of conflict. The creation of a democratic polity is hard enough in times of peace. Old habits have to be changed. Rights of disagreement have to be respected. The drive for discipline must be tempered by the respect for human freedoms and rights. Persuasion must prevail over proscription.

The advent of democracy brings latent conflicts to the surface, almost as if it was itself an affirmation of new found freedoms. The journey from dictatorship to democracy is also a journey from latent to open dissent. Public reason, not public force, provides the distinguishing approach to social conflicts in stable democracies.

The fostering of public reason as the essence of social conflict resolution is intimately tied to the consolidation of a democratic polity based on public deliberation and bargaining between different interest groups. Theoretical writings on democracy point to the existence of alternative systems of democracy. Each particular choice implies a different approach to representation and a particular structure of democratic institutions. The question might be of only historical importance in mature democracies but is of great moment in transitions designed to foster new democratic systems.

An elitist view of democracy, for instance, favours the exercise of public control over the political process in the form of periodic elections where voter preferences are revealed in the changed fortunes of particular political actors. Establishment of such procedural democratic systems involves great attention to specifying the rules of the game within which group bargaining and mediation of divergent interests can be conducted. Deliberative democracy, on the other hand, conceives of politics not in the sense of Schumpeter as a place 'where gods and demons fight it out' but as a domain where citizens through a process of deliberation can arrive at a consensus on what constitutes the public interest. This is far cry from the elitist (or economic) theory of democracy which at best saw public deliberation as a necessary evil in mediating conflicting interests and at worst a blight on all rational decision making.

In the midst of a transition at the heart of which lies the redefinition of the very rules of the game of public policy making, the deliberative democratic model might well be the more effective choice. In so far as one of the most difficult tasks of any systemic transition is the transformation of an old but defunct social contract to a new implicit social contract, the recourse to public deliberation and reason might well be the only sustainable option. As Stiglitz says, such an implicit social contract, "necessary to a market economy, cannot be simply legislated, decreed, or installed by a reform government."

In democratic polities, agencies of civil society: political parties, the media, professional associations, trade unions, universities and the advocates of specific causes all coalesce into streams of thought and channels of negotiation necessary for the formation of a durable social contract. They constitute an essential part of the legitimising force of democratic governance, a convincing display of the use of public reason to define the common good. The interaction of state and civil society lies at the core of all functioning democracies because it is a living indication of a tolerance for disagreement. Taken to its logical conclusion it defines the dividing line between authoritarianism and democracy.

A peaceful resolution of social conflict in democratic transitions is contingent on two conditions. The first is to refrain from the use of military solutions to problems of peaceful dissent. The second is to use the armoury of civil society to arrive at an accommodation in which the losers remain convinced of the legitimacy of the system. An able judiciary can provide effective channels for dispute settlement but on its own remains of marginal significance in the construction of mutually satisfactory bargains. It can also contribute little to the definition of the public interest to which individuals or groups of individuals might be prepared to subordinate their private good.

In the context of a democratic transition, where control of social conflict purely or largely by military means is not a policy option, the governing institutions and conventions of democracy must provide the means of winning hearts and minds. Only then can violent conflicts be peacefully resolved. The point is put forcefully in the Secretary General's report to the General Assembly on 13, October 2000 emphasises:

"Democracy-related issues also lie at the heart of many United Nations missions today. That is so because democracy, or lack of it, is central to the root causes of many of today's violent conflicts, the majority of which are internal. Democratisation is central to a state building and peace-building exercise if peace is to become sustainable and post-conflict reconstruction and development is to succeed".

VII. Political parties and civil society in the consolidation of Indonesian democracy

The importance of civil society

In the ideologically polarised world of the 1970's and 1980s, support for civil society organisations in foreign aid programmes was part of the war against the predatory state. The state was seen as an instrument of social control and command planning. Rolling back the state and putting an end to 'dirigism' implied a strategy of state versus civil society.

With such a view of the state it was perhaps natural for investigations into the political processes and policy choices of Third World institutional structures to concentrate on understanding the political economy of economic stagnation and state intervention in the operation of markets. So focused was much of the work on the dynamics of failed states and distorted markets that they missed altogether factors affecting change and systemic transition. This was perhaps predictable if only because these theories assumed a centrality of individual self interest in political choices. Transitions, on the other hand, signal grand sweeps of history. At the very least, they represent collective frustration and resentment against the abrogation of basic human rights and freedoms by earlier regimes.

In most Asian economies, particularly in those affected by the crisis of 1997, however, command planning and a bloated state was not the primary problem. There had been directed credit, state managed industrial growth and considerable predation but these were balanced by prudent fiscal policies and open markets. In countries such as Indonesia where the economic crisis ushered a systemic transition, the political problem was not so much as rolling back the frontiers of the state but in ensuring that a diverse country could be credibly governed by a democratic polity without excessive reliance on military means. Central to this task was the encouragement of civil society institutions into political life and to solidify the prevalent public sentiment against rule by military force, even when it took the form of a benign dictatorship.

Political parties in the Indonesian transition

Political parties, which mushroomed after the fall of the Suharto government, played an instrumental role in persuading the military to retreat to the barracks and submit to civil political control. They were almost universally supported by new civil society organisations which sprang over night with the close of the New Order era. The formation of political parties, the establishment of organs of civil society and the reform of state structures towards more open and transparent systems of representation and administration thus became the central planks of a sustainable transition to a legitimate democracy. They also constitute powerful vehicles for the containment of social conflict in the future.

Seen in this light, weaknesses of Indonesian democracy are to be found not in the large number of political parties and unchecked rise in civil society institutions but in the fact that such structures still lack grass roots democracy which would make them representative of the segment of the public opinion they claim to represent. Studies of political parties in Indonesia show that many of the parties lack detailed manifestoes, that there are few opportunities for ordinary members to influence party policies and the electoral system used in 1999 restricted the growth of political parties from below. In addition, the absence of debate on key social issues such as the economy, secession and human rights at the time of the election meant that parties did not develop substantial proposals to address some of the common concerns of the day.

The result of such weak party formation is both that any government remains a government of individuals than a compromise between different, clearly delineated competing interests. Moreover, individual parties shorn of an agenda for action beyond their sectional interests, remain unable to bring the full weight of public opinion to bear on institutions of state, especially the state bureaucracy.¹⁸

¹⁸ This description by Feith of the weaknesses of the Guided Democracy has obvious relevance to situations where political parties remain weak and fragmented:
" This is not a government which can easily exert much weight of power. Many of its decrees are effectively ignored by those who are charged with their implementation. This is sometimes attributed to the ineffectiveness of its administrative machinery. But is more

The importance of effective political parties stems not only from the vantage point of the need to provide strong government. It also stems from the need to create a stable democratic system within which strong government can be exercised. As Dahrendorf puts it:

“Two processes constitute the democratic minimum, as it were. One is the input of popular views and interests into the political system, the other is the control of those in power and their administration. If either democratic input or democratic control are blocked a constitutional crisis ensues. The Democratic ideal is not the application of some nice idea or sweet dream. It is the most sensible way of making sure that change can take place without revolution.”¹⁹

Freely constituted political parties based on democratic principles of association are therefore essential building blocs of representative democracy. They reduce the likelihood not only of democratic reversals by providing strong government with clear sense of direction, but also prevent the subversion of democracy through the construction of “total institution”²⁰ where, as Max Weber warned, national bureaucracies constituted a “cage of bondage” for future generations.²¹

VIII. Navigating the storm: policies and programmes in post-Suharto Indonesia

In Indonesia, four years of economic crisis, social conflict and political evolution have brought home the lesson that different components of the transition need to be managed simultaneously if they are to be managed at all. The preceding discussion attempted to identify the most critical inter-linked tasks of the transition; the consolidation of democracy, the establishment of a rules-based economy and the

accurately described in the political elite’s cohesion, the heavy dependence of this elite on the bureaucracy as social class, and the great importance of inter-bureaucratic politics as a force for immobilisation of government” (See Herbert Feith (1963) “The Dynamics of Guided Democracy”, in R.T. McVey, ed. “Indonesia”, p. 408.

¹⁹ See Dahrendorf (1990), “The Modern Social Conflict: An Essay on the Politics of Liberty”, p.57.

²⁰ Hence the advent of “totalitarianism”.

²¹ For a more detailed discussion see Max Weber (1971), “Politics and Government in the New Order of Germany”.

peaceful resolution of social conflict all of which need attention together, because organically intertwined.

While the need to attend to several things together was obvious from the beginning of the crisis, such simultaneity was emphasised more within particular sectors than in the context of a systemic transition as a whole. Thus, while economic policy, as agreed with the IMF, always stressed the importance of linking macroeconomic policy with structural reforms, or with the ending of monopolies and price distortions, there was little more than a reiteration of the vague hope that rapid economic recovery would reduce political unrest and promote stability. Similarly, the early concern of the social safety-net policy was to mitigate the impact of the crisis on a few key variables such as school attendance, unemployment and food consumption. It was not to address broader issues of a rebuilding of badly damaged social consensus and capital.

The acute budgetary squeeze, reflected in the sharp contraction of development spending after 1998, led to a renewal of faith in traditional coping mechanisms. Hence, the unique role of gotong royong or self-help in community responses to the economic crisis went hand in hand with the espousal of civil society, especially yayasans or non-government organisations, as a more locally sensitive and less corrupt source of social assistance. The contribution of civil society generally, beyond that of the media, as conveyers of public discussion and opinion, in the deepening of democracy was realised much later. For much of the time, the term civil society was interpreted to refer to non-governmental charity organisations, and supported, either because the shrinking of government projects left no alternative or because less government was seen as tantamount to good government.

Political parties presented even more of a puzzle. On the one hand, the departure from the de facto one-person rule orchestrated by the Golkar combine was received with general relief. On the other, the uncontrolled eruption of a large number of parties without either political vision nor programmes was watched with disdain or apprehension. At times, it was interpreted as a repeat of the chaotic days, marked prolonged economic stagnation, of Indonesia's first democratic experiment in the early 1950s. While the absence of grass roots democracy in the

operation of parties was much noted, the critical role of the political party as a foundation for public education and decision making was often underestimated. There were also fears that too many parties would add to political instability and let military government in through the back door.

The scale, frequency and location of social conflict came as a surprise to almost everyone. The Suharto period had dealt with social conflict by a combination of military force, by co-option of local leaders into the Golkar machine and by manipulation and censorship of all non-government media. It had also tried to barter high economic growth for autocratic discipline. In return for social compliance, the public purse was turned into a giant cash machine to purchase political support, stamping in rent-seeking behaviour at all levels of society.

With the coming of "reformasi", things began to change. These changes began with the end of the New Order. They continued through the Habibie administration into the period following the 1999 elections²². They were widely regarded as piecemeal response to what were perceived to be urgent problems of the day. Principal among these initiatives were changes in the composition of parliament²³ (the DPR and the MPR), the end of *dwifungsi* in the armed forces and the appointment of a civilian minister for defence, the promulgation of two regional decentralisation laws, the establishment of a number of independent commissions to promote transparency and discourage corrupt practices, the ratification of the core conventions of the ILO, the abolition of press licensing system, the establishment of a commercial court and measures to reduce government control of the judiciary. Economic policy continued to be guided by the provisions of over 14 Letters of Intent signed with the IMF since the start of the crisis. This programme emphasised the importance of structural reforms in the banking and corporate sectors intended to resolve bad debt and bankruptcy problems. In the year 2000, the Parliament

²² These elections were contested by 48 parties, with an 88% voter turnout. Around 112 million people votes in over 300,000 polling stations. The UNDP played a critical role in mobilising donor support for the organisation and monitoring of these elections.

²³ For example, chapters VI and VII of the 1945 Constitution were amended by the MPR 2000 ending the appointment of military and police representatives in the DPR and provincial and district assemblies (DPRDs) starting from the 2004 elections. See National Democratic Institute (2000) for a fuller review.

converted a detailed statement of national economic and social policy, the Propenas, into law.

These reforms do not tell the whole story. There were a number of other less publicised achievements. First, the 1999 elections were free from widespread rancour and violence. The military did not intervene in the election process and the results were broadly accepted. Moreover, although the elections did not produce an absolute majority for anyone party, leaders of major parties found a non-violent solution to the election of President and Vice President.

Second, the period since the 1999 elections has witnessed the growing power of the legislature. This dilution of power from the presidency to the parliament was the result not of statutory constitutional amendment but of the evolution of conventions and working practices emanating from the day-to-day businesses of the parliament. As a result, the MPR now meets annually compared to every five years during the Suharto era. Commission 9 of the DPR is emerging as an effective watchdog body on economic and budgetary issues. The President has to win a vote of confidence in Parliament every year. Nominations for Supreme Court Appointments now carry a distinct stamp of the National Parliament.

Third, as already noted, economic growth is higher than expected. Indonesia has moved quickly away from the state of catastrophic output collapse in 1998. Currently, Indonesia is witnessing economic recovery on a broad front. This is notwithstanding the slow pace of structural reforms and the fact that large banks have been de facto nationalised under the control of the Indonesian Bank Restructuring Agency (IBRA). To its credit Indonesia has resisted the temptation to go the Malaysia route and restrict capital movements. It has also shied away from a protectionist economic policy stance, despite the short-term political appeal of such measures.

Fourth, changes in legislation do not capture the evolution of civil society organisations after the demise of the New Order.²⁴ Before reformasi, there were 289 newspapers and magazines. By September 1999, there were as many as 1687. Television stations increased from 6 to 11. Following the ratification of the ILO convention on freedom of association in May 1999, Indonesia now has around 94 Trade Unions and around 21 Labour federations. The two principal employers organisations APINDO and KADIN, prominent under the New Order, are now joined by a range of smaller business associations. Reformasi witnessed the rapid growth in civil society organisations, especially non-government organisations engaged in community development and advocacy. The total number of civil society organisations is now estimated to be over 10,000.

The end of the New Order has been thus a period of great ferment and innovation in Indonesia. No part of the country, no element of society, no sector of the economy, has been free from this spirit of change and evolution. The government and the governed, the army and the civilian, the centre and the region, the rich and the poor, Indonesian and foreigner are all party to the change which has swept Indonesian society with end of the New Order. The real question is how to interpret this change, how to decipher from its variety and movement the extent to which it advances the threefold objectives of the transition discussed earlier. Perhaps, of even greater moment is to map out what remains to be done in a number of strategic areas to further the aims of the transition and to forestall the dangers of reversibility of the democratic experiment now underway. As the National Human Development Report argues, democracy cannot be taken for granted. For instance, between 1900 and 1985 non-democratic regimes replaced democratic ones no less than fifty two times. Huntington counts forty-seven cases of democratic reversal by the end of the 1990s. It is worth recalling that in the South East Asian region alone, democracy was reversed in Indonesia, Philippines, Thailand and South Korea. Recent events in Fiji and Pakistan are good reminders of the fact that creation of democratic systems does not imply sustainability. To take effective root they need to be nurtured and consolidated.

²⁴ This section draws heavily from Indonesia's UN Country Team's draft "Common Country Assessment", November 30,2000. The draft was prepared by Peter Stalker based on contributions from a number of inter-agency theme groups.

The Indonesia attempt at systemic transition is not however an unqualified success. Ambiguity in design and lethargy in implementation continue to limit its progress. Constitutional reform is attempted piecemeal, as Parliament seeks to redefine its role with respect to other branches of state. A more direct attempt at constitutional reform, with greater public involvement, might be more suitable to the consolidation of democracy. Such an approach was tried in the early 1950s, and failed with the advent of 'guided democracy'. Both external circumstances and the public mood are different today. It is not a priori obvious that history is likely to repeat itself in the current context.

Judicial reform at best has been unconvincing if only because hesitant. The indirect approach to constitutional reform is part of the problem. Finding ethical and trained judges is another. In addition, there are gaps in the body of the law itself. Important areas of commercial law have only recently been put on the statute book. This, together with the widespread public perception of the economic crisis being caused as much by the mistakes of creditors as the recalcitrance of debtors makes the enforcement of bankruptcy procedures difficult. Attempts to keep public order and establish rule of criminal law lack credibility. An effective, non-military police force is still at the starting block. Money is scarce. The police are generally regarded as an instrument of extortion. The strength of its force and the quality of its officers are subject to large variations across different parts of the country. If that were not enough, the appointment of Chief Justice of the Supreme Court is now at the centre of disagreement between the Parliament and the President.

Decentralisation of political authority and economic decision making, once hailed as a foundation of democracy, is now regarded as perhaps premature and ill conceived. Indonesian decentralisation, which envisages deconcentration of authority from the Central government directly to 291 districts, bypassing the Provinces, has managed to fuel suspicions of insincerity. The regions want rapid decentralisation if only as a test of the Central government resolve. They fear that the current attempt at decentralisation, like previous attempts, might be a mere political mirage. Inadequacies in the law and the growing power of the local elite have made implementation difficult. Businesses continue to protest at the prevalence of

restrictive practices and rent seeking in many districts, often with the acquiescence of the military. The allocation of budgets and personnel to the regional governments remains mired in confusion. The sharp differences across districts in administrative capacity and local resources makes the task of rapid decentralisation even more difficult.

The growth of civil society, including political parties, so central to the working of a pluralist democracy remains haphazard. Often, these institutions of democracy themselves remain short on democratic practices. The significant volume of external aid channelled through non-governmental organisations, in a bid to hasten delivery and minimise corruption, has in many instances simply visited the limitations of national bureaucracies on voluntary organisations. In the great enterprise of building national democracy the requirements of local democracy are at times forgotten. The competition between poorly funded, locally elected authority and liberally financed voluntary organisation pose another threat to the consolidation of democratic decision-making and control.

The economy continues to be a mystery. Economic recovery is attributed not so much to progress in structural reforms but to its “natural recuperative powers”. Economic policy continues to emphasise the importance of foreign investment to economic growth. This implies a strong regard for foreign investor confidence. The current performance and future growth potential of the relatively debt-free small and medium enterprise sector remains unclear. Factors governing investor confidence, both foreign and domestic, across different categories of investor, remained confined to clubroom discussions. Vital though these are, they have yet to find a place in the analytical armoury of policy making.

Social justice in a new democratic age is the great concern of the day. But its conception and content in post-crisis Indonesia is yet to be defined. Poverty reduction is surely an important part of the story. But as already mentioned, it must be located within a more comprehensive framework of social policy, intended to address issues of relative social worth and justice. If not addressed explicitly they will continue to be addressed implicitly through the more direct instruments of social conflict and labour unrest. Economic crisis and political transmutation have

damaged social consensus. Social justice, encompassing poverty reduction, stands at the centre of its renewal.

IX. Managing transition in Indonesia: some basic interlinkages

Let us pull together the threads of the Indonesian story. Identifying the prime movers of the transition process is the key to identifying priority areas of support. It is necessary to arrive at a balanced view of the scope of the task being attempted and the time it might take. This balance is needed to avoid being deflected by volatile and fleeting shifts in market or political sentiment. The establishment of pluralist democracy after over a generation of authoritarian rule and of a rules-governed market in an economy grown used to the private misuse of public money is a complicated task. In most countries this has taken decades. In yet others, the early reform promise has been cruelly reversed. Staying the course, learning from the experience of history and other nations and understanding that such transitions are ipso facto messy affairs, constitute guiding principles for those who would attempt to inspire and guide historical changes of such magnitude.

The Indonesian situation is characterised by three sets of inter-locking factors. Indonesia needs to consolidate a legitimate democracy following from the elections of 1999. It needs to accelerate the pace of economic recovery based on an arms-length, non-discretionary, rules-based market practices. It must reduce the frequency and impact of social conflict by establishing credible channels through which group conflict can be peacefully accommodated. Taken together this implies the construction of an agenda for the transition and the creation of political incentives to win general public support for its most important provisions. The key to success is the fostering of public confidence, of which the confidence of investors, both domestic and foreign is only a small part.

It is obvious that all the factors are highly inter-dependent. Without a functioning democracy, of which the rule of law is but one component, the implementation of arms length rules for business will remain an uncertain if only in the sense that they can be overridden at will by powerful political elite. The eruption of political and social differences into violent conflict will damage the economy both

now and for years to come. It will also bring to question the benefits of democracy and provide political support to those segments of the elite who had equated democracy with little more than mob rule or dismissed it as a foreign fad, a luxury for the industrialised West.

The very interdependence of these pillars of the transition militates against both a segmented and a sequential approach to their execution. It is not only the ends but also the means which are highly interconnected. The promotion of civil society is not only an instrument for transmitting public opinion to the organs of state and influencing public decisions. It is also an effective means for diffusing social conflict as well as an instrument for providing assistance to those afflicted by such violence. The enactment of rules to improve competition and to guarantee a more ethical approach to business decisions is not just good for economic recovery. It also has a direct, and favourable impact on the curbing of corruption in public life. This raises the legitimacy of the new political system and lowers the incentive for the scrupulous and the corrupt to seek political positions as a means of self-enrichment. Recent studies on the link between democracy and economic growth have shown that the ability of democracies to resolve conflicts peacefully lies at the centre of the more stable growth performance over time in a large number of developing countries.

It is precisely the strength and the variety of such interconnections that makes completing a successful transition in short historical period such a difficult and unpredictable endeavour. A segmented approach to policy in such situations while easing problems of implementation serves only to increase the errors of design and formulation. Such mistakes, exemplified in the rush for privatisation in Russia, against a torrent of rising public expectations for social justice, can only lead to future reversals which reinforce the demands for a return to the familiar and the failed.

X. The Indonesian transition: opportunities for external assistance

The Indonesian systemic transition is difficult. It is historically specific. It reaches out to every citizen and every corner of the country. Its precise direction is

still to be firmly defined. Indonesia over the last four years is groping towards a peaceful completion of this most complicated of all journeys. At the end of this endeavour Indonesia will metamorphose itself from a dictatorship into multiparty democracy; from obsolete and decaying crony capitalism into a twenty-first century, globally competitive and socially just market economy. How can external agencies and donors assist in the birth of this new Indonesia?

One approach would be to err in favour of pragmatism and to push ahead with a series of small steps in whatever areas which showed promise and where local demands made themselves felt. In periods of great change and instability this approach has much to commend itself. According to this view the 'grand design' can be left to historical evolution. External agencies can only do so much. Hence, they should focus on where local leadership and immediate opportunity will generate the most concrete results. The agenda of reform can be accelerated in a series of small steps, pushed where necessary by the financial might of official assistance or by the determination of a few skilful reformists. Effective external assistance policy therefore reduces itself to a series of shifting alliances between individual actors and tight co-ordination across major aid providers.

The other is to think of transformations, such as that underway in Indonesia, as processes which by their very nature need design and direction; which involve explaining a convincing strategy and its most critical steps to the general public and which demand much time and much energy in execution. They also require constant monitoring of pace and progress; a continual affirmation that the democratic metamorphosis is not smothered by the dictates and alliances of the moment.

There is danger in taking either of these two broad approaches to the extreme. The first risks movement without direction; thus disillusionment and reversal. The second promotes idealism without practicality, fervour without results, slogans without application. This also creates disenchantment and disfavour.

Over the last four years, the Indonesian development experience has approximated the former of these approaches. Much ground has been covered along this road. Yet, both the direction and distance along the path to democratic

consolidation remains uncertain and unpredictable. Economic policy has come closest to possessing an overall, internally consistent approach. But that has failed to guarantee determined implementation. It could be argued that if such a comprehensive approach could not work in the economy, it would be even less effective in fields even less amenable to measurement and manipulation. Politics, culture, social conflict; the great moving forces of the transition cannot be reduced to models and classroom theorising.

As Sen argues, the universal appeal of democracy does not lie in its growth enhancing properties but in its ability to create an enabling environment for basic freedoms. The fact that democracy might also lead to more stable growth paths is an added advantage. That can explain its attraction but not its claim to be of universal application. The latter requires a return to fundamental values inherent to democracies. These values centre on the equality of status of each citizen and the universal provision of civic rights and entitlements.

Idealism and value judgements are therefore integral to the consolidation of democracies. The Indonesian transition cannot therefore only be a matter of convenient alliances and approaches. A fundamental anchor is needed. Civic rights and entitlements constitute this secure foundation. As it happens, without the essential attributes of pluralist democracy such as rule of law, right to public information and representative political institutions, rules-based market economies can neither be created nor sustained. The Indonesian situation demands therefore a mixture of idealism and practicality which must come from the best practices of stable democracies, the experience of other transitions and the preferences of the Indonesian citizen.

By July 2001, Indonesia would have entered the fifth year of an economic crisis, which set in motion the most far-reaching transformation in the memory of its citizens. The meandering of this transition cannot just be attributed to failure of political will or the presence of social stress and conflict. It is not enough to treat these as exogenous variables akin to a failure of the rains or some other natural disaster. It is time to put down our traditional development approaches, to realise that what is at stake in Indonesia is the birth of a totally new society, the evolution of

a new form of capitalism and a new accommodation between ethnic groups and religions carrying with them the memories of several centuries. Political will, dampening of social conflict and the recovery of the economy are interlinked endogenous variables. That is why we need to revisit the development design and learn from other transitions.

Democracies are people-centred systems. Growth is but a means. The end is an enlargement of human capabilities and freedoms. Discipline might be good for growth at fleeting points of history. But by itself such a slogan is little more than a cloak for authoritarianism and the containment of freedom. That is what people all over the world have rejected in the second half of the 20th Century. It is time to learn that lesson and help Indonesia stand firmly in the first wave of the new democracies of the 21st Century.

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