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ASEAN and G-20: Striking the Right Balance

The Strategic Balance in Asia: Cooperation and Competition

Boediono

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Indonesia has contributed to the development of ASEAN through important periods of its evolution and rapidly changing environment. This time the Chairmanship theme is "ASEAN Community in a Global Community of Nations". Mutual suspicions have continued to characterize relations among key powers in Asia and cooperation also has a strong undercurrent of competition. Indonesia and ASEAN believe that it is not in the region's best interest for any one power to become too dominant. ASEAN+1, ASEAN+3, ARF, EAS and other regional processes are mutually reinforcing. Indonesia places importance in identifying and ensuring the complementarities among these processes so that they will not only contribute to the strengthening of the ASEAN Community but also to peace and security in the region as a whole. In relation to the East Asia Summit (EAS), during Indonesia's chairmanship, one of our pre-occupations is in ensuring that the EAS, with enlarged participation, can contribute to the maintenance and promotion of a stable and peaceful regional environment. [Ed.]

Keywords: ASEAN, East Asia Summit, cooperation, competition, peace and security

G-20: The Economic Perspective from Developing Asia

Iwan Jaya Azis

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From the Asian perspective, rebalancing translates into two strategic goals: increasing intraregional trade and stimulating domestic demand. For the first, it is important for the region to dismantle any barriers to intraregional trade and to maintain the stability of intraregional exchange rates. Along with rising inflows of portfolio investment that put a strong pressure on exchange rates, this warrants exchange rate cooperation. But Asia is likely to shy away from a strong form of cooperation or other forms that require strong institutions. For the second, spurring domestic consumption in PRC and investment in other Asian countries are the priority. But the fast growing financial sector that so far supports the region's economic growth needs to be made more inclusive. The overall macroeconomic policy should be consistent with other efforts to reverse the widespread trend of increased income inequality and declining employment elasticity. For poor Asian countries, rising oil prices

adds to the seriousness of the problem, since they are also struggling to cope with the rising food prices that raise poverty and malnutrition rates. Growing and more confident Asia implies that the region will play a greater role but should also take greater responsibility on the global stage.

Keywords: G-20, intraregional trade, intraregional exchange rate, income inequality, employment elasticity

G-20 and Global Democracy

Maria Monica Wihardja

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The G-20 is expanding its agenda from financial and monetary to development and anti-corruption agenda. Is there a room for discussions on democracy at the G-20? Because of its political hodgepodge and divergent political views on democracy, let alone the boundless definition of democracy itself, the G-20 should avoid political discussions, including democracy, at the Summit because it may ruin the global economic cooperative spirit that the G-20 strives for. We propose that the Bali Democracy Forum is one possible forum to talk about democracy issues. What the G-20 can do is to promote "global democracy". We need "global democracy" because economic globalization has increased inter- and intra- inequality; national policies have cross-border impacts - both in poor and rich nations - but countries with small wealth-shares in the world economy are not fairly represented in global institutions; the IMF, World Bank, WTO, and other international financial institutions (IFIs) remain largely answerable to industrialized nations; many of decision-making processes of IFIs remain opaque. The G-20 should strengthen the democratic structure of international financial institutions (IFIs), including the appointment of head and leadership of IFIs. Financial regulatory reforms must also be pushed for. Cross-border regulatory coordination is needed. Lastly, it must ensure that the voice of poorer and poorest countries are fairly represented.

Keywords: G-20, economic globalization, democracy, inequality, global governance

Sustainable Development

The Impact of the Two Oil Booms of the 1970s and the Post-Oil Boom Shock of the Early 1980s on the Indonesian Economy

THEE Kian Wie

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This paper describes the two oil booms which the Indonesian economy experienced during the 1970s and the policy measures which the Indonesian government took to deal with these oil shocks. The first oil boom of 1973/74 was caused by the oil embargo which Saudi Arabia and the other Arab oil-exporting countries had introduced following the war with Israel in late 1973. The second oil boom of 1979-1980 was caused by the temporary closure of Iran's oil industry when a revolution broke out against the repressive regime of the Shah of Iran. This closure greatly affected world oil prices, since Iran was OPEC's second-largest oil producer and exporter after Saudi Arabia. In 1982 the Indonesian economy experienced a third external shock when the price of oil declined steeply as a result of the weakening of the world oil market. In response to the post-oil boom shock the Indonesian government took several

adjustment measures to restore macroeconomic stability. It also introduced several deregulation measures to improve the investment climate for private, including foreign, investors and a series of trade reforms to reduce the 'anti-export bias' of the trade reforms with a view to increase non-oil exports.

Keywords: Oil booms, post oil-boom shock, deregulation measures, trade reforms

Innovation Technology for Sustainable Development: A Case Study on Palm Oil Industry

Syafrizal Maludin

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Innovation technology (IvT) plays an important role to improve the quality of life. Changes as a result of dynamic and open atmosphere of innovation technology have influenced the socio-economic and environmental resources. There are consequences following the application of new technology in a sense of balance between economic growth and sustainable development. Modern population depends on many products of palm oil and its derivatives. Meanwhile, population has increased and the demand of product based on palm oil grows. Some international communities, NGOs, local citizens often claim that this sector is associated with many unjust practices such as the destruction of forests and peat lands. It also causes extermination of endangered biodiversity. This paper will illustrate an appropriate innovation technology, called the Triple Helix in New Balance Concept, which can be applied as a solution to sustainable development in palm oil industry.

Keywords: Innovation Technology, Palm Oil Industry, Sustainable Development, Triple Helix

War on Terrorism

Martyrdom, Galvanization, and Restructuring: Understanding the Impact of Osama bin Laden's Demise for the Evolving War on Terrorism

Kumar Ramakrishna

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This article suggests that the death of Osama bin Laden represents a genuine political, symbolic and operational success for the US and its counter-terrorist allies worldwide. Americans everywhere can rightly feel that justice has been served in light of Osama's hand in the horrific September 11 2001 terrorist atrocity in New York and Washington almost a decade ago. Osama's demise has also provided President Barack Obama with a genuine boost to his popularity with an election year coming in 2012. It should also be recognized that the demise of the Al Qaeda leader is also a welcome fillip to the morale of governments worldwide that are also struggling with Al Qaeda or similar terrorist networks themselves. Nevertheless it would be premature to declare victory in the global war on terror. In essence, Osama's death has catapulted him into the pantheon of figures such as Sayyid Qutb and Abdullah Azzam who are revered by violent Islamist terrorist networks globally. Hence Osama's iconic status is now unassailable, and his death will galvanize the increasingly decentralized Al Qaeda global movement into future attacks. In sum, Osama's demise has generated what we may call the Martyrdom Effect, the Galvanizing Effect and the Restructuring Effect.

Keywords: Osama bin Laden, Al Qaeda, Al Qaedaism, Internet, Anwar Al-Awlaki

Security and Democracy in Indonesia: The Need to Strike a Balance

Makmur Keliat

197-216

This paper seeks to address the following question: why do security problems, conceptualized as the problems of violence, remain critical in Indonesia? This paper argues that the problem can be attributed to the incapacity of state to maintain its monopoly on the use of force. This arguably could be attributed to the ignorance of Indonesia's civilian political elite that fails to link 'democracy' integrally with social justice and rule of law. Practicing democracy minus social justice and the rule of law is a symbol of a weak democratic state. Only with the presence of a strong state could democracy go hand in hand with social justice and rule of law. Without the State's positive intervention to protect the weak sections of the society, and without the staunch support of the society to the rule of law, it is most likely democracy as a form of government might eventually provide a fertile ground for violence. It is plausible that civilians unable or unwilling to strengthen the role of the security actors to deal assertively with violence is not only related to the traumatic experience of the New Order, but also a possible a deliberate attempt to maintain a balance in their favor. [Ed.]

Keywords: Security, Democracy, Conflict

Review of Developments

Security and Governability Challenges in Indonesia

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The Strategic Balance in Asia: Cooperation & Competition

Boediono

As you know, Indonesia is currently the chairman of ASEAN and will shortly be hosting the 18th ASEAN Summit in Jakarta. Indonesia has requested to bring its ASEAN chairmanship forward from 2011 to 2013, not only because in 2013 Indonesia will also be hosting the APEC leaders' meeting, but hopefully also to allow us sufficient time to ensure that all of the necessary preparations are put in place for the realization of the ASEAN Community in 2015 and beyond.

Indonesia has contributed to the development of ASEAN through important periods of its evolution and rapidly changing environment. You may remember that two key agreements, Bali Concord I of 1976 and Bali Concord II of 2003, were reached under Indonesia's chairmanship. Through the Bali Concord II the member states of ASEAN agreed to the development of an ASEAN Community with three pillars, an ASEAN Economic Community (AEC), an ASEAN Political and Security Community (APSC) and an ASEAN Social and Cultural Community (ASCC).

This time the Chairmanship theme is "ASEAN Community in a Global Community of Nations". As the chair, Indonesia will endeavour to strengthen ASEAN's position as part of the solution to global problems by addressing three levels of priorities which reinforce one another:

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*This is an edited version of his keynote address at
The Asia News Network Seminar in Jakarta, April 26, 2011.*

1. To ensure the achievement of significant progress towards the attainment of the ASEAN Community. We will do this by continuing and building upon past achievements, and by identifying and forging new areas of cooperation in the three pillars. We will also continue to address issues of particular concern for region;
2. To ensure the evolving regional architecture and environment remain conducive to the pursuit of development in the region. A part of this is to ensure that ASEAN remains in the driving seat in shaping an expanded East Asia Summit as well as strengthening ASEAN's other partnerships with dialogue partners.
3. To chart a post-2015 vision for ASEAN whereby there will be a more cohesive ASEAN role in addressing global issues.

Indonesia's first priority as Chair of ASEAN is to ensure that the member states of ASEAN meet the commitments that have been laid out in the three community blue prints. In particular we want to ensure that the development towards an ASEAN Community will continue to adhere to the spirits, norms and principles contained in the ASEAN Charter. The Preamble of the ASEAN Charter clearly stipulates: "Adhering to the principles of democracy, the rule of law and good governance, respect for and protection of human rights and fundamental freedoms".

The Indonesian government has made it a matter of national policy that the evolving ASEAN Community is truly people-centered and people-oriented. After all, what is a community without the people being at the centre? In assuming the chairmanship of ASEAN the Indonesian government has, therefore, actively encouraged and sought the participation of the business community, academics, the media, NGOs and the wider civil society in various ASEAN-related activities. If we are really serious about creating an ASEAN Community by 2015, we must all work hard to change the image of ASEAN as an elitist and mostly inter-governmental organization, to one which is truly owned and cared for by the larger community of ASEAN peoples.

Within the political-security pillar, Indonesia has brought its transition towards democracy to ASEAN. With the Bali Concord II in 2003 and its ASEAN Political-Security Community Blueprint, Indonesia puts the promotion of democracy in ASEAN's agenda. Indonesia's ef-

forts to promote democracy are also reflected in the wider region, such as with the biennial convening of the Bali Democracy Forum, which is consistently attended not only by most ASEAN member countries but also by many other Asia Pacific countries.

Indonesia has also continuously pushed for the promotion and protection of human rights. The ASEAN Charter has adopted human rights and humanitarian laws. With Indonesia's insistence, ASEAN has established the ASEAN Inter-Governmental Commission on Human Rights (AICHR), the first human rights commission in the Asia Pacific.

In the economic pillar, ASEAN is establishing an ASEAN Economic Community that has four characteristics: a single market, a competitive economy, integration to the global economy and equitable development. The four characteristics must all receive equal attention.

The key point is that if we really want to create a cohesive community of ASEAN, our endeavors for trade liberalization and single market must be balanced by serious attention to equitable development. Therefore, among Indonesia's prioritized areas is the enhancement of development cooperation among ASEAN members, one such cooperation is between ASEAN's SMEs. At the same time, ASEAN's integration to the global economy suits well with the theme of the Chairmanship. ASEAN's representation in the G20 and the intention of the Chair of the G20 to meet with ASEAN Leaders are among the reflections of this trend.

Indonesia will continue the work to strengthen the caring and sharing community under the socio-cultural pillar. Among others, Indonesia is pushing for cooperation in education, health and disaster management. The establishment of the ASEAN Humanitarian Assistance (AHA) Centre in Jakarta is expected to increase the efficacy of the provision of humanitarian assistance by regional and international actors when disaster strikes.

Now I would like to turn to the second priority of the Indonesian chairmanship, namely to ensure a conducive regional environment and ASEAN's centrality in the evolving regional architecture. May I remind everyone here that this priority is not of Indonesia's own making, but is also mandated by the ASEAN Charter which states that one of the purposes of ASEAN is: "To maintain the centrality and proac-

tive role of ASEAN as the primary driving force in its relations and cooperation with its external partners in a regional architecture that is open, transparent and inclusive". Indonesia is firmly committed to ensuring that ASEAN will be in a position to play the kind of regional role that it aspires to, first by enhancing its capacity and credibility to act together, and second by skillfully managing its relations with major neighboring powers.

Asia is home to several large powers whose interests have collided in the past. With the Cold War well behind and the imperatives of globalization as well as the common transnational challenges now confronting all countries, many former enemies have increasingly developed close cooperation on many fields. Yet mutual suspicions have continued to characterize relations among key powers in Asia and cooperation also has a strong undercurrent of competition. Indonesia and ASEAN believe that it is not in the region's best interest for any one power to become too dominant.

A stable and peaceful regional environment is essential for the pursuit of economic development and social process. The Treaty of Amity and Cooperation in the Southeast Asia is the code of conduct for relations in the region. The TAC is gaining recognition from outside the region with some countries express its intention to accede to the TAC.

At the same time, the multifaceted, multidimensional and yet interlinked and constantly evolving nature of the security challenges in the wider East Asia Region defy national solutions. ASEAN must take a leading role in molding the wider region's response to the aforementioned security challenges through wider regional forums. In this regard, ASEAN+1, ASEAN+3, ARF, EAS and other regional processes are mutually reinforcing. Indonesia places importance in identifying and ensuring the complementarities among these processes so that they will not only contribute to the strengthening of the ASEAN Community but also to peace and security in the region as a whole.

In relation to the East Asia Summit (EAS), during Indonesia's chairmanship, one of our pre-occupations is in ensuring that the EAS, with enlarged participation, can contribute to the maintenance and promotion of a stable and peaceful regional environment. This can be achieved through the maintenance of a "dynamic equilibrium",

whereby emphasis is placed on win-win solutions and the absence of one or a few dominant actors. Further, Indonesia envisions the development of a sense of “community” among the EAS participants. The emphasis is placed on the notions of common security, common prosperity and common stability. With such notions and common vision in place, peace and stability are ensured.

Finally I would like to touch briefly on free trade agreements of FTAs. There are several reasons for the growing FTAs both between an individual ASEAN country and others or between ASEAN and another third country. These include (i) Deepening of production networks through FTA-led trade and investment liberalization; (ii) Need to improve international competitiveness through exploitation of scale economies; (iii) a Defensive response to European and North American economic regionalism to improve competitiveness and raise voice on global trade issues (iv) act as Insurance against the slow progress of Doha. I know there is still dispute in theoretical discourse, but in reality FTAs are seen as complementary building blocks to continued multilateral liberalization and WTO-plus scope.

The biggest challenge lies in political economy both domestically and regionally, as well as geopolitical considerations in moving forward on further and bigger economic cooperation like ASEAN+3/+6. Whichever road is taken, integration should be deepened and domestic reforms pursued.

No country can afford to remain isolated from the growing trend of economic interdependence and integration without suffering losses. On the other hand, we must also recognize the differences between countries and ensure that all necessary measures must be taken to prevent the growing gap between more competitive and less competitive economies. I must say that Indonesia in particular needs, and is resolved, to work much harder to improve our national competitiveness by eliminating bottlenecks, improving infrastructure, rooting out corruption and improving bureaucratic effectiveness, among others.

At the regional level as the economies of the ASEAN countries are becoming more integrated there is also a need to harmonize or introduce rules and laws on regional level. There are still a lot of works to be done in this area.

Once the ASEAN Community is realized in all the three pillars, or significantly so, then ASEAN will undoubtedly be able to make a much greater mark within the Global Community of Nations through its greater ability to take collective action based on a common regional platform.

G-20: The Economic Perspective from Developing Asia

Iwan J Azis

Global Imbalances

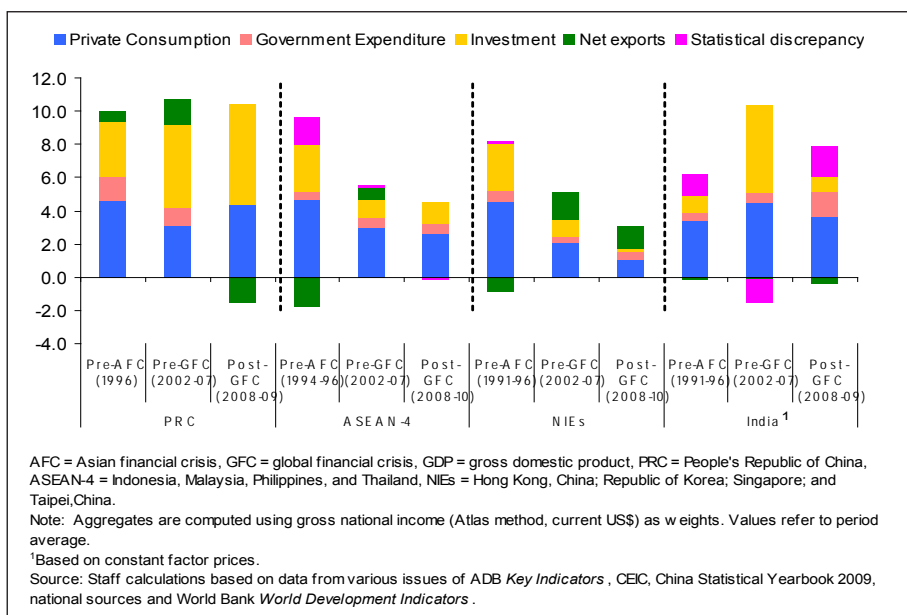
As the most dynamic region in the world, Asia has an important role to play in shaping the G-20 agenda for balanced and sustainable growth. This requires Asia to help provide global public goods and to rebalance the global economy. From the Asian perspective, rebalancing translates into two strategic goals: increasing intraregional trade and stimulating domestic demand.¹ This is particularly relevant for East Asian countries. In the last few years, the region's trade pattern has been characterized by increased intraregional trade of intermediate inputs, while trade of final goods is mostly with industrial countries. A production network has emerged in a big way, where multinational companies can lower the cost of production by taking advantage of the proliferating free trade agreements (FTAs) in the region.

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¹ Iwan J. Azis, *Crisis, Complexity, and Conflict* (London: Emerald, 2009).

After the recent crisis, such a trade pattern cannot be sustained; alternative markets need to be found as the demand prospect from industrial countries becomes more uncertain. The alternative that makes sense is the region itself. For export-oriented economies, shifting entirely from external to domestic demand does not make sense, while for other economies, strengthening domestic demand is critical. Raising consumption should be the priority for the PRC, and raising investment is the most important challenge for the rest of Asia. Since early 2000, a major source of growth in most countries except the PRC has been private consumption, not investment (Figure 1). This has caused the saving–investment imbalance to widen.

Figure 1: Sources of GDP Growth, Expenditure Approach—Emerging Asia
(percentage points)



Why the low investment? Since the Asian crisis, most investors in the region have turned cautious and more conservative. The “usual suspects” also persist, i.e., institutional constraints, a less than favorable investment climate, and limited infrastructure. On the other hand, saving remains high and growing. Households in developing economies have strong precautionary motives to save, for, among other rea-

sons, a lack of formal social safety nets. The corporate sector also has a high propensity to save because of various kinds of uncertainties. It is ironic that excess saving occurs when the region badly needs financing for new and improved infrastructure.²

Growing demand in industrial countries and low supply elasticity in the US mean a strong growth of exports and continued trade surplus in export-oriented economies. This contributes to the widening of global current account imbalances. In terms of size, the imbalance is largest between the US and the PRC. Trade of the PRC with other Asian countries is generally in deficit, while imbalances of Asia excluding the PRC with industrial countries and the US are relatively small. Thus, the role of PRC is critical as far as Asia's contribution to global imbalances is concerned.

An easy money environment was one of the important sources of global imbalances that fueled the recent crisis.³⁶ The fear of deflationary pressure associated with falling asset prices after the Asian financial crisis, the tech bust in 2000, and the looming Iraq war, prompted the Federal Reserve to adopt an accommodative fiscal and monetary policy that caused not only excessive spending and a credit boom, including one in the housing market, but also raised US imports, particularly from Asia (see Azis, 2009). This exacerbated the already large US current account deficit caused by the growing fiscal deficit, especially since early 2000. The resulting appreciation of Asian currencies—albeit not all are fully flexible—and lower returns in industrial countries brought most capital back to Asia. Hence, a round-tripping pattern was established with high transaction costs. Market intervention by most Asian authorities then caused further accumulation of foreign re-

² ADB (Asian Development Bank) and ADBI (Asian Development Bank Institute), *Infrastructure for a Seamless Asia* (Manila: Asian Development Bank, 2009).

³ In its final report, the congressional commission of 10 members formed to investigate the causes of the crisis concludes that it was the result of "human action and inaction, not of Mother Nature or computer models gone haywire." The report clearly singles out the Federal Reserve for backing "30 years of deregulation." The report also points out that the IMF did appropriately stress the urgency of addressing large global current account imbalances that risked triggering a rapid and sharp decline in the dollar that could set off a global recession, although it failed to link these imbalances to the systemic risks building in financial systems (Source: FCIC (Financial Crisis Inquiry Commission), "Conclusions of the Financial Crisis Inquiry Commission," 2011, available at www.fcic.gov/report/conclusions).

serves.⁴ From this perspective, to deal with global imbalances, policies directed toward lowering the US fiscal deficit are as critical as other measures.

During the crisis, global current account imbalances actually narrowed as world trade volume also fell. Asia contributed to this encouraging trend: trade began to diversify, with intraregional trade expanding to include more Asian countries, while exports to non-Asian emerging markets increased as well. The current account surplus in many countries started to fall, and the largest source of growth was domestic demand. The PRC's 12th Five-Year Plan also put a strong emphasis on rebalancing demand toward domestic sources, particularly consumption. There is, however, no reason to believe that this trend of declining global imbalances will continue. The growth of global trade, which showed a V-shaped recovery in 2009–2010, has started to slow. Many forecasts also predict that global imbalances are likely to grow in the coming years.⁵ This is worrisome because the current recovery in many countries is fragile. From the recent crisis we have seen the severe damage that growing imbalances can create.

Rising oil prices raise further concerns, although G-20 can actually resolve this matter in a more coordinated way since its members include both the world's largest oil producer and world's largest consumer. During the past decades we have seen several episodes of oil price increase and their impact on the world economy. Unlike in the past, however, the surge of oil prices that began in the fall of 2004 did not result in a major economic slowdown; at least not in any of the G-20 countries. In oil-importing economies, the demand-driven nature of the oil price shock counteracted its adverse repercussions.⁶ But the impact of the current oil price increase may be different. It may be more serious because many economies have just started to recover

⁴ With rising costs of keeping a large amount of reserves, some Asian governments set up and use government-controlled investment companies to manage a portion of official foreign reserves to adjust portfolio composition.

⁵ IMF, "Global Economic Prospects and Policy Challenges," prepared for the Meeting of G-20 Finance Ministers and Central Bank Governors, 2010, available at <http://www.imf.org/external/np/G-20/pdf/060410.pdf>.

⁶ Most countries in Asia are net-oil importers, intensive in energy use, and are relatively inefficient in energy use; in some countries, however, the share of oil in total energy use is not that large.

from the most severe crisis since the Great Depression, and because the recovery in Europe and the US is still fragile.

For poor Asian countries, this adds to the seriousness of the problem, since they are also struggling to cope with the rising food prices that raise poverty and malnutrition rates. Ironically, in many agriculture-based economies, rising food prices do not necessarily translate into higher incomes of farmers, that is, the farmers' terms of trade does not improve. While there may not be much that can be done to deal with the supply-side shock (weather-related), a policy reform in food production and distribution that will ensure the pass-through of food price increases to farmers' income can be proposed as part of the G-20 development agenda.

Intraregional Trade and Exchange Rate Cooperation

The impact of a sharp fall in world trade during the crisis was particularly severe in export-oriented economies such as Japan, Korea, PRC, Malaysia, Singapore, and Thailand. Industrial countries including the US are important markets for their final goods exports, whereas intermediate goods are imported from other Asian countries. This pattern of trade has been one of the characteristics of the production network that has spread across East and Southeast Asia.⁷ Although industrial countries made assurances during the London G-20 Summit that they would keep their markets open, it would be ill-advised for Asia to continue relying on markets in industrial countries for their final goods exports. With demand falling from the slow-growing industrial countries, intraregional trade in final goods is expected to increase. It is therefore important for the region to dismantle any barriers to intraregional trade.

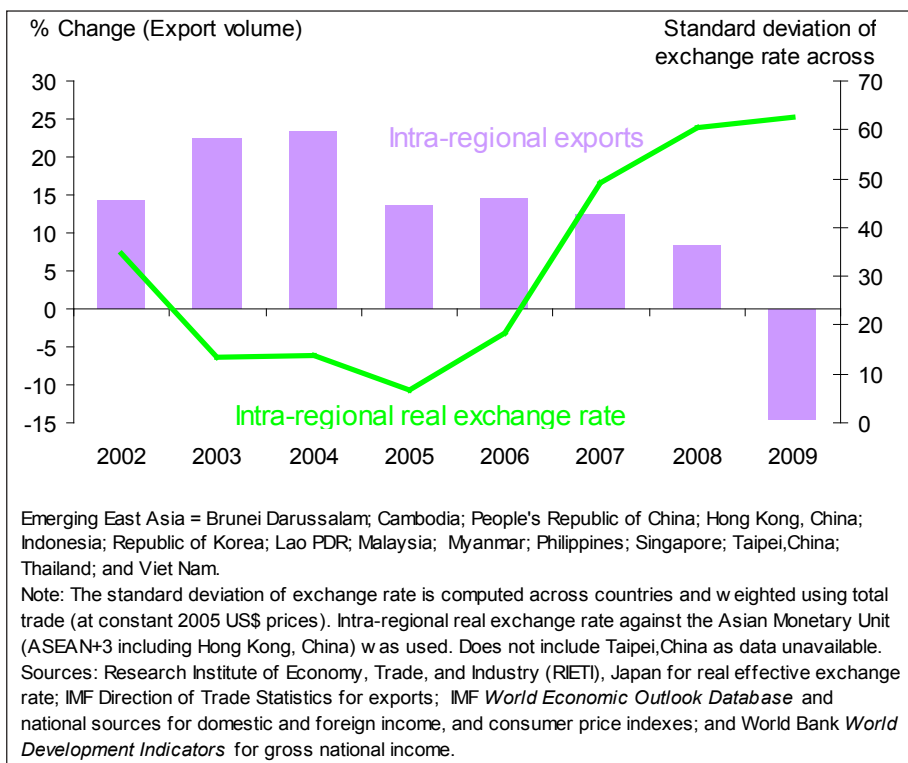
A scenario where PRC consumers can take up lost US demand for products from Asia is unlikely in the short run. Freer trade among Asian countries is the only reasonable solution that will simultaneously deal with the problems of global imbalances. Here, the proliferation of FTAs among Asian countries is helpful.⁸

⁷ This production network has played an important role in forging the region's productivity.

⁸ Although some agreements that cover all Asia are still elusive, and in some cases the pace of implementation remains questionable.

No less important is the stability of intraregional exchange rates. Evidence has shown that stable intraregional rates can help foster intraregional trade. After Lehman's collapse, intraregional rates started to become more volatile and intraregional trade fell (Figure 2).⁹ External forces that are also at play caused volatility to continue. The second round of quantitative easing by the US Federal Reserve, aimed at preventing a possible deflationary spiral at a time of fiscal policy paralysis, is adding more pressures for capital to flow out from the US. Even before this second round was announced, interest rates in the US and

**Figure 2: Intra-regional Exports and Exchange Rate—
Emerging East Asia**

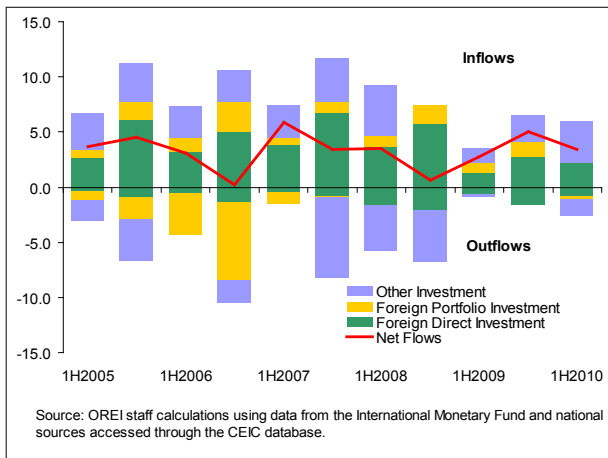


⁹ Greater intraregional exchange rate stability can also help reduce policy tension. It is, however, to the region's advantage if flexibility of their currencies against non-regional currencies is maintained. The flexibility is important for managing external shocks and further capital flows.

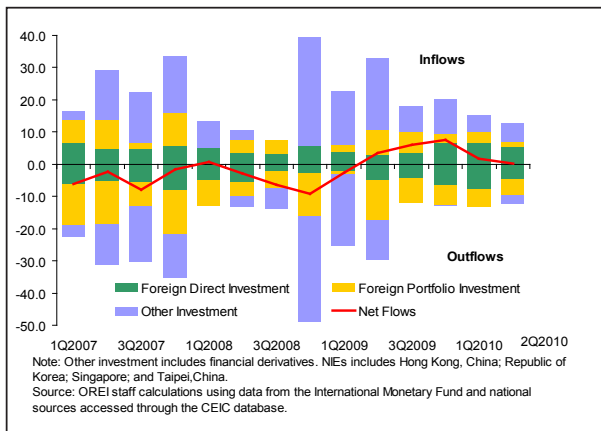
other industrial countries were already low, triggering a wave of capital outflows. A substantial amount of them flowed into emerging Asia with its high returns, robust growth, stable macroeconomic conditions, and strong currencies. As shown in Figures 3a, 3b, 3c, and 3d, after dipping sharply during the crisis, capital has returned to the region. Even in net terms, the trend in ASEAN-4, the newly industrialized economies, and India showed a marked increase of inflows right after the crisis.

Figure 3: Financial Account Flows
(% of GDP)

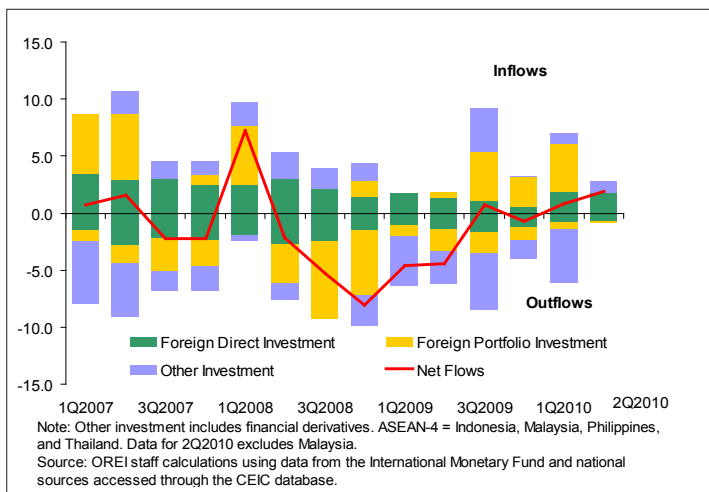
a) People’s Republic of China



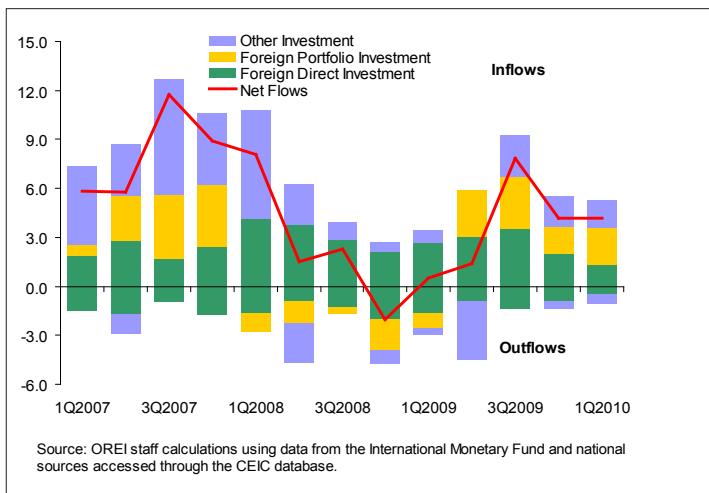
b) ASEAN-4



c) NIEs



d) India



While the composition of capital flows varies across countries, rising portfolio investment put a strong pressure on exchange rates. The resulting dollar depreciation (Asian currencies' appreciation) led many countries to respond by either imposing capital controls or conducting exchange rate intervention. This makes efforts to maintain stability of intraregional exchange rates more difficult, but at the same time it

opens up the possibility of policy coordination. Indeed, some countries in ASEAN+3, supported by the ADB, have initiated a series of discussions and policy dialogues on this issue.

The spillover effects of unilateral capital control, and awareness that it can potentially create distortion, also reinforce the need for cooperation. The fear of a sudden stop (as in 1997) is another source of concern. But the difficulty in finding an acceptable modality of cooperation due to the diversity of exchange regimes and associated political sensitivity may have put off any formal arrangement from emerging. A classic case of the prisoner's dilemma thus prevails.

Because the PRC's trade balance with most ASEAN countries is in deficit, a scenario of simultaneous exchange rate adjustment through cooperation will also make the realignment of the Yuan easier. It may be more effective than pressuring a country to adopt a particular exchange system. Indeed, economists are not always in agreement as to what exchange rate system is best to adopt. While globally there has been a trend of increasing number of floaters, it remains unclear how to determine the extent to which a currency deviates from its equilibrium level. Appropriateness of a particular regime depends on each country's conditions. The exchange rate system in Asia is diverse, ranging from a floating Japanese yen to a currency board system in Hong Kong, China (others are in between). Equally ambiguous is the precise definition and level of equilibrium exchange rate. While some currencies may be undervalued, the type and the extent of intervention considered acceptable remains a gray area. In the past, the IMF often supported efforts made by industrial countries to coordinate their monetary and fiscal policies that could alter the exchange rate in the name of maintaining global financial stability.¹⁰

While exchange rate cooperation is warranted, Asia is likely to shy away from a strong form of cooperation or other forms that require strong institutions (such as monetary union or common currency). The recent sovereign debt crisis in Europe made the benefit of having such arrangements doubtful. Also, Asia does not have a good track record

¹⁰ At least the IMF does not place any obligations on those countries when they conduct such efforts.

of institution-heavy economic cooperation.¹¹ But there is still a whole spectrum of options to select, ranging from a basket system that can be designed to avoid the “N-1” problem, to Bretton Woods–like systems where countries directly peg their currencies to each other and let them float jointly against other currencies, say, the US dollar (similar to what happened in Europe before a common currency was adopted and managed by a supranational body, the European Central Bank). The rates against a regional basket such as the Asian Monetary Unit (AMU) can also be used as a reference zone, certain deviations from which will trigger some policy measure. The lightest form of arrangement would be simply to enhance policy dialogue among member countries, for example through the existing Economic Review and Policy Dialogue forum. After the Chiang Mai Initiative was multilateralized in early 2010 (to become CMIM), finance ministers of ASEAN+3 made a decision to establish an independent surveillance unit, the ASEAN+3 Macroeconomic Research Office. This marks the region’s first step toward institutionalizing financial cooperation. It is likely that exchange rates and capital flows will be part of that office’s surveillance analysis, along with other macroeconomic issues.

Another related source of concern is the declining value of the US dollar. Many Asian countries worry that rising commodity prices and a soaring US deficit to pay for stimulus can lead to higher inflation that will undercut the value of their US dollar-denominated reserves. The PRC and Japan are the largest holders of US Treasury bills. No wonder on several occasions PRC officials questioned profligate US spending habits. It is in this context that ideas were floated that Asians either need their own currency or should adopt a currency basket to replace the dollar. Actually such a proposal was raised right after the Asian financial crisis, but the recent trend may have strengthened its rationale—and it may quicken the process. Looking at currency movements in selected Asian countries, over the last few years reliance on the dollar has been declining, and the role of other currencies, including the yen and Yuan, has increased. This occurred without any announcement about a basket system. But to move to the next step, closer policy coordination is obviously needed.

¹¹ Even during the recent crisis, the Chiang Mai Initiative was not used.

Through the G-20, Asia can learn from the experience of other G-20 countries—in Europe in particular—in policy coordination and exchange rate cooperation. By realizing the differences between the two sets of economies, lessons can be learned as to what policy direction to take, what not to take, and what needs to be done. The speed and nature of each stage and the components of cooperation can be studied, and when found relevant to the Asian context, they can be emulated.

Domestic Demand and Interactions with Development Issues

From Asia's perspective, giving a more prominent role to development issues in the G-20 agenda, as decided at the Seoul Summit, is commendable. One of the G-20 development initiatives highly relevant for Asia is financial inclusion. Through the Financial Inclusion Experts Group, nine Principles for Innovative Financial Inclusion were announced at the Toronto G-20 Summit. The principles, from leadership to regulatory framework, are intended to form the basis of a concrete action plan for improving access to financial services for the poor, details of which were released at the Seoul Summit. Two broad agenda have been selected: access through innovation, and finance for small and medium-sized enterprises.

But G-20 also covers other development issues, many of which are relevant for Asia as well. Most governments in Asia realize the need to strengthen social safety nets, including pension and health insurance programs; speed up the development of physical infrastructure to reduce supply bottlenecks; and raise investment for more sustainable long-term growth, such as energy efficiency, renewable and clean energies, green transportation, and quality-of-life services (health care and sanitation). All these are not inconsistent with rebalancing. Strategies have been discussed and designed, measures have been taken, and some may not be the most optimal and their implementation may face many bottlenecks, especially when macro and fiscal policy is inconsistent with more development-oriented measures such as these. Still, any strategies and policy measures (including those directed toward lowering global imbalances and mitigating their impact) ought to be linked with the ultimate goal of welfare improvement. The effectiveness of those policies needs to be evaluated based on indicators that go beyond the narrow macroeconomic and financial sector.

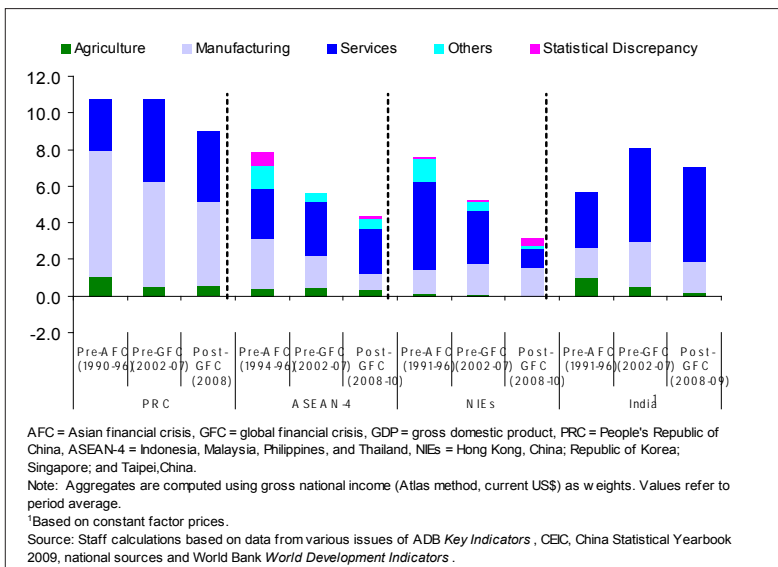
Indeed, while development issues are diverse and by themselves deserve attention, little has been done to understand the interactions between these issues and macro-financial-trade measures in the context of Asia's efforts to rebalance. Thus, exclusion of the poor and small and medium-sized enterprises from financial services, issues of the environment and climate change, income inequality and poverty—all of which are so critical in many G-20 countries—should not be seen only as the consequential impact of macro-financial measures that will be subsequently countered by some compensating policies (such as financial inclusion). Yet this practice is common, instead of attempts to reassess the respective macro-financial policy and explore an alternative that will ensure inclusion.

Interactions imply two-way directions. A proactive rather than reactive approach suggested above is not only preferable in terms of cost-effectiveness, but it can also preclude any possible negative feedback effects. For example, a deteriorating environment due to an unsustainable pattern of development in many Asian countries can have an adverse impact on the supply and productivity of many sectors in the economy, and it can contribute to the increase of food prices, commodity prices, and inflation in general. Rising inequality across any country in Asia is likely to have an adverse impact on growth, hence its sustainability. The mechanisms of this can work through at least three channels: uncertainty caused by greater social instability, insecurity due to lack of property rights, and rent-seeking practices that can raise transaction costs and so dampen growth. Although the impact may not be felt in the short run, when output growth falls, so will household income, including those in the low-income bracket. When inflation rises and a food crisis looms, poverty incidence tends to increase.

Excess saving and the link between financial sector development and broader development issues is another noted example. According to flow-of-funds data, most countries in Asia have excess saving in the sense that total saving exceeds actual investment in the real sector. This excess largely goes to financial assets, both abroad (foreign reserves in US treasuries) and at home (equity, bonds, and other securities). As a result, economic growth is strongly supported by a growing financial market. This is also consistent with the information from national income accounts where the financial sector is recorded as one of the

major sources of growth, along with domestic trade and other services (Figure 4). Except during the Asian financial crisis, this pattern has been persistent and self-reinforcing, as incentives to invest in financial assets continue to exceed those to invest in the real sector. Although this may foster overall growth and financial sector development, it fails to provide sufficient employment opportunities. This can spell trouble in some countries in Asia where the labor force is growing fast. Consequently, an unchanged rate of output growth creates much less employment now than in the past (declining employment elasticity). The same applies to poverty reduction (declining poverty elasticity).

Figure 4: Sources of GDP Growth, By Sector—Emerging Asia
(percentage points)



Thus the challenge for Asia is how to channel the excess saving toward more productive investment in a manufacturing sector that will generate jobs, since this is generally more employment-creating than services in general. This is why improvements in the business and investment climate are so important. From this perspective, efforts to raise domestic demand are not only necessary for lowering global

imbalances, but for many Asian countries they are also warranted to make development and growth more inclusive.¹²

Indeed, the growth pattern in many Asian countries has been far from being inclusive. While the region has done relatively well in terms of output growth and macroeconomic management, even during the recent crisis, the development and welfare outcome has not been good. In many countries environmental conditions have worsened, resource depletion has become alarming, unemployment (especially among youth and the educated segment of the labor force) has increased sharply, and income inequality has risen almost across the board. To be credible and accepted by the global community, G-20 needs to assume leadership in this area. It should encourage policy makers to seriously reassess the development pattern that has produced unfavorable outcomes. In particular, focus ought to be directed toward the interactions of these issues with the strategy and policy approach needed to lower and mitigate global imbalances. This is the only way to achieve “strong, sustainable, and balanced growth,” the stated goal of G-20.

Global Role and Governance

In Chinese, the word “crisis” is made up of the characters for “danger” and “opportunity”. From Asia’s perspective, the G-20 should see the recent crisis as these two things. The fact that the global recovery is “strengthening, but is still uneven” and that the international monetary system has proven “resilient, but vulnerabilities remain” indicate that the work is only half done. Emerging economies have become important forces in helping the world to weather the crisis, and this highlights the importance of the G-20. Indeed, the G-20 has done remarkably well in helping the global economy to recover. It has emerged as the leading forum for coping with the crisis. But the unevenness of the recovery and the persistent vulnerability in the global financial system remain serious challenges. Financial regulations have been strengthened but are still far from sufficient to avert a similar shock in the future, especially when “too big to fail” problems remain. Many components need further structural changes, especially those related to the least regu-

¹² J. Zhuang (ed.), *Poverty, Inequality, and Inclusive Growth in Asia: Measurement, Policy Issues, and Country Studies* (Manila: Asian Development Bank, 2009).

lated financial instruments. For Asian countries, the lesson of the Asian financial crisis is clear—that a too liberalized financial sector not supported by proper regulation and supervision is a recipe for disaster. Whether the world economic structure of the past, as characterized by liberalization and deregulation, can realize a smooth transformation of the global economy to achieve more sustainable and balanced growth with minimum risk of crisis, depends on how far the G-20 can help to push reforms of the international monetary system. The recent crisis should be seen as an opportunity to push such moves.

The unevenness of growth and the difficulties in achieving more significant financial sector reform present another difficult challenge as it touches on the issue of power influence. The role of the IMF in reporting the vulnerabilities prior to the crisis is a notable example. Despite the Fund's warning, officials from powerful industrial countries concealed such important information and put pressure on the Fund to tone down warnings before the crisis. Often the IMF wilts in the face of officials' demands to water down criticisms.¹³ One cannot imagine that being true for developing and emerging countries. The extent to which the G-20 can balance the influence between the developed world and emerging economies is a major test for the future development of this global forum. Another critical test is whether it can properly handle its relationship with non-G-20 countries.¹⁴ Unless it listens and caters to their claims and respects their interests, its legitimacy—and perhaps its existence—will be seriously questioned.

Asians are coming of age. In formulating the strategy to support its agenda, the G-20 can absorb the experience in Asia that may provide lessons to be shared, both good and bad, on macroeconomic and development policies. In addition to providing financial resources, Asian members of the G-20 can also play a greater role in helping to set the vision and ambitions for global rebalancing, and to share Asia's

¹³ Revealed in a report by the IMF's Independent Evaluation Office (IEO) in January 2011. In some cases, according to the report, so intimidated were the IMF staff that they did not challenge the officials' arguments. See IMF, "IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004-2007," Prepared by IMF's Independent Evaluation Office, 2011, available at www.ieso-imf.org/eval/complete/pdf/01102011/Crisis_Report_English.pdf.

¹⁴ G-20 member countries only account for 10% of more than 200 states that engage in global economic activity.

unique experience in areas such as establishing international production networks, and using the government and public sector to play a vital role in supporting these networks.¹⁵ In the global financial reform, Asia should no longer be content to leave it to powerful industrial nations to decide; it must join in setting new standards for global financial institutions and in regulating risk. Regional or subregional arrangements can be used to facilitate Asia's stronger voice and sense of ownership.

The new global economic governance structure will need to be based on representative institutions that reflect the changing economic weight of emerging economies in the global economy. Asia should and will play a greater role on the global stage.

¹⁵ The way the region looks at the importance of investment and the necessary infrastructure, beyond just trade, by establishing international production networks is acknowledged by many countries and institutions, including the Inter-American Development Bank. It suggests that Asia has a unique track record in establishing such production networks. Asia also has much to offer in terms of resources management, innovative financing, technical expertise on engineering and design, to project management.

G-20 and Global Democracy

Maria Monica Wihardja

Introduction

The G-20 is a part of global governance, whose establishment is a stepping stone towards global governance reforms because it strikes a balance between legitimacy and efficiency and it recognizes the shift of global gravity to the East and South, albeit belatedly. It is a hodgepodge of “advanced democracies” (G-7, Australia, and the EU), “emerging-market democracies” (Argentina, Brazil, India, Indonesia, Mexico, South Africa, South Korea, and Turkey), and “non-democracies” (Russia, China, and Saudi Arabia).¹ Among the G-20 countries is the U.S., which is “the premier democratic country of the modern world,” and whose identity as a nation is “inseparable from its commitment to liberal and democratic values.”²

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¹ Marc F. Plattner, “The Impact of the Economic Crisis. From the G-8 to the G-20,” *Journal of Democracy*, Vol.22 (1): 31-38.

² Samuel P. Huntington, *The Third Wave. Democratization in the Late Twentieth Century*. (Norman and London: University of Oklahoma Press, 1991), 29-30.

Although currently the advanced democracies together make up for almost 66% of the world GDP (in 2009) while the emerging-market democracies and non-democracies make up for about only 11% for the world GDP each, the striking difference of the economic growth rates between the G-7 (an estimated average of 2.31% in 2010) and the emerging-market democracies (an estimated average of 6.56% in 2010) plus the non-democracies (an estimated average of 5.95% in 2010) sets a path for the emerging-market democracies and the non-democracies to overtake the power of the advanced democracies in just a few years to come.

Following the 2008 Global Financial Crisis (GFC), which originated in the U.S. and the Western Europe, which are all advanced democratic countries, some predict an erosion of free-market and democratic ideology and credibility. In the U.S., trillions of dollars of tax-payers' money were injected to save a few large private banks while millions of jobs were lost as a result of the crisis. Money is corrupting politics. Roughly one-half of US Congressmen are millionaires, and many have close ties to companies even before they arrive in Congress.³ Corporate crime is rife.

A Nobel Prize Winner in Economics, Joseph Stiglitz recently wrote: "Corporate corruption is out of control for two main reasons. First, big companies are now multinational, while governments remain national. Big companies are so financially powerful that governments are afraid to take them on. Second, companies are the major funders of political campaigns in place like the US, while politicians themselves are often part owners, or at least the silent beneficiaries of corporate profits."⁴

Is the world democracy under threat?

"We are in a very fluid situation.. The old moral compass is challenged," said Larry Diamond from the Hoover Institute.⁵ It is not surprising that the "old moral compass" has been challenged. Kaushik Basu, the chief of economic adviser to the Indian government, con-

³ Jeffrey D. Sachs, "The Global Economy's Corporate Crime Wave," *The Jakarta Post*, May 11, 2011.

⁴ Joseph E. Stiglitz, "The IMF's s with in time, but will governments, market care?" *The Jakarta Post*, May 12, 2011.

⁵ Ward, "How will Democracy Fare?"

tended that “wars are often waged in the name of democracy and freedom.⁶ He said that when one accounts for the human toll of the firepower used in some of these theaters of war, it takes a handsome amount of gullibility to believe that wars are indeed in the interests of freedom and democracy in the nation being bombed. An official statistics showed that U.S. bombing during the Vietnam war translated into hundreds of kilograms of explosives per capita during the war.

Recently, China, that is proving itself to be a regime maker instead of a regime taker, made a political retaliation by accusing the U.S. of human rights double-standards, demanding internet freedom overseas while imposing harsh restrictions at home. China’s State Council Information Office reported “its malicious design to pursue hegemony under the pretext of human rights.”⁷

Joseph E. Stiglitz, recently wrote: “American have been watching protests against oppressive regimes that concentrate massive wealth in the hands of an elite few [Tunisia, Egypt, Libya, etc.]. Yet in our own democracy, 1 percent of the people take nearly a quarter of the nation’s income or 40% of the nation’s wealth - an inequality even the wealthy will come to regret.”⁸

India, the world’s largest democracy, has been battered with a web of scandals, from the flawed 2G spectrum auction to inflated contracts for the Commonwealth Games to the lucrative real estate deal: “this web of scandals,... are deeply corrosive of India’s democracy and could lead to a loss of public faith in the country’s democratic political institutions.”⁹ “The recent scandal in India is nothing new. But recent accusations appear to place India in the same class as Africa’s worst kleptocracies,” one analyst contended.¹⁰

Indonesia, the world’s third largest democracy, is at a standstill,¹¹ and if social issues worsen and social capitalism of “unity in diversity” breaks apart, religious radicalism and terrorism may threaten

⁶ Kaushik Basu, *Beyond the Invisible Hand. Groundwork for a New Economics*. (New Jersey: Princeton University Press, 2011), 180.

⁷ Branigan, “China Accuses US.”

⁸ Joseph E. Stiglitz, “Of the 1%, by the 1%, for the 1%,” *Vanity Fair*, May 2011, 126.

⁹ Sumit Ganguly, “Corruption eating at India’s democracy,” *East Asia Forum*, May 13, 2011.

¹⁰ Sandy Gordon, “India and China: Mega-population, mega-corruption, mega-growth,” *East Asia Forum*, May 10, 2011.

¹¹ John McBeth, “Indonesian democracy at standstill,” *The Straits Times*, May 10, 2011.

the country's security, stability, and prosperity. In other parts of the world, many countries are undergoing transitions to democracy - Central and Eastern European countries, North Africa and throughout the Middle East, Singapore. Singapore just experienced a watershed election, where the opposition party gained the highest number of seats in Parliament in history. ASEAN Secretary General, Surin Pitsuwan, was confident that democratic governance among ASEAN countries would be the future norms, as he quoted Winston Churchill that democracy was "the least bad form of government."¹²

This dynamics highlights that democratization is a complex process and there is no "one-size-fits-all" recipe for a success. It may occur through "shock therapy" or "gradualism" and sequencing matters.¹³ More importantly, democratic aspiration must come from the heart of the people, and not pressured from outside. Democratic consolidation needs a vibrant and well-informed civil society because, as the above examples show, democracy can be easily captured by wealthy elites, where the cycle of inequality may become self-reinforcing as "wealth begets power, which begets wealth."¹⁴

Indonesia's big-bang experience of democratization can be an example and lessons to some new democracies or non-democracies. It democratized in the midst of economic crises, in which stringent policy conditionality was formulated under the IMF Letter of Intent. Interestingly, after twelve years of democracy, a recent survey shows that representative people were still reminiscing the Soeharto era. Soeharto came out to be the most popular president among all Indonesian presidents. Corrosive and widespread corruption in the post-reform era was among the factors that brought up this Soeharto nostalgia. Another study showed that people did not feel represented by the people who were supposed to represent them. This is not to say that Indonesia should go back to autocracy. But, this is not a black-or-white matter.

¹² Kavi Chongkittavorn, "ASEAN development and democracy," *The Jakarta Post*, May 24, 2011.

¹³ Erik Berglof, "After reform, stuck in transition," *The Jakarta Post*, May 24, 2011.

¹⁴ Stiglitz, "1%," 128.

Do we have a *true* champion of democracy?

Marc Plattner, a coeditor of the *Journal of Democracy* wrote¹⁵:

The big question for the future is what role [the emerging-market democracies] will play in the global order: Will their international behaviour be motivated purely by national advantage and by the common interests that they share with fellow developing countries, or will they also pursue foreign-policy goals that reflect the democratic character of their regimes?

Plattner concluded that the emerging democracies were yet to decide what they wanted to do on the international political landscape: "The emerging market democracies are still struggling to find their identity in the international order - whether it will be shaped by their opposition to the advanced democracies on issues such as trade, climate change and representation in international institutions, or by their common interests as democracies."¹⁶

Firstly, Plattner argues that there is little evidence that these emerging-market democracies are to align with the advanced democracies with respect to their internal politics and foreign policies. This is evident from the recent event when India, Brazil, and Indonesia joined Russia and China, both are the UN Security Council permanent members, to abstain on a UN vote authorizing military strikes to enforce the no-fly zone in Libya, while the three other UN Security Council permanent members, namely, France, the U.S. and the U.K. were the main supporters of the military strikes. Moreover, as Larry Diamond from the Hoover Institute and the author of *The Spirit of Democracy* (2008) said, "there is little sign of concern for promotion or defense of democracy in the foreign policy of some G-20 members." Brazil and Turkey voted against the U.N. sanctions on Iran over controversial nuclear programmes; India continued to trade with Myanmar and had abandoned her support for Aung San Suu Kyi; Brazil's former President Luiz Inácio da Silva continued sustenance to Venezuela's Hugo Chavez; South Africa played a key role in supporting Robert Mugabe of Zimbabwe.¹⁷

¹⁵ Plattner, "From the G-8 to the G-20," 37.

¹⁶ Plattner, "From the G-8 to the G-20," 38.

¹⁷ Plattner, "From the G-8 to the G-20," 38.

Secondly, the emerging-market democracies and the non-democracies have increasingly concerted their efforts to slowly yet surely dominate the political landscape. Although BRICS (now, with an added 'S') is not (yet) a political grouping, its economic power as an economic caucus may transform into a high political bargaining power. BRICS contributes 18% to the global trade and 45% to the global economic growth, and BRIC economies are expected to overtake the U.S. economy by 2018. "BRICS is an idea whose time has come,"¹⁸ with China leading the way and Indonesia standing in the wings. Its voice is heard - recently BRICS sent a letter to the IMF to remind the IMF that the appointment of the Managing Director should not be based on nationality.

Is there a room for democracy discussion at the G-20?

Because of its political hodgepodge and divergent political views on democracy, let alone the boundless definition of democracy itself, the G-20 should avoid political discussions at the Summit because it may ruin the global economic cooperative spirit that the G-20 strives for. For example, "Americans have a special interest in the development of a global environment congenial to democracy,"¹⁹ while Chinese Premier Wen Jia Bao promised socialism for another century and reiterated that "China must walk its own way in terms of building a democratic system," rejecting the Western-style democratic reform.²⁰

How should the G-20 contain political tensions that already exist to begin with even without political discussion on the table, because of political divisions on cases such as the U.N. vote to attack Libya? First, the G20 Finance Ministers' and Central Governors' Meeting ('FMCGM') must reach a strong consensus and commitment on the economic fronts so that the focus and agenda during the Leaders' Summit will not be lost.

Second, in the midst of unstable and uneven global economic recovery, reform momentum should be maintained, including international financial institutional reforms, rebalancing global imbalance,

¹⁸ Sourabh Gupta, "BRICS and the international economic order - an idea whose time has come," *East Asia Forum*, May 22, 2011.

¹⁹ Huntington, *The Third Wave*, 30.

²⁰ Richard Spencer, "China Promises Socialism for 100 Years," available at <http://www.telegraph.co.uk/news/worldnews/1544125/China-promises-socialism-for-100-years.html>

and structural reforms. While all these reforms were just put in place, or are yet to be put in place, the G20 leaders need to show full commitment to them. The G-20 was formed in the midst of economic crises, the FMCGM in 1997, the Leaders' Summit in 2008, and it should remain committed to avoiding any possible risk of another crisis.

We propose that the Bali Democracy Forum is one possible forum to talk about democracy issues. If the G-20 is to avoid political discussions at the Summit, does the subject on democracy still have any relevance within the G-20 process?

Global Democracy

What the G-20 can do is to promote "global democracy". Kaushik Basu, in his latest book, wrote: "political globalization is clearly trailing behind economic globalization. One consequence of this is an erosion of democracy and the tolerance of global inequalities at levels that would not have been tolerated in any economy under a single government."²¹ Stiglitz recently wrote: "The rules of economic globalization are designed... to benefit the rich: they encourage competitions among countries for *business*, which drives down taxes on corporations, weakens health, and environmental protections, and undermines what used to be viewed as the 'core' labor rights, which include the rights to collective bargaining."²²

The absence of global democracy threatens the world into not only social instability, but also inter-states conflicts and wars. Wars are partly results of a lack of political globalization. Hence, we need "global democracy" because:

1. Economic globalization has increased inter- and intra- inequality.
2. National policies have cross-border impacts - both in poor and rich nations - but countries with small wealth-shares in the world economy are not equally or fairly represented in global institutions.
3. The IMF, World Bank, WTO, and other IFIs remain largely answerable to industrialized nations.
4. Many of decision-making processes of IFIs remain opaque.

²¹ Basu, *Beyond the Invisible Hand*, 182.

²² Stiglitz, "1%," 129.

Further steps to be undertaken by the G-20

Firstly, democratic structure of international financial institutions must be strengthened. Aspiring to more legitimate and credible global governance, the G-20 must complete its plan to reform the international financial institutions including the IMF quota reforms with the goal to continue the dynamic process of adjusting quota shares to reflect shifts in the global economy. Despite the current IMF quota and voice reform agenda, some observers contend that the quota and voting reforms should be propped up to 50 percentage points of quota and voting shares between advanced economies and emerging and developing countries from the proposed 42.3 and 44.7 percentage points respectively.

As reiterated at the G20 London Summit 2009 that “the heads and senior leadership of the international financial institutions should be appointed through an open, transparent, and merit-based selection process.” Governance reforms, which included the reduction of European countries Executive Board representation by two chairs and an appointment of second Alternate Executive Directors to enhance representation of multi-country constituencies should be pushed for. Upon the resignation of Dominique Strauss-Kahn on May 19, 2011, a new Managing Director from an emerging country, a non-EU, has been deliberated, and this deliberation should not be rejected. The IMF Executive Directors of the BRICS demanded that appointment was not based on nationality.

Institutional reforms at international organizations should also include pushing decision-making processes more transparent. We want to avoid the so-called the WTO’s “green room”, where the agenda was pre-set and the results were pre-determined.

Secondly, financial regulatory reforms, including the globally-systematically important financial institution reforms, must also be pushed for. During the 2008 Global Financial Crisis, billions of dollars of taxpayers’ money were used to bail out Fannie Mae and Freddie Mac and AIG, to name a few, while “two years after the biggest financial crisis in history, which was fueled by unscrupulous behavior by the biggest banks on Wall Street, not a single financial leader has faced jail.” Furthermore, the collapses of these financial institutions and the burgeoning budget deficit of the U.S. have adverse global impacts

Meanwhile, corporate corruption continues to threaten the global economy, which is difficult to contain because big financial companies are so financially powerful and they are the major political campaign funders in places like the U.S.. Financial regulatory reforms should correct the current financial regulations that privatize gains but socialize losses. Stiglitz argued that “The wealth, power, and illegality enabled by this hidden system are now so vast as to threaten the global economy’s legitimacy...”²³ Moreover, unfair financial regulations also increases inequality: “Much of today’s inequality is due to manipulation of the financial system.”²⁴

Thirdly and more challengingly, global governance must ensure a fair representation and participation of a citizen of one country on the international arena regardless of the country’s affluence, especially in the world whereby policies in one country can affect the lives of citizens from the other countries. Financial deregulations in the U.S. since the early 1980s has been widely blamed as the cause of the 2008 GFC that impacted the lives of citizens in other countries worldwide. This transnational impact has been accelerated by technological progresses, especially in the communication and transportation sectors, where costs are becoming increasingly cheaper.

Transnational and “one person, one vote” voting system are not yet feasible under the current world system. What is more pragmatic is a consensus-building approach, in which the G-20 adopts currently. However, it must ensure that the voice of poor countries, even with very small wealth and market shares of the world economy, are represented at the G-20. This is a challenge for G20 members to represent and reach out to the poorer and poorest nations worldwide. Moreover, cross-border regulatory coordination is needed.

Lastly, the G-20 should also focus on not only combating global poverty but also inter-country and intra-country inequality that is widening, partly as a result of economic globalization.

On a side note, President Obama in his address to the British Houses of Parliaments on May 25, 2011, stated that the rise of superpowers like China and India did **not** mean the end for American and

²³ Sachs, “Corporate Crime Wave.”

²⁴ Stiglitz, “1%,” 128.

European influence in the world, but in fact, he said, the time of the developed countries' leadership was now. In a globalized world, all nations stand under one global government, and hence fair representation of voices from all nations - rich and poor - needs to be protected. We try to avoid one-power dominance within a nation, but we must also remember that we also want to avoid one-power dominance, or two-power dominance, or a hegemony of a group of nations, within the global world. BRICS strikes a balance between emerging countries and the hegemony of the G7. But, it must also be remembered that BRICS, or any other coalition, does not need to form a caucus, although caucusing is encouraged. The G-20 should preserve this multilateralism. It is not time for rivalries, but managing voices.

The Impact of the Two Oil Booms of the 1970s and the Post-Oil Boom Shock of the Early 1980s on the Indonesian Economy¹

THEE Kian Wie

INTRODUCTION

Over the period 1974–1981 the Indonesian economy grew at a high and sustained average annual rate of 7.7 per cent. This rapid growth was to a large extent attributable to the considerable improvement in the country's international terms of trade caused by the two oil booms Indonesia experienced during the 1970s. However, in 1982 Indonesia experienced a third external shock when the price of oil caused by a weakening of the world oil market led to a substantial deterioration in Indonesia's external terms of trade.

This paper describes the impact of these two oil booms on the Indonesian economy, and the policies which the Indonesian pursued in response to these oil booms. This paper will also describe the policies of the Indonesian government in response to the end of the oil boom in 1982.

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¹ Revised and abbreviated paper originally published in the Proceedings of the Third Afrasian International Symposium "Resources under Stress: Sustainability of the Local, Community in Asia and Africa" (editors: Yoshio Kawamura, Hisashi Nakamura, Shiro Sato, Aysun Uyar, and Shinya Ishizaka), Afrasian Centre for Peace and Development Studies, Ryukoku University, Kyoto, and the Center for Southeast Asian Studies, Kyoto University, Kyoto, 2008.

THE FIRST OIL BOOM, 1973-74

Even before the Saudi Arabia, the largest oil exporter, and the other Arab countries had imposed an embargo on their oil exports in late 1973, the price of oil had been gradually inching upward before it jumped to \$ 11.70 a barrel in April 1974 as a result of the oil embargo.²

As a result of the steep rise in the price of oil, the value of oil exports rose steeply after 1973. The table below also shows that even before the oil boom of 1973/74, oil exports had started rising rapidly in view of rising world demand (Table 1).

Table 1: Indonesia's oil exports, 1969/70 – 1975/76 *

(millions of US)

1969/70	384
1972/73	965
1973/74	1,729
1974/75	3,727
1975/76	4,204

Source: Grenville, "Survey of Recent Development," 2.

The resulting surge in Indonesia's oil exports naturally widened the options for economic policy-making because it loosened up the financial and foreign exchange constraints faced by Indonesia during the 1950s and 1960s.³ Because of this, the oil bonanza also transformed Indonesia's economic prospects, as it considerably added to the external resources available for development.⁴

² Stephen Grenville, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies* 10 (1): 2.

³ Anne Booth and Peter McCawley (Eds.), *The Indonesian Economy During the Soeharto Era* (Kuala Lumpur: Oxford Press, 1981), 11-12.

⁴ H.W. Arndt, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies* 10 (2): 1, 3-4.

Following the steep rise in the price of oil, the Indonesian government made three important decisions. First, in April 1974 the sales price of Indonesia's crude oil exports was further raised from \$10.80 per barrel to \$11.70 per barrel. Secondly, the income-sharing arrangements with foreign oil companies were revised. Under a new arrangement, Indonesia's share was raised to 85 per cent of net earnings in excess of a price of \$5 per barrel. Thirdly, in order to continue encouraging oil exploration by the foreign oil companies, the Indonesian government decided not to insist on a reduction in the 40 per cent limit to deductible costs under the production sharing contracts.⁵ The government's budget received a substantial boost by the large increase in oil revenues due to the large increase in tax revenues from the foreign oil companies.⁶

As a result of the vast increase in tax revenues from the oil companies, the government slackened its tax efforts. The buoyant oil revenues were clearly responsible for the less effective enforcement of non-oil income and corporation taxes and the imposition of higher taxes on luxuries, including urban real estate.⁷

In early 1975 the government's development plans experienced a sudden setback because of the unexpected bankruptcy of Pertamina. The reason was that Pertamina was involved in a wide range of operations, including in the oil sector and activities directly servicing it, and in far too many non-oil activities.⁸

Believing that Indonesia's finances had to be managed carefully and systematically to avoid inflation and to allocate funds for maximum economic growth, the economics ministers imposed restrictions on medium-term borrowing by Pertamina to fund its many projects. Pertamina circumvented this restriction by taking off-shore short-term or long-term loans that is loans repayable in less than one year or over fifteen years. However, in February 1975 the roof fell in on Pertamina when it missed a payment on a small loan from a small bank in Dallas. Pertamina's default created considerable difficulties for Pertamina, but

⁵ Arndt, "Survey of Recent Developments 10," 3.

⁶ Phyllis Rosendale, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies* 10 (3): 1, 9-10.

⁷ Rosendale, "Survey of Recent Developments," 11.

⁸ H.W. Arndt, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies*, 11 (2): 3.

also for the Indonesian government, since it generated negative attention, and finally brought to light Pertamina's financial problems.⁹

To contain the damage, the Indonesian government had to step in by announcing that it guaranteed repayments of all of Pertamina's short-term foreign loans. On 12 March 1975 Bank Indonesia, the central bank, paid off two loans. To prevent a recurrence of Pertamina's freewheeling ways, the government announced that henceforth all foreign borrowing by Indonesia's state-owned enterprises would be channeled through Bank Indonesia or the Department of Finance. The government also moved promptly to deal with the crisis that threatened Indonesia's credit standing.¹⁰

The costs of the Pertamina crisis were reflected in the balance of payments, which showed an estimated fall in reserves of \$ 240 million for 1975 instead of the hoped for increase of \$400 million. In mid-1975 the private capital account showed an outflow of over \$600 million. The downward revision of the private capital inflows was primarily due to the debt repayments on Pertamina's behalf.¹¹ Because of Pertamina's bankruptcy, a considerable part of the government's oil revenues were wasted bailing out Pertamina.¹²

The principal means the government used to recoup the Pertamina losses was to extract more money from the foreign oil enterprises by taxing them more heavily, specifically by reducing the profits gained by oil companies on each barrel of crude oil they produced. This required a renegotiation of the contracts with all the foreign oil firms in which the government was able to impose a change in the basic split of 65 per cent to 35 per cent in the government's favor to 85 per cent to 15 per cent in the government's favor.¹³

⁹ Radius Prawiro, *Indonesia's Struggle for Economic Development – Pragmatism in Action* (Kuala Lumpur: Oxford University Press), 107.

¹⁰ Arndt, "Survey of Recent Developments 11," 6-7.

¹¹ Peter McCawley, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies* 12 (1): 8-9.

¹² Thee Kian Wie, "The Soeharto era and after: stability, development and crisis: 1966 – 2000," in *The Emergence of a National Economy – An Economic History of Indonesia, 1800-2000*, eds. Dick, Howard, Vincent Houben, Thomas Lindblad and Thee Kian Wie, (Leiden: Allen and Unwin, St. Leonards, NSW and KITLV Press), 210.

¹³ John Bresnan, *Managing Indonesia – The Modern Political Economy* (New York: Columbia University Press, 1993), 186-187.

After the economic technocrats had solved the Pertamina crisis, Widjojo, the leader of the economic technocrats, designed a new law for Pertamina which was aimed at putting Pertamina under strict government supervision. This Law provided for a Board of Supervisors, the members of which all had ministerial rank. The Minister of Mining, was made ex-officio chairman of the Board, with the other ex-officio members including the Chairman of the National Planning Board (*Bappenas*) and the State Secretary. In this way the power and autonomy of Pertamina were gradually trimmed.¹⁴

The Pertamina crisis occurred just as the first oil boom was reaching a peak. If this crisis had not occurred, the economy might possibly have grown at 8 perhaps even 9 per cent because of the boost caused by the oil boom revenues. Instead, in 1975 the economy grew at only 5 per cent.¹⁵

THE SECOND OIL BOOM, 1979-1980

Concerned that the oil boom was over and that the economy was facing serious structural problems caused by the 'Dutch disease' effects of the oil boom, particularly the modest growth or even decline of the non-oil tradable sectors (except timber), the government on 15 November 1978 devalued the *rupiah* by 50 per cent to offset the real appreciation of the *rupiah* over the 1972-1976 period because of the higher inflation in Indonesia vis-à-vis its major trading partners.¹⁶

While the economy was still recovering from the adverse effects of devaluation and adjusting to large increases in the world market prices for its non-oil exports, in mid-1979 events suddenly took another turn when Indonesia experienced a second oil boom. Like in the first oil boom, the second oil boom led again to a huge increase in oil export earnings and fiscal revenues.¹⁷

The second oil boom of 1979-1980 was caused by the temporary closure of Iran's oil industry when a revolution broke out against the

¹⁴ Mohammad Sadli, "Recollections of My Career," *Bulletin of Indonesian Economic Studies* 29 (1): 35-51.

¹⁵ Prawiro, *Pragmatism*, 110.

¹⁶ Ross Garnaut, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies* 15 (3): 21.

¹⁷ Garnaut, "Survey of Recent Developments," 1.

repressive regime of the Shah of Iran. This closure greatly affected world oil prices, since Iran was OPEC's second-largest oil producer and exporter after Saudi Arabia. The resulting imbalance between the world's oil supply and demand led to further doubling of the price of oil to about \$30 per barrel by early 1980.¹⁸

Once again Indonesia was faced with the benefits and problems of how to manage the sudden large increases in oil windfall earnings. In particular, Indonesia was once again faced with the problem of new inflows of oil money which could lead to renewed inflationary pressures and an economy out of balance again¹⁹ because of the adverse effects of the 'Dutch Disease'.

The immediate response of the government to the second oil boom appeared rather slow compared to the quicker response to the first oil boom. Following the oil price rises of 1973/74, the government responded by importing large quantities of rice and fertilizer to spread the benefits of the oil boom to the needy groups in society. After the second oil boom, the government at first appeared not to recognize that a big increase in *rupiah* spending would increase inflation and thus dissipate the gains in the purchasing power of the public sector as well as the enhanced international price competitiveness of the non-oil traded goods caused by the devaluation of November 1978. Instead, the government raised the salaries of government employees by 50 per cent.

Despite these misgivings, the Indonesian economy performed quite well in 1980, growing at 7.1 per cent, compared to the much slower growth in 1979 when the economy grew only at 4.9 per cent due to the uncertainty caused by the expected *rupiah* devaluation in November 1979. The better performance in 1980 could be attributed to the improved terms of trade caused by the second oil boom, increased domestic activity, and the stimulus of a surplus in both the overall balance of payments (\$2.7 billion) and the current account (\$0.9 billion).²⁰

Table 2 presents the GDP growth rates of Indonesia during the two oil booms. The data in Table 2 show that most sectors grew at much

¹⁸ P.R. Odell, P.R., *Oil and World Power* (Harmondsworth: Penguin, 1981), 255-256.

¹⁹ Prawiro, *Pragmatism*, 118.

²⁰ D.T. Healey, "Survey of Recent Developments" *Bulletin of Indonesian Economic Studies* 17 (1): 1.

higher rates in 1980 compared to 1979, including the manufacturing sector which grew much stronger in 1980 (11.6 per cent) following this sector's sluggish growth in 1979 as a result of the devaluation. Indonesia's more rapid growth during the 1970s was not only stimulated by increased investment made possible by the oil boom revenues, but also by the more modern and sophisticated process and product technologies embodied in the imported capital goods.²¹

Table 2: Growth Rates of Indonesia's Gross Domestic Product by Sector of Origin in 1973 Constant Prices, 1975 - 1980
(in percentages)

Year/Sector	1975	1976	1977	1978	1979	1980
Agriculture, forestry, fisheries	3.7	4.7	1.3	5.2	2.5	5.0
Mining & quarrying	- 3.6	15.0	12.4	-2.0	-0.5	-1.3
Manufacturing	12.3	9.7	13.8	11.3	8.8	11.6
Construction	14.1	5.5	20.5	14.0	6.4	7.8
Commerce	5.7	4.4	6.4	6.4	7.1	8.0
Transport & Communication	5.2	13.2	24.8	14.5	10.4	10.2
Banking & Financial Services	15.9	14.7	29.1	9.3	10.3	15.4
Public administration & Defense	27.3	5.5	16.0	11.3	4.8	13.2
Services	2.6	2.5	2.1	2.4	2.4	2.3
Gross Domestic Product	5.0	6.9	8.8	6.9	4.9	7.1

Source: Healey, "Survey of Recent Developments," 34. Appendix Table 1, derived from BPS (Central Agency of Statistics), Jakarta.

THE OUTCOMES OF THE OIL BOOM ERA

Although the oil booms did relieve Indonesia from its long balance of payments and budget constraints, enabling the economy to grow faster, the oil windfall was in some respects worth less to Indonesia

²¹ R.M. Sundrum, "Indonesia's rapid economic Growth, 1968-81," *Bulletin of Indonesian Economic Studies* 23 (3): 63-64.

than most other oil-exporting country. Because of its large population, Indonesia's oil windfall in dollars per capita was quite modest compared to the other OPEC countries. Because of its much wider resource base, Indonesia's oil windfall as a percentage of GDP was also smaller than in the other OPEC countries.²²

Due to the higher oil revenues, the Indonesian government was able to launch several ambitious development programs. These new programs included promoting development in the outlying regions of the vast archipelago, social development, expanding physical infrastructure and establishing large-scale basic (heavy) industries. To promote regional development, the government recycled part of its oil revenues through the so-called 'Presidential Instruction', or *Inpres (Instruksi Presiden)* programs to the various provinces (Thee 2002: 208). Most of these *Inpres* grants were allocated to the three tiers of local government – the province, district and sub-district – to be spent on rural infrastructure development.²³

A subsidiary aim of these *Inpres* programs was to improve the quality and effectiveness of local public administration. To qualify for the *Inpres* grants, the local governments had to prepare plans and budgets and, at the end of each fiscal year, submit reports on the activities financed by these grants.²⁴

During the oil boom era an increasing part of the government's oil revenues was also recycled into social development, particularly education, health care and family planning.²⁵ The strong commitment to social development persisted, even after the oil boom era had ended in the early 1980s.²⁶

Since the early 1970s first foreign aid and subsequently the increased oil revenues were also spent on rehabilitating and expanding the long-neglected physical infrastructure, particularly in the rural areas. Vast amounts were also spent on expanding and modernizing the transport infrastructure, including roads, railways, harbors, airports and communications (Dick and Forbes 1992: 265, 274, 280).

²² John Bresnan, *Managing Indonesia – The Modern Political Economy* (New York: Columbia University Press, 1993), 190.

²³ Prawiro, *Pragmatism*, 175.

²⁴ McCawley, "Survey of Recent Developments," 29-30.

²⁵ Thee, "Soeharto," 209.

²⁶ Prawiro, *Pragmatism*, 175.

The first oil boom in the mid-1970s happened to coincide with the end of the first (easy) phase of import-substituting industrialization. Instead of moving into export-promoting industrialization, the government embarked on an ambitious state-led program of the second phase of import-substitution. This second-phase involved the establishment of state-owned, upstream, basic industries.

The architect of the plan to develop a range of basic industries was A.R. Soehoed, the Minister of Industry during the period 1978-1983. During his term in office Soehoed proposed the establishment of 52 basic industries in which the government would have to take the initiative, because at the time private entrepreneurs were not yet ready. The problems with establishing basic industries were that a considerable amount of capital was needed, that the gestation period was quite long, the physical infrastructure had to be laid out, and the profit margins were generally low.²⁷ Once a strong foundation of a range of basic industries, financed with the rapidly growing oil revenues, was established, industrial development would accelerate by itself. Although Soehoed's plan was not fully implemented because of the end of the oil boom in 1982, many industrial projects could be implemented during his term in office, including fertilizer and cement plants, the Asahan aluminium smelter in North Sumatra, paper and plywood mills and the nucleus of a steel and engineering industry.²⁸

THE POST-OIL BOOM ERA

When in 1979 the Indonesian government was suddenly overtaken by the second oil boom which unexpectedly and vastly increased its revenues from oil taxes and its earnings revenues from oil exports, it would again be overtaken by an unexpected event, namely the steep decline in the world price of oil in 1982 due to a sudden weakening of the world oil market.

The developments of 1979/80 and 1982 again underlined the vulnerability of the Indonesian economy to both international and domestic exogenous shocks. The domestic exogenous shock was the severe

²⁷ A.R. Soehoed, "Reflections on Industrialization and Industrial Policy in Indonesia," *Bulletin of Indonesian Economic Studies* 24 (2): 43-57.

²⁸ Soehoed, "Industrialization."

drought in 1982 which hit the agricultural sector hard and adversely affected most of the main rice-growing areas, as rice output was estimated to fall by 5 to 10 per cent in 1983.²⁹

The Indonesian government's responses to the two oil booms of the 1970s, indicated that it had been both willing and able to implement the required macroeconomic stabilization policies.³⁰ In response to the worsening external conditions, the Indonesian government in early 1983 initiated a broad-based adjustment program aimed at restoring macroeconomic stability. To deal with the rising current account deficit, the government devalued the *rupiah* in March 1983.³¹ In response to the tightened fiscal position, the government also pursued tight fiscal policies.³²

In response to the falling government revenues, a new tax law was introduced in December 1984 aimed at increasing non-oil taxes, particularly personal and corporate income taxes and a new value-added tax (VAT) to offset the decline in oil company taxes. To improve the efficiency of the banking system and the better mobilization of domestic funds, a banking deregulation measure was introduced in June 1983 to the effect that the state-owned banks were now allowed freely to set their interest rates, while credit ceilings were lifted.³³ Besides the stabilization measures to restore macroeconomic stability, the government also introduced several adjustment measures and structural policy reforms in 1983 aimed at weaning the economy away from its high dependence on oil (and gas) exports and at improving economic efficiency and private sector initiatives. To this end, the government introduced a series of deregulation measures to improve the investment climate for both domestic and foreign investors by dismantling the complex regulatory framework.³⁴

The deregulation measures also included a series of trade reforms which were taken in 1985 and early 1986 aimed at reducing the 'anti-export bias' of its trade regime by introducing a duty exemption and

²⁹ McCawley, "Survey of Recent Developments," 1.

³⁰ McCawley, "Survey of Recent Developments," 3-4.

³¹ Thee, "Soeharto," 210.

³² McCawley, "Survey of Recent Developments," 18-19.

³³ Thee, "Soeharto," 210-211.

³⁴ World Bank, "Indonesia – Strategy for Growth and Structural Change," Report no. 7758-IND. Washington, D.C. 3 May, 1989, xiii.

drawback scheme in May 1986. This scheme was designed to protect Indonesian exporters from the 'high cost' local economy by allowing producer-exporters to import their inputs free of import duty and VAT payments.³⁵

In addition to these trade reforms, the government pursued a supportive exchange rate policy to improve the international competitiveness of non-oil exports. In September 1986 the government devalued the *rupiah* following a second, even steeper decline in the price of oil in early 1986. Thereafter Bank Indonesia, the central bank, pursued a managed floating exchange rate by allowing the *rupiah* to depreciate by 4-5 per cent annually to offset the differential between Indonesia's higher inflation rate and those of its major trading partners. By keeping inflationary pressures under control and pursuing an active managed float, the government was able to keep the real effective exchange rate from appreciating, and to keep the local costs levels in line with those of its major international competitors.³⁶

The stabilization measures and structural reforms soon bore fruit, as domestic and foreign direct investment in export-oriented projects rose steadily after 1986. As a result, non-oil exports, particularly manufactured exports, rose rapidly. The surge of manufactured exports was so rapid that in 1996 manufactured exports accounted for more than 50 per cent of Indonesia's total exports, as compared to only 5 per cent in 1965 (Table 3). The rapid growth of manufactured exports fuelled the rapid growth of the manufacturing sector which, in turn, fuelled the growth of the whole economy. Hence, within a relatively short time, the manufacturing sector had replaced the oil sector as a major engine of growth and as a major source of export revenues.

³⁵ World Bank, "Indonesia," 59.

³⁶ Mari Pangestu, *Economic Reform, Deregulation and Privatization: The Indonesian Experience* (Jakarta: Centre for Strategic and International Studies, 1996), 19.

Table 3: Indonesia's Industrial Growth in ASEAN Perspective, 1965-1996

	Manufacturing value added (millions of US\$)		Manufacturing value added as % of GDP		Manufactured exports as % of total exports	
	1970	1996	1965	1996	1965	1996
Indonesia	994	58,244	8	25	4	51
Malaysia	500	34,030	9	34	6	76
Philippines	1,622	18,908	20	23	6	84
Thailand	1,130	51,525	14	29	3	73

Source: Thee, "Soeharto," 221 [as quoted from World Bank: *World Development Indicators*].

Despite the resumption of rapid economic growth in the late 1980s which was sustained until the onset of the Asian financial crisis in mid-1997, several disturbing developments indicated the emergence of various factors which undermined the resilience of the Indonesian economy, including corrosive corruption, collusion between influential power holders and their business cronies, and nepotism, as reflected by the brazen preferential treatment given by President Soeharto to the many businesses of his six greedy children and their cronies.³⁷

Another worrisome development was the waning influence of the economic technocrats who had largely retired by the late 1980s. One manifestation of the diminished influence of the economic technocrats was the proliferation of off-budget expenditures to finance inefficient state-owned enterprises, the companies of the President's children and their cronies, and the 'strategic industries', which led to an erosion of financial discipline. These conditions set the stage for the economic meltdown following the onset of the Asian financial crisis.

CONCLUSION

The above account of the two oil booms in the 1970s and the post-oil boom shock of the early 1980s underlined the vulnerability of the Indonesian economy to external shocks. However, the above account also showed that the economic technocrats during the first two de-

³⁷ Thee, "Soeharto," 213-214.

acades of the Soeharto era were able, though not without difficulty, to push through the necessary policy measures required to overcome these shocks.

However, when in 1997/98 the Asian financial and economic crisis hit Indonesia, the Soeharto government proved to be unable to come to grips with the crisis. This was in part caused by the inappropriate policy measures which the IMF had imposed on Indonesia after Indonesia had turned to the IMF for financial assistance. These included the requirement that the government had to pursue tight fiscal and monetary policies, even though the Indonesian government had a fiscal surplus. Another shortcoming of the IMF 'recipe' was its demand to liquidate 16 insolvent banks, even though no credible deposit insurance was in place at the time. This understandably led to a bank run which eventually led to the breakdown of the whole banking system. Hence, in the case of Indonesia, the financial crisis was aggravated by a serious banking crisis.

However, Indonesia's steady economic deterioration was also due to the reluctance of President Soeharto to faithfully implement the provisions of the agreement with the IMF, particularly the structural reforms which he saw as threatening the business interests of his children. As economic conditions continued to deteriorate, a serious political crisis arose which led to the inglorious fall of President Soeharto in May 1998 after a reign of 32 years.

Innovation Technology for Sustainable Development: A Case Study on Palm Oil Industry

Syafrizal Maludin

Innovation Technology (IvT): An Overview

Innovation has turned to be a popular word, discussed on TV and seminars, from food street vendors to the President. The important role of innovation is also recognized. It is the right momentum to turn this *holy word* to reality.

Dodgson, Gann and Salter (2005) stated that: *“Technology is a replicable artifact with practical application and the knowledge that enables it to be developed and used which manifested in new products, processes, and systems, including the knowledge and capabilities needed to deliver functionality that is reproducible.”*¹ Science usually connects with scientific researches that tend to work as basic researches without regard to the motivation of scientists or researchers to gain commercial values. It is so likely to see science as abstract and far from any kind of practical application. On the contrary technology is more applicable and more practical.

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¹ Mark Dodgson, David Gann, and Salter Ammon. *Think, Play, Do: Technology, Innovation and Organization* (New York: Oxford University Press, 2005).

*“Innovation is the creation of a new idea and its reduction to practice and it includes all the activities required in the commercialization of new technologies”.*² It is more than invention and creates one single application of technology. For example, the invention of bio-base power generator or heavy duty quality of flexible screen should be utilized with other supported applications. A successful implementation of IvT depends upon the creativity to blend and pull together appropriate supportive applications.

IvT process is different in every sector, in economic scale and technology. It is absurd to run the program in one developing country which based on previous successful model of program from OECD countries.

It was Adam Smith who examined the job specialization and distribution in Industrial Revolution. He emphasized the important role of “invisible hand” in economic development. Smithian was split into two schools. The first school, developed by Walras, Kenneth Arrow and Gerhard Debreu, stress on entrepreneurship in economic system. Other school, called Austrian School developed by Karl Menger, Eugen Von Böhm-Bewerk and Joseph Schumpeter, highlights the role of *innovative* entrepreneurs as an essential actor in the economy³.

Schumpeter introduced Evolutionary Economics which emphasizes the essential role of sustainable transformation. The Schumpeterian perspective views evolution as a natural way to study innovations and their consequences⁴. Metcalfe (2003) states that innovation involves behavioral differences of economic agents in evolutionary processes. In the case of innovation in palm oil sector, readiness of transition is required. Therefore, the technology frontier should replace business-as-usual economic activities with a limited consideration on natural capital (ecosystems) and social capital (relations between people). It is easier to expand the plantation and burn palm oil trunks instead of innovating with high uncertainty and risk.

² Freeman Chris, “Continental, national and sub-national innovation systems - complementarity and economic growth,” *Research Policy*, 2002: 191 - 211.

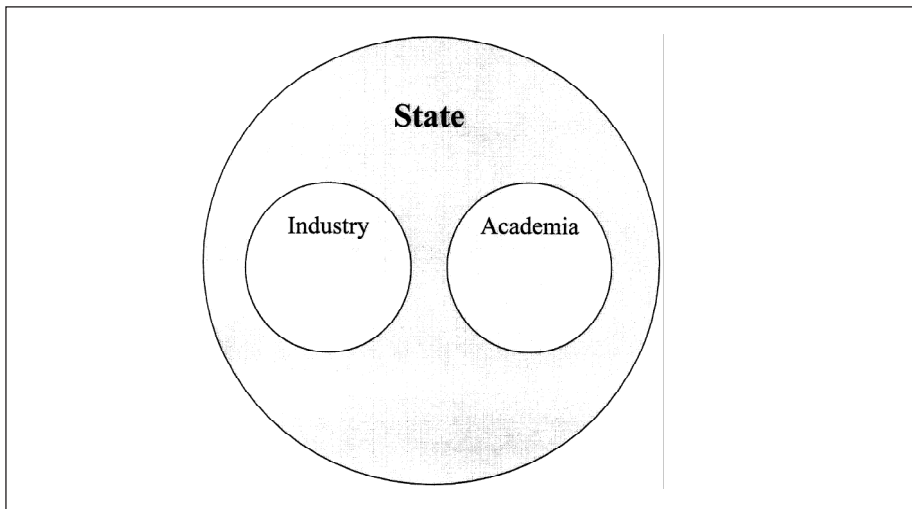
³ Syafrizal Maludin, “Memahami Peran Dinamika Sosial-Ekonomi Dalam Sistem Inovasi Indonesia.” In *Ekonomi Inovasi*, by Suhono Harso Supangkat, 61 - 66 (Bandung: Lembaga Pengembangan Inovasi dan Kewirausahaan, 2010).

⁴ John Stanley Metcalfe, “Industrial Growth and the Theory of Retardation: Precursors of an Adaptive Evolutionary Theory of Economic Change,” *Revue économique*, 2003: 407 - 432.

IvT leads to Innovation System as a tool to analyze the linkage amongst actors in the national or sub-national system. This system requires transitional, dynamic and open relations amongst actors in the system such as academia, state and industry and among sub-systems such as Employment System, Financial System and Market System.

Leydesdorff et. al. (2000) illustrate three configurations of Innovation System (hereafter, this system is named Triple Helix or TH).⁵ The first system is Etatistic Model (Figure 1) that puts State at the centre among Academia and Industry. This model was applied in Eastern Europe and Latin America.

Figure 1: An Etatistic model of university–industry–government relations



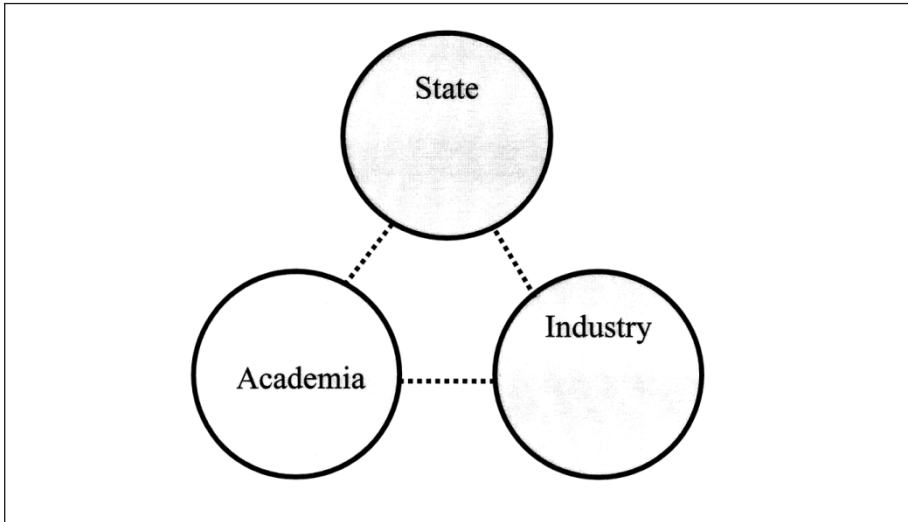
Source: Henry Etzkowitz and Loet Leydesdorff, "The dynamics of innovation: from National Systems and 'Mode 2' to Triple Helix of university - industry - government relations," *Research Policy*, 2000: 109 - 123.

The *authoritative role of government* in this model was successful in Japan and South Korea. Both countries are not equipped with abundant natural resources. The Meiji Restoration was successfully transforming Japan into an industrial country.

⁵ Henry Etzkowitz and Loet Leydesdorff, "The dynamics of innovation: from National Systems and 'Mode 2' to Triple Helix of university - industry - government relations," *Research Policy*, 2000: 109 - 123.

The second model of Triple Helix is *Laissez-Faire Model* (Figure 2). This model is formed by each actor connecting directly to every other actor in the system. Sweden is applying this model.

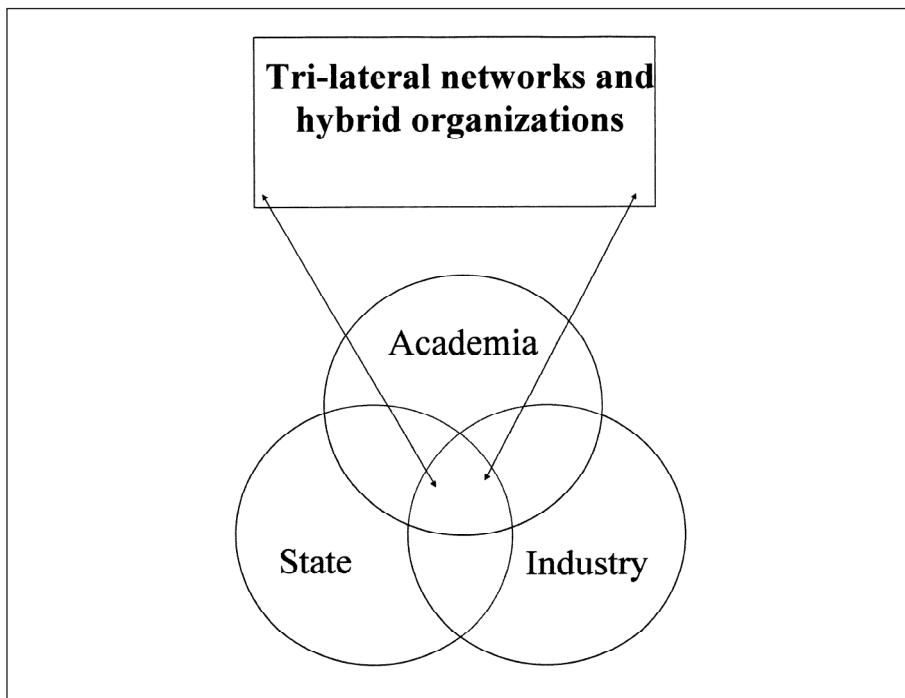
Figure 2: A “laissez-faire” model of university–industry–government relations.



Source: Etzkowitz and Leydesdorff, “Triple Helix.”

The third model of Triple Helix is formed by a structure of knowledge among institutions that allows one actor to undertake other members in the system (Figure 3). Three actors intersect in a space called the Hybrid Organization. This model is initiated by government with no or limited intervention in the system. The intersection stimulates independence and a suitable environment that includes research, government and private sector as illustrated in Figure 3.

Figure 3: The Triple Helix Model of University–Industry–Government Relations.



Source: Etzkowitz and Leydesdorff, "Triple Helix."

Promoting innovation in palm oil cluster should be comprehensive that represents the innovation system in a macro, micro and meso scale. Academia should be involved in taking a stake and understand how to establish a eco-innovation to every actor in the system including oil palm growers, palm oil processors, traders, retailers, local government and environmental conservation organization. Research outcomes which are related to the quality of seeds, soils and crop productivity should be accessible. Inventors claim that their findings are more advanced than their counterpart in Malaysia. Some scholars give lectures in that country. However, our plant productivity was only 3.4 million ton per hectare compared to Malaysia that can produce 3.6

million tons per hectare⁶. Government's funds on S&T's (Science and Technology) should be expended to facilitate their research activities.

Introducing Sustainable Development

It is widely recognized that we are highly dependent on firms that produce any kind of our basic needs. Firms provide us with food, clothes, water, and in particular case we also need them to provide oxygen. But, they also produce carbon, waste and air pollution from their manufacturing processes. So, there are positive and negative sides of commercial activities. Dunphy, Griffith & Benn (2007) imply that "*corporations are the fundamental cells of modern economic life and their phenomenal success in transforming the earth's resources into wealth has shaped the physical and social world in which we live.*"⁷ Hence, they also argue that some traditional organizational values and forms are not sustainable and, unless they are significantly reshaped, it will continue to undermine the sustainability of society and the planet.

Moreover, *sustainable development generally understood as development which meets the needs of the present generation without compromising the ability of future generations to meet theirs*. Since then, integrating the social, environmental and economic dimensions of sustainability as a holistic process has proven a major challenge to business managers, community activists, politicians, bureaucrats and theoreticians. Every actor in the system has a responsibility to pass on a better environment for the next generation. The impact of climate change to business sector should also be considered as it is shown in Table 1.

⁶ Martha Prasetyani and Ermina Miranti, "*Bank Negara Indonesi*," January 20, 2007, available at <http://www.bni.co.id/Portals/0/Document/197%20Potensi.pdf>, accessed on February 20, 2011.

⁷ Dexter Dunphy, Andrew Griffiths, and Suzanne Benn. *Organizational Change for Corporate Sustainability: A guide for leaders and change agents of the future* (New York: Routledge, 2007).

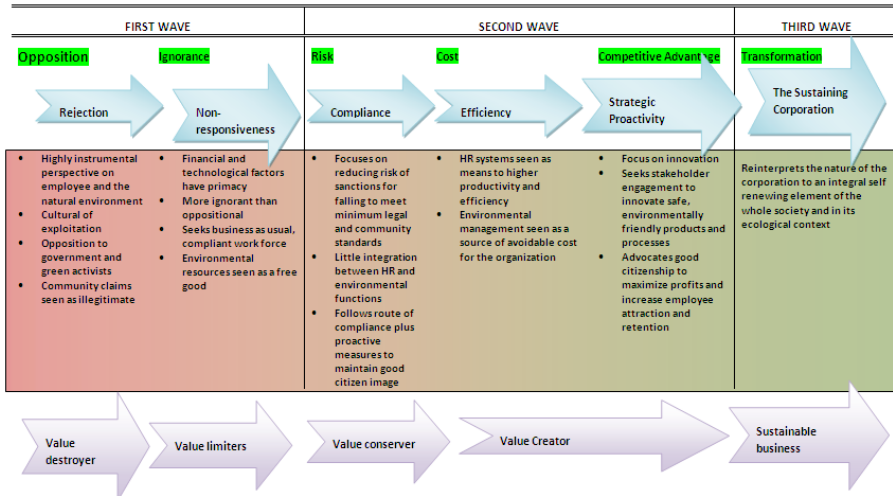
Table 1: Effects of climate change on various sectors

Sector	Weather related risk Short-term	Regulatory related risk	Potential oppor- tunity	Long-term
Property and Con- struction	Higher insurance costs	Higher insurance costs or inability to get insurance Decrease in asset value due to changes in flood levels or poor energy perfor- mance. Increased con- struction costs due to changes in building codes	Minimum ener- gy performance standards. Inclusion of energy inten- sive construc- tion materials into Emission Trading Scheme (ETS)	Growth market for energy efficiency/ management prod- ucts and services Growth market for energy efficient construction ma- terials. Property energy performance used as differentiation to attract key clients
Trans- port and Infra- structure	Increased mainte- nance and insur- ance costs due to increased storms and flooding Increased variabil- ity in water supply	Increased con- struction costs due to changes in civil engineering standards	Minimum energy transport performance standards Inclusions of avi- ation in fuel and airline industry in ETS	New water infra- structure Alternative fuels
Tour- ism and tourism related	Destruction of major tourist attrac- tions	Destruction of major tourist at- tractions Increase in tropical diseases impacting at- tractiveness as destination		
Retail and con- sumer discre- tionary	Increased volatil- ity in earnings of weather exposed or season dependent products due to increased weather variability	As for short term	Compulsory energy perfor- mance standards for consumer	Growth in demand for energy-efficien- cy consumer goods
General	Increased business interruption due to extreme weather events	As for short term	Need to include ETS related assets and liabilities in financial ac- counts increased electricity price	

Source: I. Woods and M. Wilder, "Climate Change and Company Value," on Andrew Dunphy and Benn, *Organizational Change for Corporate Sustainability: A guide for leaders and change agents of the future 2007* (Sydney: AMP Capital Investor and Baker McKenzie, 2005).

Pimm, et. al. in Lee (2010) argue that \$ 18.4 billion is needed to protect 70% of global biodiversity.⁸ The transition to a new organization is required to save the environment. The phase of transition is shown in Table 2.

Table 2: The Third Waves of Sustainability



Source: Stark Kemp and Tantrum 2004 in Dunphy, Griffiths, & Benn, 2007.

There are some evidence that land clearing for palm oil plantation is still supported, as reiterated in the statements by government and associate groups to palm oil industry via publicity in media and seminars. Thus, most companies are still in the phase of first wave. This group targets short term profits, increasing rate of employment and higher contribution to national income.

Palm Oil: Natural Resource Curse?

It is almost impossible to live without products from palm oil and its derivatives. Demand of these products is developed in line with increasing population. However, expanding the plantation to the forest and conservation zone should be out of consideration.

⁸ Robert Lee, *Changing Paradigms in Biodiversity Conservation for New Concept for Sustainable Humankind and Society Lecture Series*. Presentation, Jakarta: International Center for Interdisciplinary and Advanced Research (ICIAR), 2010.

Since 1848 when palm oil was planted in Bogor Botanical Garden from its original home in Africa, this crop has multiplied massively. The production for commercial use of palm oil in the Dutch East Indies reached its peak in 1938 (227,000 tons).⁹ It has grown to approximately 22 million tons in 2010.¹⁰ Ministry of Agriculture set the target of production of palm oil to 40 million tons in 2020 through producing high-quality seeds and rejuvenating land. This is the appropriate entry point for collaboration with national S&T institutions.

The establishment of Roundtable on Sustainable Palm Oil (RSPO) which started in Zurich, Switzerland on April 8 2004 rules that any new plantation opening after 2007 is not allowed in the primary forest and peat land¹¹. Poster and information releases about the loss of specific flora and fauna due to clearing the forest for palm oil plantation should have been considered. On the other hand, palm oil plantations manage the land very efficiently; 6 – 10 times more efficient compared to soybean cultivation. Data from Oil World shows that this sector requires production cost less than US\$250 for 1 hectare to produce 4 ton/ha.¹²

It shows that the palm oil production have the potential to preserve the land from an inefficient use by other vegetable oil production. In other words, this sector has also an essential role in sustainable development.

Introducing Innovation in Sustainable Palm Oil Plantation

Universities and publicly funded research institutions as technology providers play a potential role to provide technology as the solution for sustainable economic development. This issue is important because of the question of how firms can access an appropriate technology as a solution to cope with the turbulent move of the market. While we are still dealing with land clearance for palm oil plantation and expanding the capacity to meet the demand of Crude Palm Oil

⁹ Y. SATO, "The Palm Oil Industry in Indonesia: Its Structural Changes and Competitiveness," in Y. SATO, & M. E. Pangestu, *Waves of Change in Indonesia's Manufacturing Industry*, 63 - 94 (Tokyo: Institute of Developing Economies, 1997).

¹⁰ N. Sutanto, "Plantation sector: Increasing demand versus tight supply," *The Jakarta Post*, 9 December, 2010.

¹¹ Rosediana Suharto, "Why Indonesia Needs ISPO," *The Jakarta Post*, 2 December, 2010.

¹² Business News, "Wakil Menteri Pertanian: UE Pertimbangkan Ubah Persepsi Soal Sawit. News," *Business News*, 2011.

(CPO), Malaysia had moved forward to Processed Palm Oil (PPO) and ready to gain more profits from carbon trading.

So far, companies in this sector are unlikely to be interested to run a new technology. It is not completely wrong due to the lack of legal framework to support knowledge transfer system (KTS) in this sector.¹³ Sobel 2008 implied that KTS is also influenced by economic, political and legal institutions. A better approach to KTS will produce efficient policies that will stimulate companies to innovate.

International bodies and Non-Governmental Organization have also made a strong appeal to this business. There are six agreements between the Government of Indonesia and ASEAN regarding deforestation and haze pollution, three Letters of Intent with Australian Government in forestry and capacity building and also 5 joint declarations with the Government of Japan since 2001. There are numbers of the joint projects between the Government of Indonesia and international organizations in relation to sustainable plantation, agricultural and forest, including:

1. The Association of Southeast Asian Nations: Consensus on Agricultural and Forestry
2. The Government of Australia: Indonesia-Australia Forest Carbon Partnership
3. The Government of Canada: Loan agreement to finance the equipment to be supplied for Forestry Central Training Center
4. The Royal Danish Embassy of The Government of Denmark: Cooperation under the Clean Development Mechanism Projects
5. The State Forestry Administration of The People's Republic of China: The cooperation in the field of forestry
6. The National Oceanic and Atmospheric Administration of The United States of America: Collaboration in Climate Research
7. The Ministry for Foreign Trade and Development of The Republic of Finland: Climate Change and Sustainable Forest Management

¹³ From research dissemination which was funded by the Sumitomo Forestry to palm oil industries in North Sumatra , November 2010.

8. Loan from The Government of Japan for Climate Change Program
9. The Prime Minister of The Kingdom of Norway on Climate Change and Energy Issues
10. Ministry of Environment of The Hashemite Kingdom of Jordan on Environmental Protection and Natural Resources Conservation Cooperation
11. Fauna & Flora International, United Kingdom regarding Collaborative Program to Support the Conservation of Biodiversity in Indonesia.
12. Asian Development Bank (ADB) on Palm Oil Waste Management

In addition, Indonesian Institute of Sciences (LIPI), together with United Nations Educational, Scientific and Cultural Organization (UNESCO), conducted researches on science and technology relating to global climate and ecosystem services and was engaged in 5 projects, which are:

1. Man and Biosphere (MAB)
2. Intergovernmental Oceanographic Commission (IOC)
3. International Hydrological Programme (IHP)
4. Management of Social Transformations (MOST)
5. Intergovernmental Bioethics Committee (IGBC)

There is also the International Center for Interdisciplinary and Advanced Research (ICIAR) which includes the Green Advanced Materials and Climate Change & Disaster Risk Management.

But again, the problem in utilizing innovation and building awareness of environmentally friendly conducts re-appears. Sugiyono et. al. (2007) state that the level of interaction between two major national research institutes - Indonesian Institute of Sciences (LIPI) and Agency for Assessment and Application Technology (BPPT) - and three main palm oil seed producers was in a low level.¹⁴ The interaction of S&T network with downstream palm oil industry is even lower. Moreover,

¹⁴ Nora N. Rachma Sugiyono and Manaek Simamora, *Science & Technology Network in the Innovation System of Up-stream Oil Palm Industry in Indonesia* (Jakarta: UN-ESCAP and LIPI, 2007).

there are technologies are never socialized and are kept in research centers’ libraries.

Moreover, Indonesian Palm Oil Research Institute (IOPRI; PPKS: Pusat Penelitian Kelapa Sawit) is inactive in its collaboration with industries in this sector in developing new product development. It is because the institute’s function is limited to cooperation mainly with state-owned plantations in soil investigation and tree crop cultivation technology.

In spite of this, it is not an indicator that both parties should avoid to collaborated. The government regulations and legal procedure are not innovation-friendly. The quantity of patent registered is still the target with no legal framework to support it so it is not easy for inventors to claim royalties for their inventions. It is a policy drawback from Decree on National System of S&T and Government Regulation on Technology Transfer System with Decree on State Budget (2003) and Stock Treasury System (2004)¹⁵ as described in Table 3.

Table 3: Policy Drawback

Decree on National System of S&T and Government Regulation on Technology Transfer System	Decree on State Budget and Treasury System
<ul style="list-style-type: none"> ▪ Return from IP commercialization could be directly used. ▪ The value of royalty is based on license value. ▪ Royalty is considering as a credit point for inventors/creators. ▪ Need a distinctive regulation to operate this policy. 	<ul style="list-style-type: none"> ▪ Return from IP should go to the state treasure. ▪ The value of royalty is to be followed by a decree. ▪ Inventors/creators are servants of the state, so their royalties are the rights of the state. ▪ Expenditure mechanism obeys the stipulations and regulations of the national budget (APBN).

Source: Bambang Subiyanto, *National Technology Transfer System and Innovation Management Capacity Building Initiatives Case: Indonesian Institute of Sciences* (Jakarta: Center for Innovation, 2011).

¹⁵ Act of the National System of Science and Technology no. 18 of 2002 and Government Regulation on Technology Transfer; State Finance Act 2003 and Treasury Bills Act 2004

Until 2011, the number of patent granted is still a target although increasing the number of patent by the inventor does not reflect the welfare of inventor due to the existing regulation. It is important for government to encourage research institutions to enhance Indonesia's technological capability and awareness of the significant innovation.

Evolutionary theory places dynamics, process and transformation at the centre of the analysis which equipped with learning and knowledge as key elements to change the economic system.¹⁶ This phenomenon is described by Metcalfe (2002) who sees Schumpeterian Perspective as an approach to see the economy as an ensemble not an aggregate entity and to see more clearly the importance of micro-diversity in the relationship between growth of knowledge and growth of economy.¹⁷ This perspective which also includes evolutionary economics continually places appropriate innovations to function in industrial practices.

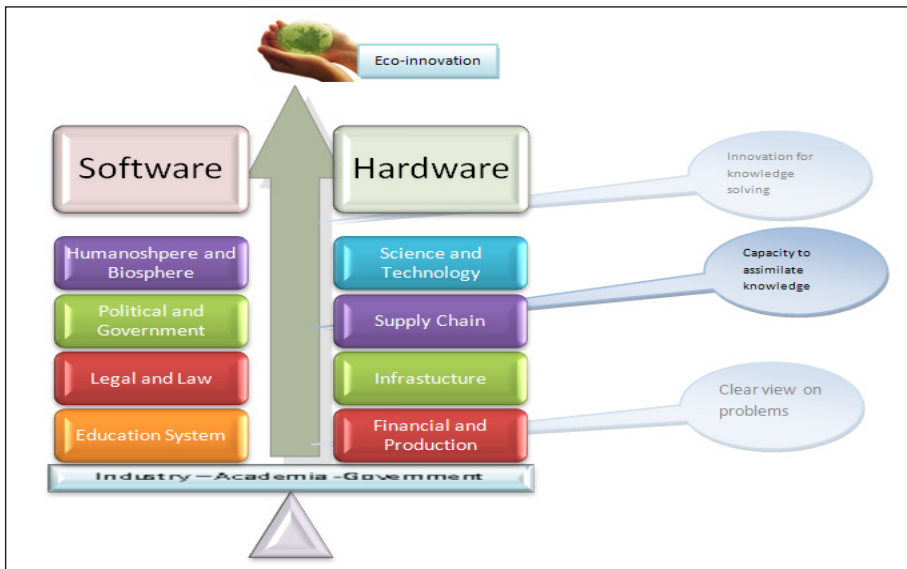
Triple Helix in New Balance Concept for Sustainable Development

Triple Helix in New Balance Concept (NBC) (see Figure 4) is a concept that considers the balance of role of every part in the system to harness innovation system with triple helix as foundation. Each factor in two sides should be managed appropriately in three phases. The first phase includes a clear view on the problem. It is important to get a consensus on the problem. If actors cannot agree on the issue, they are not recommended to move to the next phase as a capacity to assimilate knowledge. The second step requires every side to develop an alternative solution. The third phase is when all sides must find IvT as the solution to their problems.

¹⁶ Franco Malerba, "Sectoral systems of innovation: A framework for linking innovation to the knowledge base, structure, and dynamics of sectors," *Economy, Innovation, New Technology*, 2005: 63 - 82.

¹⁷ Metcalfe, "Evolutionary Theory of Economic Change."

Figure 4: Triple Helix in New Balance Concept



Source: “New Balance Concept: An Innovative Approach in SME Development through Knowledge Transfer System,” The 2nd Indonesia International Conference on Innovation, Entrepreneurship and Small Business (Serpong: CIEL-SBM-ITB, 2010), 1050 - 1057.

There are two sides on the scale: the direct factors to raise the profit and the indirect factors. The use of words of “software” and “hardware” is to illustrate that one side should compatible with the other side. A computer program will operate only when the software is compatible with the hardware. However, even it is compatible, it is also important to understand the function of the program.

In this NBC, the actors in Triple Helix need to work in mutual partnership, though it also admits that private sector should have a major role. Whether we like it or not, the responsibility for ensuring a sustainable world falls largely on the shoulders of the world’s enterprises, the economic engines for the future.¹⁸

There is an equal value to be considered in each side of the steel-yard balance to stimulate social entrepreneurs and small businesses

¹⁸ Kenan Stuart Hart, Flagler Business School in Dunphy, Andrew, & Benn, Organizational Change for Corporate Sustainability: A guide for leaders and change agents of the future, 2007.

to be aware of how technologies change. On the left side there are Seven Factors to consider. These factors are related to indirect factors or “software” in transferring Knowledge which are (1) Humanosphere and Biosphere, (2) Political and Government, (3) Education (4) Legal and Law.

Humanosphere and Biosphere relate to human and environment or it is called People and Planet in the Triple Bottom Line approach. This part is the most important in this balance to achieve the objective. If we learn that in most cases of human occupation, there will be a change in nature in the form of extinction flora and fauna. For example, the number of bison in North American continent had declined from between 30 million to 60 million since the time of European Settlement to 600 in 1800s.¹⁹ So, from that lesson, socio-economic and cultural factor should be considered as central among others.

The problems in utilizing new technology in the palm oil sector mostly occur because of the divergent objectives between business initiation and **government** policy. Business owners have a goal to gain a short-term profit but when it grows it should have legal aspects to work with. This is the beginning of a problem. The role of government is also suggested by Porter’s hypothesis stating that a better designed regulation can lead to greater innovation, reduce uncertainty, raise corporate awareness and signal areas of potential resource inefficiency.

Legal and law is vital for both parts in the balance. It is impossible to expect technology to be utilized by the corporation with no legal assurance. Inventors will keep their innovation if there is no guarantee that they will obtain benefits appropriately.

The right side consists of seven factors as well. There are (1) Science and Technology, (2) Supply Chain, (3) Infrastructure, (4) Financial and Production,

Science and technology is likely to be treated as one alternative solution in developing this sector. It offers neutral measurement of oil, air and water pollution, improvement of crops, and finally increases in profit. Researchers have the autonomy to conduct researches in basic, applied or commercial.

¹⁹ Dexter Dunph, Griffiths Andrew, and Suzanne Benn, *Organizational Change for Corporate Sustainability: A guide for leaders and change agents of the future* (New York: Routledge, 2007).

Potential user of technology is recommended to understand the problem that they face and provide a number of alternative solutions (dos and don'ts). Better machinery which is possible to produce a huge amount of pulp might turn to be expansive to forest and harm unique tropical flora and fauna, for example. To conclude, the capability to view appropriate technology as a solution is essential.

Second factor in right side, **Supply Chain**, should have a lot of attention in developing innovative and sustainable palm oil industry. Interconnection between the members of supply chain influences the efficiency of production. The mutual assistantship to small holders of palm oil farmers will contribute significantly to the productivity of this sector.

Infrastructure of information and communication are also essential in developing innovative palm oil industry.

Refurbished **the financial and production sides** is essential to achieve fair reward for Humanosphere and Biosphere. This step should have more attention in exploring palm oil and other natural resources in Indonesia. In most cases, the communities who live in a golden zone are left in poor condition. It will have big impact to the majority of small farmers and workers to get better standard of living.

This is a **grand design** to achieve sustainable development for palm oil production that should operate comprehensively not partly. When every part of the balance works by itself, it is not possible to achieve sustainable development of innovation in this sector. The situation right now is similar to Schumpeter illustration of bad horsemen who are very busy to get to the horse without having the knowledge of where to go.

There is opinion in the media about Vereenigde Oostindische Compagnie (VOC) that successfully developed plantations (rubber, coffee, sugar cane etc), constructed rail track and built mineral mining. But now, we are importing sugar, soybean, salt, meat, rice, and petrol.

Concluding Remarks and General Recommendations

1. Deforestation and clearing land for Palm oil plantation is still continue. Environmentalists argue that forest and peat land transformation contribute high carbon and destruct the equilibrium of nature. This turn to the extinction of protected flora

and fauna. The right to destroy and destruct has been preserve in the name of people welfare through the providing of employment and contribution to Gross National Product (GNP). The expanding of oil palms plantations put Indonesia as the third biggest carbon emitter after United States and China. It is required a firm action to any illegal action.

2. New and advanced technologies have been operated in this sector so the milling process is more efficient and chopping trees is faster. It is the negative impact of IvT that should be brought to an end.
3. IvT is abundant across research centers in Indonesia that it is highly possible to bring companies to move to an upstream market. Technology is also offer efficient support of plantation management. However, it takes all relating parties in this business environment through transition readiness as it is addressed by the Schumpeterian perspective.
4. Climate change is not a myth. There are evidences of effects of climate change on various sectors. It requires a holistic process to deal with this problem.
5. Business has fundamental a factor in modern economic and the product of CPO & its derivatives are attached to human basic needs. The demand of this product is increasing so far. But nothing lasts forever especially if we consider the era of carbon trading. Ivt is one rational alternative to preserve environment and meet the increasing demand. There is no "one size fits all" approach and it requires a comprehensive research.

Martyrdom, Galvanization, and Restructuring: Understanding the Impact of Osama bin Laden's Demise for the Evolving War on Terrorism*

Kumar Ramakrishna

Introduction

The death of Al Qaeda founder Osama bin Laden in a compound in Abbottabad, Pakistan at the hands of a crack US Navy SEALs unit on 2 May 2011, represented a hugely significant milestone in the global campaign against terrorism. As the man who created the notorious Al Qaeda terrorist network in the late 1980s and the chief planner of the

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* This article fleshes out and expands upon ideas drawn from two short think pieces: "World War IV is not over Yet", Today (Singapore), 4 May 2011. "Osama's Demise: End of Al Qaeda?", RSIS Commentaries, No. 70, 3 May 2011.

September 11 2001 attacks in the United States, Osama, by leveraging on globalization and what Thomas Friedman famously called the democratizations of technology, information and finance, very much transformed international politics.¹ The 911 strikes demonstrated that small teams of highly dedicated individuals could inflict physical, psychological, economical and geopolitical costs on a superpower. The attacks, horrifying as they were, were nevertheless an example of asymmetric warfare par excellence. Not surprisingly many scholars now speak of the current global campaign against terrorism as World War IV. World War III is regarded in some circles as the long Cold War between the US and Soviet blocs that lasted from the end of the Second World War till the dissolution of the Soviet Union in 1991.² It would be very difficult to exaggerate Osama's global impact. He was largely responsible for creating the Al Qaeda organization, brand and ideology in the late 1980s in Afghanistan. He inspired thousands of like-minded terrorists³ worldwide and Al Qaeda has evolved from an organization based in Afghanistan into a global movement. As the *New York Times* columnist Maureen Dowd puts it, Al Qaeda has become more like a "worldwide state of mind",⁴ while the British journalist Jason Burke has argued that Osama created not just an organization but a comprehensive – and violent - template for looking at the world which Burke called "Al Qaedism".⁵ Like-minded terrorists throughout the world hero-worshipped him, were inspired to emulate his exploits in their own regions and even named their children after him: the executed Indonesian Jemaah Islamiyah (JI) leader and Bali bomber Mukhlas, for instance was one militant who claimed to have met the Al Qaeda leader in Afghanistan in the 1980s and subsequently named one of his sons

¹ Thomas L. Friedman, *The Lexus and the Olive Tree: Understanding Globalization*, rev. edn. (New York: Anchor, 2000).

² Eliot Cohen, "World War IV: Let's Call the Conflict What it is", *Wall Street Journal*, 20 Nov. 2001; Norman Podhoretz, *World War IV: The Long Struggle against Islamofascism* (New York: Doubleday, 2007).

³ In this essay the terms "terrorists" and "militants" are used interchangeably. The debates surrounding the term "terrorist" have been well rehearsed elsewhere and need not detain us here. For an in-depth discussion of the controversy surrounding terminology, see Kumar Ramakrishna, *Radical Pathways: Understanding Muslim Radicalization in Indonesia* (Westport and London: Praeger Security International, 2009), chapter one.

⁴ Maureen Dowd, "Hey, W! Bin Laden Still Determined to Strike in US", *Free Democracy*, 17 July 2007, available online: <http://freedemocracy.blogspot.com/2007/07/maureen-dowd-hey-w-bin-laden-still.html> (accessed 31 May 2011).

⁵ Jason Burke, "Think Again: Al Qaeda", *Foreign Policy*, 1 May 2004.

after him.⁶ This begs the question: does the demise of Osama bin Laden represent a dislocating blow to the global terrorist movement? Does his death spell the end of his influence? What does his demise mean for the ongoing counter-terror campaign globally and in Southeast Asia?

This article suggests that while the death of Osama represents a genuine political, symbolic and operational success for the US and its counter-terrorist allies worldwide, it would be a little premature to declare victory in the global war on terror. First, the good news: Without doubt, Osama's elimination represents a huge political and symbolic victory for the US and its allies. Lest it be forgotten, the September 11 2001 Al Qaeda attacks in New York and Washington represented the worst terrorist atrocity in history, claiming almost 3000 lives in a single day. It was a profoundly humiliating blow to US prestige and its psychological impact on Americans both within and outside government linger to this day. By finally eliminating Osama, Americans everywhere – particularly those who lost loved ones in the strikes that day - can rightly feel that justice has been served and a sense of closure attained. The killing of Osama also represents a vindication of the professionalism and skill of US counter-terrorist and intelligence forces and hence provides a vital morale booster in the ongoing struggle against Al Qaeda and its allies. It is also worth keeping in mind that the elimination of the Al Qaeda leader has also provided President Barack Obama with a genuine boost to his popularity ratings with an election year coming in 2012. Obama has certainly wasted little time in thanking the Navy Seals troops, military support teams and intelligence units that eventually located and killed Osama.⁷ Finally, the demise of the Al Qaeda leader is also a welcome fillip to the morale of governments worldwide that are also struggling with Al Qaeda or similar terrorist networks themselves. Little wonder that many world

⁶ "Bali Bombers Await Firing Squads as Indonesia Stands Guard", *AFP*, 31 Oct. 2008, available online: <http://afp.google.com/article/ALeqM5hNq2tHYypRvCygRHHsZCPTQ24mxQ> (accessed 31 May 2011).

⁷ Richard Sisk, "President Obama Thanks Navy Seals Team that Killed Osama Bin Laden", *NYDailyNews.com*, 6 May 2011, available online: http://articles.nydailynews.com/2011-05-06/news/29534139_1_release-osama-death-photos-president-obama-highest-honor (accessed 31 May 2011). See also Patricia Zengerle, "Obama Thanks CIA for Helping Track Down Bin Laden", *Reuters.com*, 20 May 2011, available online: <http://www.reuters.com/article/2011/05/20/us-obama-cia-idUSTRE74J69A20110520> (accessed 31 May 2011).

leaders have come out to congratulate President Obama on the success of the operation⁸. However, one should not hastily assume that World War IV is over with Osama's death. That would be a grave strategic error. Some degree of circumspection is needed, for three reasons: we may call these the Martyrdom Effect, the Galvanizing Effect and the Restructuring Effect.

The Martyrdom Effect

First, precisely because Osama died in battle with "infidel" US forces, his followers can claim that he died as a martyr defending the faith. Hence Osama's personal prestige and iconic status with the global militant movement will only be enhanced rather than diminished now that he has passed away. This is truly ironic, as his direct influence on and command of Al Qaeda's global network had in fact been declining ever since 9/11, because heavy pressure by US and Coalition forces since late 2001 had forced him into hiding. So great had US and Coalition pressure been that it had disrupted Al Qaeda's central leadership and infrastructure in Afghanistan after the end of 2001 and led to the dispersal of many key militants elsewhere. To be sure, evidence has emerged from the treasure trove of information recovered from Osama's Abbottabad lair that even while in hiding he tried to plan new attacks in the US and Europe and retained a degree of contact with top Al Qaeda commanders through a system of couriers.⁹ Nevertheless in recent years it is arguable that other iconic figures in the global militant movement such as the late Abu Musab al-Zarqawi in Iraq and more recently the Yemeni-American ideologue Anwar al-Awlaki had overshadowed Osama in global militant popularity stakes. Osama's death has thus paradoxically ensured for him an enduring status in the pantheon of heroic radical Islamist¹⁰ figures lionized by Al

⁸ Nick Collins, "Osama bin Laden Dead: World Leaders react", *The Telegraph* (UK), 2 May 2011, available online: <http://www.telegraph.co.uk/news/worldnews/asia/pakistan/8487925/Osama-bin-Laden-dead-world-leaders-react.html> (accessed 31 May 2011).

⁹ "Osama bin Laden was planning Attacks on America and Europe till Last Moments, Reveals Handwritten Journals", *The Economic Times* (India), 12 May 2011, available online: http://articles.economictimes.indiatimes.com/2011-05-12/news/29536162_1_bin-al-qaeda-huge-cache (accessed 31 May 2011).

¹⁰ As the Middle East scholar Daniel Pipes explains, Islamism is not Islam. Islamism seeks to transform "Islam, a religion and civilization, into an ideology". See his "Distinguishing between Islam and Islamism", 30 June 1998, available online: <http://www.danielpipes.org/954/distinguishing-between-islam-and-islamism> (accessed 31 May 2011).

Qaeda militants and associates worldwide such as Zarqawi, Osama's late mentor Abdullah Azzam and the late Muslim brotherhood ideologue Sayyid Qutb. That Osama's name is not likely to pass from the scene with his killing is clear for all to see: throughout the world, hardliner groups responded to news of his death by holding prayer vigils and demonstrations. In Solo, Central Java in Indonesia for example, a previously unknown group calling itself Al Kaida Solo held a rally in honor of Osama and its leader, a cleric called Choirul, declared that Osama's "fight would not be ending".¹¹ Meanwhile in Manila, another hardliner cleric Jamil Yahya led a dozens of Muslim protestors from the main mosque to the US embassy and had to be held back by police with anti-riot shields. It was clear that Osama's death is being seen by his supporters worldwide as the ultimate embodiment of his principle of "living nobly or dying a martyr".¹²

The Galvanizing Effect

Closely related to the Martyrdom Effect of Osama's demise is what may be called the Galvanizing Effect. If one scrutinizes the historical record with care, it would be obvious that killing militant leaders does not always demoralize the movements they created. Rather, the opposite is often true – the members of such movements stiffen their resolve and are galvanized to strike back at their enemies. In Egypt, the hanging by President Gamel Abdul Nasser of his Muslim Brotherhood nemesis Sayyid Qutb in 1966 galvanized the entire following generation of radical Islamists – including the current Al Qaeda second-in-command Ayman al-Zawahiri. The death of Qutb helped pave the way to the emergence of even more virulently radical groups such as Egyptian Islamic Jihad, which later joined forces with Al Qaeda in Afghanistan. In Indonesia, moreover, the execution in the early 1960s of S.M. Kartosoewirjo, the charismatic founder of the Darul Islam armed separatist movement did not destroy it. Instead former Kartosoewirjo acolytes such as the late Abdullah Sungkar and a certain Abu Bakar Ba'asyir were galvanized to keep Kartosoewirjo's dream of an Islamic State in

¹¹ "Protestors Condemn 'Brutal Killing' of bin Laden, *MSNBC.com*, 6 May 2011, available online: http://www.msnbc.msn.com/id/42927020/ns/world_news-death_of_bin_laden/t/protesters-condemn-brutal-killing-bin-laden/ (accessed 31 May 2011).

¹² 'Brutal Killing'

Indonesia alive. It should never be forgotten that it was the followers of Sungkar and Ba'asyir who later fought with Arab and other Muslim fighters against the occupying Soviet forces in Afghanistan - and returned to Southeast Asia to form the violent Jemaah Islamiyah network in the early 1990s.¹³ In truth, rather than destroy the global Al Qaeda-led and inspired militant movement, Osama's death will be seen as a rallying point or what conflict scholar Vamik Volkan calls a "chosen trauma" to energize newer leaders and followers.¹⁴ In this connection it is telling that Abu Bakar Ba'asyir, on being informed of Osama's death, insisted that he had become a martyr and that Al Qaeda would not die with him.¹⁵ Finally, if history is any guide, it can be expected that militant groups and for that matter individuals worldwide who have been inspired by Osama and Al Qaeda will not stand still. Instead they will redouble their efforts to mount significant terrorist attacks against US and allied interests in home countries and abroad, simply to make the statement that Osama's demise will not be in vain and that the struggle carries on. At the time of writing, reprisal attacks have already occurred in Pakistan. On 13 May, a mere 11 days after the death of Osama, a suicide bomber killed 98 soldiers of the Frontier Constabulary at its training centre. Then on 22 May, militants laid siege to the Pakistan Navy's premier base in Karachi for 16 hours, killing 10 Pakistani troops. Moreover, a US Consulate vehicle was attacked in Peshawar on 19 May while a further 41 police men were killed in attacks on police stations in Hangu and Peshawar on 25 and 26 May. All these attacks were claimed by Tehrik-e-Taliban Pakistan, better known as the Pakistani Taliban. The Pakistan Taliban has also warned of future attacks and made it clear that they were "in retaliation for the killing of bin Laden at the hands of both Pakistan and the United States".¹⁶ It should not be forgotten in this regard that this year marks the 10th anniversary of the

¹³ For a more detailed account of how the current JI network emerged from the Darul Islam separatist movement, see Ramakrishna, *Radical Pathways*.

¹⁴ Vamik Volkan, *Killing in the Name of Identity: A Study of Bloody Conflicts* (Pitchstone Publishing, 2006).

¹⁵ "Al Qaeda Will Not Die: Radical Indon Group", Nine News (Australia), 2 May 2011, available online: http://news.ninemsn.com.au/mobile/article.aspx?id=8243789&noid=6304&_s=FFFFFFFF-FFFF-FFFF-FFFF-FFFFFFFFFFFFFF (accessed 31 May 2011).

¹⁶ Aamir Latif, "Militants in Pakistan More Brazen After the Bin Laden Raid", *GlobalPost*, 28 May 2011, available online: <http://www.globalpost.com/dispatch/news/regions/asia-pacific/pakistan/110527/pakistan-news-naval-base-al-qaeda-osama-bin-laden> (accessed 31 May 2011).

911 attacks in New York and Washington. Hence it would not at all be surprising if a major terrorist attack by Al Qaeda and/or its various affiliates would be attempted as the anniversary date approaches. It has in fact been confirmed that Osama had been plotting to attack the US rail network around the 10th anniversary of September 11. To avenge his death, Al Qaeda inspired affiliates may now be galvanized to carry out fresh attacks worldwide, ranging from “cheap, small-scale” strikes using pipe bombs, targeted car crashes and even lone gunmen, to paralyzing commando-type Mumbai-style attacks. Little wonder that Interpol has warned law enforcement agencies in 188 countries to “be on alert for retaliatory attacks”.¹⁷

The Restructuring Effect

Compounding the Martyrdom and Galvanizing Effects is what may be termed the Restructuring Effect. To be sure, this third Effect had been well underway long before Osama was killed: the forced dispersal of many Al Qaeda functionaries from Afghanistan following the US attack on that country a decade ago led to a restructuring of the organization. It has since become, as noted, a movement built on increased reliance on the Internet for purposes of recruitment, training and indoctrination. In fact as the leading terrorism scholar Marc Sageman argues, after 2004, chatrooms and discussion groups on the Internet became important sites – rivaling the radical mosques in a previous era - in which small groups of individuals became radicalized to the point of deciding to embark in what he calls “leaderless jihad”.¹⁸ Indeed some Al Qaeda strategists – particularly Abu Musab al-Suri – have argued that a global grassroots-based Islamist resistance could be generated by small semiautonomous cells through the Internet. With the loss of such a central, unifying symbolic personality as Osama,¹⁹ it seems likely that the global Al Qaeda movement will shift far more decisively from a “hub-and-spokes network” with “Waziristan as the hub”, in the direction of what the eminent American analyst John Arquilla calls a “‘mesh’

¹⁷ “Internet Chatter Up on Bin Laden Revenge Attacks”, *AP*, 6 May 2011, available online: <http://www.google.com/hostednews/ap/article/ALeqM5jdG9YDvp2WG58wIXMpT-E9YAnbw?docId=1c1e72fe6ae4455b84e8104482a5cc1b> (accessed 31 May 2011).

¹⁸ Marc Sageman, *Leaderless Jihad* (Philadelphia: University of Pennsylvania Press, 2008).

¹⁹ See Peter Bergen, “Five Myths About Osama bin Laden”, *The Washington Post*, 6 May 2011.

network composed of small, loose-jointed cells distributed globally”.²⁰ It should be noted that the late Noordin Top was apparently an admirer of al-Suri’s emphasis on small cells taking the fight continually to the enemy and sowing fear and confusion in his ranks.²¹

The Restructuring Effect was also expedited it must be said, by the US invasion of Iraq in March 2003 and subsequent occupation. This resulted in two outcomes of enduring strategic significance: first, it created a global pool of resentful young men who bought into Osama’s “The-West-is-at-War-with-Islam” theme and became more easily radicalized. Second, the Iraq intervention also arguably distracted the US from Afghan affairs and this led in part to the resurgence of Taliban and Al Qaeda in that country and Pakistan. The Iraq intervention thus on balance created conditions for Al Qaedaism – to use Jason Burke’s phrase –to thrive even further. The transmutation of the Al Qaeda structure over the past decade has led to the emergence of Al Qaeda offshoots in North Africa, Iraq, Yemen and elsewhere, including in Southeast Asia. Anwar Al-Awlaki, the so-called “Bin Laden of the Internet”, who arguably better represents the current Internet-based face of Al Qaeda more so than Osama, is part of the very active Al Qaeda in the Arabian Peninsula (AQAP) group based in Yemen. It should be noted that thanks to Al Qaeda’s presence on the Internet, ideologues such as Awlaki have been able to extend their reach worldwide beyond the Afghanistan-Pakistan zone, to radicalize individuals such as US Army Major Nidal Hassan, who killed fellow servicemen in Fort Hood, Texas in November 2009, as well as the so-called Nigerian “underwear bomber” Umar Farouk Abdulmuttalab, who tried to blow up an American commercial aircraft en route to Detroit on Christmas Day 2009.²² It should not be forgotten that Awlaki also radicalized individuals in Singapore last year: a 20-year old national serviceman, Muhammad Fadil Abdul Hamid made direct email contact with Awlaki and was radicalized to the point of wanting to fight alongside Aw-

²⁰ John Arquilla, “The New Seeds of Terror”, *Foreign Policy*, 10 May 2011.

²¹ “Indonesia: Jihadi Surprise in Aceh”, *Asia Report No. 189* (Jakarta/Brussels: International Crisis Group, 20 April 2010), p. 13.

²² See John Duffey, “Anwar Al-Awlaki Linked to Underwear Bomber”, *Examiner.com*, 6 Jan. 2010, available online: <http://www.examiner.com/homeland-security-in-national/anwar-al-awlaki-linked-to-underwear-bomber> (accessed 31 May 2011).

laki in Palestine, Afghanistan and Iraq. In addition, a freelance religious teacher, Muhammad Anwar Jailani and his student, Muhammad Thahir bin Shaikh Dawood, were radicalized by CDs of Awlaki's compelling, folksy sermons as well.²³ Hence while Osama may be gone, there are other individuals like Awlaki, "the bin Laden of the Internet", who seem able to spread the ideological virus of Al Qaedaism in the strategic cyberspace medium.

Implications

In essence the threat facing the world today is not entirely identical to that which Osama first presented a decade ago. It continues to evolve. In Southeast Asia for example, in addition to organized Al Qaeda-like and linked terror networks such as JI and its various affiliates, self-radicalized individuals such as the aforementioned Singaporean national serviceman and various small groups have emerged. They have no direct institutional connection to Al Qaeda or JI but nevertheless embrace Osama's violent worldview to some extent. For example, the respected analyst Sidney Jones of the International Crisis Group has recently identified the emergence of several small groups within the Indonesian radical Islamist milieu: a Bandung-based group that attacked police in March-April 2010; a Medan-based group called Kumpulan Mujahidin Indonesia that assaulted a police station in Hamparan Perak in September 2010 and a Klaten-based cell of young vocational students that attempted to bomb churches and police posts in Central Java.²⁴ Such groups must be contended with. At the same time, older movements such as the Negara Islam Indonesia (NII) have recently appeared to ramp up recruiting efforts on university campuses across Indonesia – and a newly formed cell linked to NII was implicated in the attempted bombing of a church in Serpong, on the outskirts of Jakarta, as well as sending "book bombs" to prominent figures in Jakarta deemed as not Islamic enough.²⁵ These included

²³ Kumar Ramakrishna, "Self-Radicalization and the Awlaki Connection", *RSIS Commentaries*, No. 75, 7 July 2010.

²⁴ Sidney Jones, "Three Strategies for Jihad – and More Prevention Needed", *Tempo*, 12 April 2011.

²⁵ Farouk Arnaz, Zaky Pawas, and Nurfika Osman, "Church Bombing Suspect 'Was NII'", *Jakarta Globe*, 25 April 2011.

liberal Muslim figures and a counter-terrorism official.²⁶ In addition, in an apparently unrelated incident, a suicide bomber attacked a mosque in a police compound in Cirebon, West Java, killing himself and wounding 30 others.²⁷ The suicide bomber, Mohammed Syarif, was apparently part of another small group that had some ideological connections with Jemaah Anshorut Tauhid (JAT), an above-ground hardliner mass organization led by Abu Bakar Ba'asyir, currently on trial for alleging funding a terrorist training camp in Aceh that was discovered in February 2010 - and of course a co-founder of the older JI network.²⁸ The point of fact is this: as long as the virulent ideology of Al Qaedaism that Osama formulated and promoted is permitted to thrive and mutate, every single terrorist leader and combatant who is eliminated will likely be replaced by freshly indoctrinated recruits - as well as even newer and potentially more lethal terrorist networks. In light of the Martyrdom, Galvanizing and Restructuring Effects unleashed and reinforced by the demise of Osama bin Laden, what should be the response of open and free societies? Two broad options appear to be worth further exploration:

First, Osama's elimination should rightly be seen as validation of the continuing importance of so-called "kinetic", or "hard" military and law enforcement measures. Such measures are needed to neutralize active, real-time physical threats to societies everywhere. Hence continued investment in comprehensive counter-terror capacity-building, especially in countries targeted by Al Qaeda and its associates - such as the key states of Afghanistan and Pakistan - remain very much a priority. Within Southeast Asia, continued intelligence-sharing and operational co-ordination by the ASEAN countries most affected by transnational terrorism remains a high priority. In Indonesia, in many ways the regional locus of Al Qaedaism in Southeast Asia, continued investment in strengthening the professional skills of prison staff and combating prison corruption are critical measures in preventing re-

²⁶ "Indonesia Arrests Six over Book Bombs: Police", *Agence France-Presse*, 21 April 2011, available online: <http://174.143.173.70/global-filipino/world/04/21/11/indonesia-arrests-six-over-book-bombs-police> (accessed 31 May 2011).

²⁷ "Book Bombs".

²⁸ Farouk Arnaz, "Bashir Has No Ties to Cirebon Bomb Attack: Assistant", *Jakarta Globe*, 21 May 2011.

leased terrorist prisoners from backsliding and rejoining or starting new networks.²⁹

Second, such hard measures must be supplemented, however, by a range of “soft” measures. These soft measures are needed to diminish the underlying conditions that generate hordes of readily radicalizable young men as well. Such soft measures include good governance that promotes safe and secure communities where families can earn a decent and dignified living. A particularly crucial soft measure is education that equips young people with the critical faculties to evaluate what they see, read or hear online or in the real world. One of the factors, according to Indonesian terrorism analyst Noor Huda Ismail, that led to the emergence of a terror cell amongst vocational school graduates and students in Klaten was because as “youngsters” they were “being targeted because they are easier to persuade, with their poorly developed critical thinking skills making it easy for a charismatic figure to brainwash them”.³⁰ Furthermore, given the increasing importance of the Internet chatrooms and discussion groups in radicalizing impressionable young people, calls for enhancing digital literacy amongst youth are also worth further study.³¹ It is essential that sufficient resources continue to be invested in counter-ideological work directed by qualified and savvy Muslim scholars who can engage with Al Qaedaist arguments online.³² Other possible softer measures include what is being done in Singapore: the Islamic Religious Council of Singapore (MUIS) runs the Asatizah Recognition Scheme “to enhance the standing” of Singapore’s Muslim religious teachers (*asatizah*) and “to serve as a reliable source of reference for the Singapore Muslim community.”³³ MUIS was in fact able to weed out Jailani, the Awlaki-radicalized religious teacher mentioned above, as a result of this very

²⁹ See Carl Ungerer, “Jihadists in Jail: Radicalisation and the Indonesian Prison Experience”, *Special Report Issue 40* (Canberra and Singapore: Australian Strategic Policy Institute and the S. Rajaratnam School of International Studies, 19 May 2011).

³⁰ Farouk Arnaz and Obey Sianipar, “Suspecting Students with Terror Links, Police Probe Klaten Technical School”, *Jakarta Globe*, 27 Jan. 2011.

³¹ Jamie Bartlett and Carl Miller, *The Power of Unreason: Conspiracy Theories, Extremism and Counter-Terrorism* (London: Demos, 2010).

³² See “Indonesian Jihadism: Small Groups, Big Plans”, *Asia Report No. 204* (Jakarta/Brussels: International Crisis Group, 19 April 2011), p. 21.

³³ “Asatizah Recognition Scheme,” MUIS, September 2010, <http://www.muis.gov.sg/cms/services/Islamic.aspx?id=506>.

scheme.³⁴ Complementing the work of MUIS, the respected nongovernmental organization of volunteer Muslim scholars, the Religious Rehabilitation Group (RRG), has guided the ideological counteroffensive against Al Qaedaism. The RRG was formed following the discovery of the Singapore JI cell at the end of 2001. Between 2004 and 2006, the RRG conducted more than five hundred counseling sessions with JI detainees and has since expanded this program to the immediate families of detainees and the wider Singaporean Muslim community.³⁵ Ultimately then, a holistic counter-terrorism approach involving government, non-Muslim civil society and religious community leaders remains the key to coping with the complex threat posed by Al Qaeda and its ideological bedfellows worldwide.

Almost six decades ago the legendary British High Commissioner in the Federation of Malaya, General Sir Gerald Templer, broke the back of the Communist Party of Malaya's revolt. Worrying that a sense of complacency would quickly set in, he reportedly warned with his trademark non-nonsense candor: "I will shoot the b*stard who says the war is over".³⁶ Certainly Osama bin Laden's passing is a significant victory. But General Templer's forceful if not colorful injunction to keep the foot on the pedal is surely relevant now as it was then.

³⁴ Kumar Ramakrishna, "Build Firewalls against Extremism," *Straits Times*, 8 July 2010.

³⁵ Kumar Ramakrishna, "A Holistic Critique of Singapore's Counter-Ideological Program," *CTC Sentinel* 2, no. 1 (January 2009): 8-11. The RRG also runs a useful website, available at <http://www.rrg.sg/main>.

³⁶ For more on Templer's background and his considerable role in the ultimate defeat of the Communist insurrection in Malaya, readers should consult Kumar Ramakrishna, "'Transmogrifying' Malaya: The Impact of Sir Gerald Templer (1952-54)", *Journal of Southeast Asian Studies*, Vol. 32, No. 1 (Feb. 2001). Pp. 79-92.

Security and Democracy in Indonesia: The Need to Strike a Balance

*Makmur Keliat**

Introduction

This paper seeks to address the following question: why do security problems, conceptualized as the problems of violence, remain critical in Indonesia? This paper argues that the problem can be attributed to the incapacity of state to maintain its monopoly on the use of force. Specifically, security actors working under an increasingly weakened democratic state seems to have become ineffective in holding and executing such monopoly during the *Reformasi* period. This is a significant reversal of events compared to the New Order regime where the security approach had become the “commander” and a key instrument of political control. To support this argument, the paper will be divided into four parts. The first part seeks to provide a conceptual basis and clarity with regards to the various security problems that Indonesia faces. The second part attempts to depict the broader picture of Indonesia’s transition into democracy, and further scrutinize how security

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sector reform has become an integral part of that process. The penultimate part is concerned with identifying the specific security problems arising from the reform process, while highlighting the ineffectiveness of security actors to deal with those problems. Finally, we will provide some concluding remarks.

Security Problems in Indonesia

Within the context of Indonesia, what do we mean by 'security problems'? This question merits special attention for several reasons. First, for over a decade now there has been an academic zeal and enthusiasm to broaden the concept of security, especially within the security studies circle. This can be seen for example, from the emergence of numerous terms such as "food security", "energy security", "environmental security" and so on. However, this broadening of concept has also led to various conundrums and intricacy. How could we draw the line or clear boundary between food policy and security policy, between energy policy and security policy, or between environment policy and security policy? If every issue therefore can be defined as security issue—a process known as "securitization"¹—then the academic concept of 'security' would become dubious and vague. But more importantly, broadening the concept of security could also create various complexities for policy makers.² The reason is very simple. In very basic terms, a policy making process should from the outset begin with a clear, sound understanding of what the actual policy problem is. As the old saying goes, something that cannot be defined clearly certainly cannot be understood fully. This is why the definition of security needs to be specific in its scope.

This paper takes the position however that 'security problems' must be understood in essence to be problems of violence, or the use of force. This does not necessarily mean that the landscape of security problems is solely driven by or coming from military sources. Non-military sources such as disputes over natural resources, or various eth-

¹ For a comprehensive discussion on the idea of "securitization" see, Barry Buzan, Ole Waever, and Jaap de Wilde, *Security: A New Framework for Analysis* (Boulder, CO: Lynne Rienner, 1998).

² For further discussion on the traditionalists' concern of the widening of the security concept, see Stephen M. Walt, "The Renaissance of Security Studies", *International Studies Quarterly*, 35 (2), 1991.

nic, religious and cultural animosities could certainly also give birth to violent conflicts. However, if the dispute and animosity does not arise from or lead to specific forms of violence then they need not be considered as an object of security studies. Specifically, security problems as the problem of violence can take place at the three levels: inter-state (or popularly known as the state-centric model), intra-state and trans-national. A classical example of security problems within the state-centric model is a war of military aggression between states. Armed conflicts between communities and civil wars taking place within a state, which could result in serious political and social disorder, could also be considered as a security problem at the intrastate level. Violence by non-state actors—such as terrorist attacks or violent acts of sea piracy with their international network—which are also associated with terms like war against terrorism, can be classified as transnational security problems. In this regard, violence taking place either at the intrastate or transnational level can also be put under the term ‘non-conventional’ issues of security.

Secondly, violence is basically in direct contravention to the idea of democracy. It would be out of question to cultivate democratic values in a sovereign territory where violence, either taking place vertically between communities versus the state or horizontally between communities, has become the order of the day. When there is a tendency for a large number of people to take law into their own hands, there would be two negative impacts for society or the quality of their polity. It may indicate that a society has a government, but without a capacity to govern. But there is another alternative: a society may also conceive an authoritarian government as an answer to resolve the anarchical situation. These two extreme political options are certainly inimical to the idea of democracy.

From a procedural point of view, a democracy as a form of government in a sovereign territory is stated to have come into existence if citizens have the right to cast their votes in a regular election within a competitive multi-party, an institutionalized succession of national leadership, and the presence of a free media based on the freedom of expression, and so on. However, this viewpoint does not fully grasp the essence of democracy. Of particular importance, democracy also needs to be conceived as a mission, namely how multifarious groups

within a society with diverging interests agree to live in co-existence and find peaceful solutions to their differences.³ These two emphases imply that democracy will have no strong root to achieve the mission, and even become meaningless if a democratically elected government is permissive to the series of violent acts in its society. What matters most therefore is that the purpose of and demands for establishing a democratic government should also be achieved in tandem with demands to protect citizens from violent threats. In this regard, security considerations should not be utilized as an argument to dampen democracy down, while similarly, the needs of the citizens to obtain security protection should not also be sacrificed for the sake of democracy. Ideally, there has to be a balance between the two.

The third reason is related to the numerous studies on violent conflicts in Indonesia. These studies, which were conducted shortly after Suharto's downfall in 1998, have provided us with a number of interesting findings. Statistically speaking, these studies have shown us that violent conflicts have increasingly becoming from frequent in the *Reformasi* era when compared to the New Order period.⁴ These conflicts seems to have also taken place either horizontally between communities such as in Ambon and Poso, or vertically between the State and communities, such as in the Aceh province before the signing of Memorandum of Understanding in August 2005, or those in the volatile region of Papua. These are in addition to the serious security problem caused by terrorist attacks. It is estimated that nine suicide terrorist attacks have plagued Indonesia in the last ten years.⁵ Though the entire situation in Indonesia is by and large still under the grip and strong control of the central government, it is difficult to erase the impression that the potential for violent conflicts remains high for the years to come. It is also worth mentioning that it is not uncommon to see riots and violence surrounding or following local elections

³ See, John J. Di Iulio Jr., "Three Questions about Contemporary Democracy" in Hans F. Zacher (Ed.), *Democracy: Some Acute Question. The Proceeding of the Fourth Plenary Session of the Pontifical Academy of Social Science 22-25 April 1998*, (Vatican City: Pontifical Academy of Social Science, 1999).

⁴ The World Bank made a very exhaustive review on the matter. See Patrick Barron *et. al.*, "Understanding Violent in Indonesia", *Social Development Papers Conflict Crime and Violence*, Paper No. 17, June 2009.

⁵ As reported by *Kompas*, 16 April 2011.

in several places of Indonesia.⁶ In brief, the current imminent threat to Indonesia has remarkably been characterized by intrastate security problems with transnational dimensions.⁷

The fourth reason is concerned with the various explanations of the roots of the problem. There are those who point out that the institutional capacity of the New Order regime—either militarily, politically and administratively—in dealing with social grievances was far more vibrant compared to the *Reformasi* regime. It is said that the democratic regime has destroyed the institutions inherited by the New Order but, unfortunately, it has not succeeded in replacing them with new viable institutions; to the effect that violent conflicts have become rampant and acute in the society.⁸ Another view is that the violence is believed to have become part of Indonesia's political culture and history—one that is said to have been filled with bitterness and violence.⁹ Therefore, they are of the opinion that what has been occurring in the country, in so far as violence is concerned, is by no means new. This also implies that it would be a gigantic task and long journey for Indonesia to sustain its democracy in the future.

⁶ See "Indonesia: Preventing Violence in Local Election", *Asia Report, International Crisis Group*. 8 December 2010. According to the report the number of violent incidents in local election have increased. While in 2005-2008 there were only thirteen incidents, the recorded number in 2010 has increased into at least twenty.

⁷ See Kusnanto Anggoro, "Reformasi Sektor Keamanan, Kewenangan Negara, dan Partisipasi Publik" in Andi Widjajanto (ed), *Reformasi Sektor Keamanan Indonesia* (Jakarta: Propatria 2004). The government has been also fully aware of its intrastate security problems that has an international dimension. See, among others, *Buku Putih Pertahanan Indonesia* (Jakarta: Departemen Pertahanan Indonesia, 2008); *Strategi Pertahanan Negara* (Jakarta: Departemen Pertahanan Indonesia, 2008), and *Analisa Lingkungan Strategis 2008-2010 Implikasi Bagi Pertahanan* (Jakarta: Departemen Pertahanan Indonesia, 2008)

⁸ The problem of political institutionalization in new democracies has become a classical concern for scholars of democratic transition. The classical work by Huntington serves as one of the main references. See, Samuel Huntington, *Political Order in Changing Societies* (New Haven: Yale University Press, 1968). For further instances see, Edward D. Mansfield and Jack Snyder. "Democratic Transitions, Institutional Strength, and War", *International Organization*, 56(2), 2002; Edward D. Mansfield and Jack Snyder, "Incomplete Democratization and the Outbreak of Military Disputes", *International Studies Quarterly*, 46(4), 2002; Håvard Hegre, et. al., "Toward a Democratic Civil Peace? Democracy, Political Change, and Civil War, 1816-1992" *The American Political Science Review*, 95(1), 2001; Aurel Croissant and Wolfgang Merkel, "Introduction: Democratization in the Early Twenty-First Century", *Democratization*, 11(5), 2004; and Bruce A. Magnusson, "Democratization and Domestic Insecurity: Navigating the Transition in Benin", *Comparative Politics*, 33(2), 2001.

⁹ For instance, see Prabowo's views quoted in Elizabeth Fuller Collins, "Indonesia: A Violent Culture?", *Asian Survey*, 42(4), 2002.

However, this is not the only view. A recent emerging view argues that the violence could be attributed to the on-going and unfinished competition between the so-called “old political elements” represented by supporters of the New Order regime against “the new political elements” symbolized by the presence of the *Reformasi* democratic regime. A series of violence taking place in Indonesia is therefore said to have resulted from the hidden agenda exercised by “the old political elements”, whose main motive is to give false impression to the public that democracy is a luxury Indonesians should not deserve yet.¹⁰ Another study has shown that violence in Indonesia may possibly have its roots in the distinctive characteristics of the social associations in the country with a strong tendency to be exclusive, mainly built along with ethnic division and a very limited crosscutting engagement from each other.¹¹ With the exception of the study conducted by the UNDP,¹² however, the above studies seems to have made no specific attempt to highlight violent conflicts from the substantial changes that have taken place in Indonesia’s security sector for the past ten years.

Reformasi: Anti-state paradigm

There is no doubt that the abovementioned studies have helped us understand the distinctiveness of violent conflicts in Indonesia. However, from the perspective of security studies, those violent conflicts also suggest that Indonesia is wrestling with the serious problem of how to assert the monopoly of state on the use of force. It is specifically a symbol of the weakening power and authority of the state in exercising its monopoly over the use of force. It has been widely agreed that a state is conceived as a political institution with two main functions: as a provider of security and welfare to the public. These two functions are implemented through a myriad of regulations with the

¹⁰ See for instance, Angel Rabasa and John Haseman, *The Military and Democracy in Indonesia: Challenges, Politics, and Power* (Santa Monica, CA: Rand Cooperation, 2002).

¹¹ See for instance Ashutosh Varsney, “Ethnic Conflict and Civil Society: India and Beyond”, *World Politics*, 53(3), 2001.

¹² See, Christopher Wilson, *Overcoming Violent Conflict Peace and Development Analysis in Indonesia* (Jakarta, UNDP, 2005). Though not specifically focused on security sector reform, the report has in its concluding remarks the importance of the on-going security sector reform process particularly in conflict-ridden regions.

view to bind a society collectively as a nation in a sovereign territory.¹³ As a security provider, the state as an institution is entitled to have a monopoly on the use of force. With regard to the welfare function, the state is obliged to protect the weaker parties. The state therefore is not conceptualized as a passive political institution, as some may have conceived, in which a large number of diverse social groups compete freely against each other to promote their divergent interests without taking state regulations into account. In other words, all competitive political groups in a democratic society are bound to compete within the legal framework made by state.

However, as described later, three main features have characterized Indonesia's transition to democracy. First, it has been mainly inspired by 'anti-state' paradigm. This, in turn has resulted in the increasing ties of communal sentiments in Indonesia and a decreasing sense of respect for the rule of law. Second, the entire security actors in Indonesia have worked under a democratic environment. However, as democracy evolved without a strong spirit of social justice and rule of law, it has given birth to the intricacies and complications in dealing intra-state security problems. Third, security actors could be utilized to fill up the gap between the demands for democracy and for security. However, the country's civilian authority has yet to take the initiative to change the existing regulatory framework for security actors. An analysis is made in the following parts to explain how this process has taken place. It begins with a description of the main characteristics of democratization in Indonesia and followed with an analysis of the new functions and roles of the security actors; conducted through a security sector reform within the overall process of dealing with intrastate security problems. Let us begin with the context through which democratization has proceeded in the country shortly after Suharto's downfall.

This is important because the great transformation of Indonesia's security actors into their new roles and functions did not exist in po-

¹³ The paper takes the position that the concept of 'strong state' should be differentiated from the concept of 'strong power'. While strong power connotes more on the capability of the military force to deal with the external environment, a strong state is more associated with the questions and issues surrounding the resolution of domestic problems in a peaceful and democratic way. Therefore the concept of strong state emphasizes less on the hard component of power (force). For further discussion see Barry Buzan and Richard Little, *International System in World History: Remaking The Study of International Relations* (Oxford: Oxford University Press).

litical vacuum. It has in fact become an integral package of the broader political and economic reform launched shortly after Suharto's downfall in 1998. If Suharto were still in power, no reform would have taken place in the country. Considering that the political and economic contexts played a remarkable and very crucial role in the entire process of security sector reform in Indonesia, it seems necessary to depict first the initial process and the nature of the reform.

The most important factor of the reform has been Indonesia's transition from an authoritarian into a democratic state. The *zeitgeist* of the transition from the outset has come from the idea that the state's role in its relations to society and market should be redefined. There was a strong belief that the excessive intervention by the state is the main reason of why the authoritarian New Order, concentrated in the hands of Suharto, had succeeded in maintaining its power for more than three decades. What lies behind the *Reformasi* movement primarily has been to neutralize the excessive power of state (personified in Suharto's figure). The country's security actors, the Indonesian Defense Forces (*Tentara Nasional Indonesia / TNI*), the Indonesian Police (POLRI) and the Intelligence agencies, which were the main pillars of the New Order, were also re-designed to be put under the control and oversight of the civilian authority. Therefore, democratization and Security Sector Reform cannot be entirely decoupled and must be achieved along with other reform objectives..¹⁴

However, reform measures undertaken by the civilian authority to neutralize the power of state have primarily been directed more on the State's negative intervention. No concrete and substantial measures have been made to encourage and promote the positive intervention of state. The concept of welfare state, which necessitates the state to intervene with the purpose to protect the weaker side, appears to have been neglected and not seen as a critical issue. It seems that the political atrocities and bitter legacy of the New Order affected the new civilian authorities more than welfare distribution and development disparity, either within society or between regions (especially between

¹⁴ For a further discussion on the relationship between SSR and democratization in Indonesia, see Rizal Sukma and Edy Prasetyono, *Security Sector Reform in Indonesia*, Working Paper 9 (Netherlands: Institute of International Relations 'Clingendael' Conflict Research Unit, February 2003).

Java and other islands). The media and NGO communities have also paid more attention to civil and political rights such as freedom of expression than social justice.

Since from the very beginning, the top political agenda of the *Reformasi* regime has been to liberate the society from the control of state; whether economically or politically, the nature of *Reformasi* has thus been based on anti-state paradigm. The state was almost seen as a monster. Some even argued that Indonesia's economic problems, such as the huge debt and the drastic fall of exchange rate in 1998 and even corruption, have its roots in the state's excessive role. Thus, under the anti-state paradigm, measures for economic liberalization as a way to curb the power of state, have been launched. These include, for example, privatization, the opening up of national economy to regional and global economic forces, abolishing capital control, and insulating the Central Bank (Bank Indonesia) from intervention made by the Executive. Further policy prescriptions, dictated by the International Monetary Fund in the wake of the 1997 financial crisis through the signed twenty-one Letters of Intent (1997 to 2003), has driven the economic liberalization, almost uninhibited.¹⁵ In brief, "the best state is less state" has been the most popular lexicon of economic liberalization in the current *Reformasi* regime.

It is also under the banner of the anti-state paradigm that the *Reformasi* regime launched an array of political liberalization measures. Aside from holding free general elections, the regime allowed the media to exercise the "freedom of the press" almost with no limit, supported a pluralistic and competitive political party system, and further weakened the power and authority of the state through decentralization. This last policy essentially divulged political and financial powers to the provincial and district governments, especially with regards local resource management). Though monetary, fiscal, security, and defense policies remain the exclusive purview of the Central Government, de-

¹⁵ An insider's account by Soedrajad Djiwandono, who was the Governor of Bank Indonesia in the final days before Soeharto decided to step down is very interesting. The account clearly indicates that the IMF opined that the roots of Indonesia's financial crises in 1998 had its origins in the domestic side rather than in the nature of financial instability at the international level. See J. Soedrajad Djiwandono, "Bank Indonesia and the Recent Crisis", *Bulletin of Indonesian Economic Studies*, 36(1), 2000.

centralization was supposed to bring more transparency and accountability of local leaders in running local governments and in responding to local aspirations. It is not surprising therefore that demands for greater authority to exploit local natural resources has become part and parcel with the direct election of District Chiefs or Mayors, and Governors—all under the the 'regional autonomy' scheme.

However, this "democratic decentralization", promoted by the proponents of neo-liberal institutionalism, in the words of Vedi R. Hadizy, has failed to achieve its stated objective—let alone as the panacea of Indonesia's democratic challenges.¹⁶ In fact, it seems that nowadays, the corruption, collusion and nepotism are more dispersed and the players become more diverse; where old political oligarchies along with local leaders joined and competed in the march of democratic decentralization to exploit economic benefits offered by market liberalization. The failure of the neo-liberal proponents in transforming the new rules and norms of decentralization into the expected outcome can be partly attributed to their ignorance of the structure of economic and financial power inherited by the New Order. While the political structure has greatly changed because of democratization, the old economic power structure remains intact.

It is worth mentioning that almost all major political parties have given a place and space for the old political elite to become party officials. It is an irony that though KPK (Corruption Eradication Commission)¹⁷ has come into being and gained high reputation, New Order corruption cases seems to have disappeared like dust in the wind under the *Reformasi* regime. As such, it is not surprising that the democratization process has provided a sanctuary for the old political oligarchies. The initial high public expectation for political parties to play a role as a transmission belt between the state and society has increasingly dimmed. There is also a tendency that voter turnout in local elections in some parts of Indonesia has decreased.

¹⁶ See Vedi R. Hadiz, "Decentralization and Democracy in Indonesia: A critique of Neo-Institutionalist Perspective", *Development and Change*, 35(4), 2004.

¹⁷ Indeed the establishment of the KPK was part of the economic reform package formulated by the IMF in their letter of intent.

Under this peculiar political atmosphere, it is not difficult to find number of political elites relying the support of the old oligarchy, especially given the lack of resources to compete in local elections and because of the limited capacity of local institutions. Eventually, 'political transactions', almost similar to those under market mechanism, or excessive political pragmatism has become a remarkable feature of Indonesian politics, both at the national and local levels. While political platforms distinguishing one party with the other exists, in practice they do not guide party behavior. In coalition building for instance, it has become evident that no one can say with certainty the patterns and landscape of political coalitions from one region to another.

Impacts on security problems and on security actors

The impacts of this democratization with anti-state paradigm on security problems and on security actors are paramount. First of all, the negligence of the democratic civilian authority on the importance of welfare state has resulted in the strengthening of communal sentiments in the society. Since Indonesian democracy were nourished with the deficit of trust over the state, the people have only two options to fight for their interest and resolve their problem: either they go to the market, or rely on communal networks. However, because not everyone can compete in the market, some have no choice but to pick the latter rather than but relying on the power and authority of the state to resolve their problem.

In essence, Indonesian democracy currently tends to be built along the lines of communal sentiments where people tend to see the network of family bonds, religion, race and sectarian sentiments as more paramount and influential compared to the regulations mandated by state. The State that is ideally conceptualized as a myriad of state regulations have been understood more as a myriad of communal interests. The lack of positive intervention by the state in turn has led more people to see democracy as an ineffective instrument for the purpose of welfare distribution. It has become an undeniable reality even that while the political map of party coalitions tend to be very dynamic in the last ten years, the geographical map of poverty and disparity from one region to another seems to be on hold.

As a result of the increasing sentiments of communal bonds, the term citizen as *Rechtsperson*, as conceptualized by Gret Haller, seem to find it difficult to take a strong root in the society.¹⁸ When political transaction and pragmatism have afflicted civilian democratic authority and when the civilian authority has a tendency to turn rules of game into a game of rules in the name of democracy, it seems unrealistic to expect that every individual within a society could behave as individual legal entities aware of their rights and obligations. The lack of a sense of citizenship in terms of *Rechtsperson* is the crux of the intrastate security problem in Indonesia. When laws as mandated by the state are not fully respected, no one can expect that there would be a rule-based society. And when a society is facing problems to arrange their life on the basis of fixed rules, a huge distrust over the political process could lead to the emergence of a fertile ground for violence and public disorder. A high sense of respect for the law by the people therefore is a fundamental requirement to maintain and strengthen social fabrics and to bind people collectively as well. In essence, security in the sense of violent conflict avoidance is a very serious concern when respect for the rule of law exists only in very minimal expression.

It is likely that the re-emergence of the idea of the Indonesian Islamic State (NII) recently implies that some sections of society feels alienated from the existing political process. They might even feel more comfortable living within their communal identity, though by doing so they might confronting the idea of the Unitary State of the Republic of Indonesia (NKRI), possibly risking their life too. It is conceivable therefore that the negative responses shown by some sections of society vis-à-vis the concept of NKRI as a democratic state, whether manifested into a number of radical forms such as the NII, separatist movements, violent terrorist attacks or, in a milder version, violent demonstration by students, suggest the weakness, if not failure, of the civilian authority to fight for democracy in an integrated form with social justice and rule of law. In this regard, without a real intention and sufficient capacity to take over the welfare function of communal groups and

¹⁸ An interesting discussion of the importance of the term and the different perceptions between the United States and Europe on the relationship between the state and society are in Gret Haller, *The Limits of Atlanticism Perception of state, nation and religion in Europe and the United States* (Oxford: Beghan Books, 2007).

put it under state responsibility, it is likely that security problems at the intrastate level would prevail.

In this regard, as an archipelagic country with more than 17,800 islands, decentralization policy does not seem to provide an exhaustive answer to the problem. To some extent it even created additional problems in the efforts to mitigate intrastate security problems with transnational dimension. Since local elites must now compete in direct local elections to be district chiefs, mayors, or governors, it might be unrealistic to expect them to pay proper attention to the sparsely populated area, or to small and tiny islands located far from their capitals. What politically matters most for them are densely populated areas that could be utilized as potential voter base during local elections. However, those scarcely-populated remote areas and small islands carry a security value as these areas could be utilized as territorial footholds for terrorists to maintain and proliferate their transnational network. Of course one could argue that security policy is not under the responsibility of provincial and local governments. However, a modern sovereign state requires the presence of a civilian bureaucratic system enabling state institutions to identify its population. When a person could have more than one identity card, despite existing legal restrictions, there would be a serious problem in dealing with a terrorist threat with a transnational dimension. So what local elites think as 'strategic' in local elections might not be 'strategic' if seen from a security perspective.

Within this context, strengthening the role of the security actors could be conceived as a way to fill the gap between the demands for democracy and demands for security. However, the existing regulatory framework is not favorable to such objective. Let us see why it has become difficult to strike a balance between security and democracy and how politically, there would be little possibility to fill the gap. As stated earlier, the term Security Sector Reform has become a popular lexicon in the period of *Reformasi*. The reform aims to restructure the role and function of the TNI and the Police. Driven by a similar spirit of decentralization, the civilian authority has introduced a number of laws with a view to uprooting the political pillars of the New Order.

It started with the MPR Decree No.6 and No.7 of 2000, which promulgates that the TNI and the Police are no longer under the same in-

stitution and their main functions and tasks are different from one another. The TNI is mainly geared for external defense, while the police are designed to primarily deal with domestic security. Shortly after, the term Security Sector Reform (SSR) became fashionable. The Law on Police No. 2/2002, the Law on Defense No. 3/2002, and the Law on the TNI No.34/2004 are the legal products of the SSR process in Indonesia. In essence these Decrees and Laws prohibits the active duty personnel to be involved in political activities by becoming members of the legislative institutions as under the New Order.¹⁹

These new regulations are certainly a great political breakthrough. Legally speaking, the political space is now entirely under the civilian authority. The endorsement of the parliament (DPR) for the appointment of the TNI Commander and Head of the Indonesian Police also indicate the shifting of the balance of power into the favor of civilian democratic forces. The new regulatory framework emphasizing the specialized functions and structural differentiations between the TNI and the Police have enabled civilian democratic forces to weaken the institutional solidity and solidarity of the security actors. While the TNI, under the existing regulation has been put under the coordination of the Ministry of Defense, the Police is still institutionally directly under the President.

Actually under the new Law on TNI, the military can be involved in the so-called Military Operations Other than War. Out of 14 operations cited in the Law²⁰, two are crucial: that the TNI can be involved in operations against armed separatists and against armed terrorists. But there has been no serious discussion in parliament on the operational mechanism to deploy the TNI in such operations. Therefore, as

¹⁹ A number of achievements of the Indonesian Security Sector Reform process, particularly in the context of military reform, see Andi Widjajanto, "Transforming Indonesia's Armed Forces", *UNISCI Discussion Papers*, No. 15 (October 2007).

²⁰ Article 7(2) of the TNI Law specifies 14 tasks: (1) overcoming armed separatist movements, (2) overcoming armed rebellions; (3) overcoming terrorist acts; (4) protecting border areas; (5) protecting strategic vital objects; (6) participating in world peace activities in line with foreign policy; (7) protecting the President and Vice President and their respective families; (8) empowering defense areas and its supporting forces; (9) assisting local government tasks; (10) assisting Indonesian Police in maintaining security and public order tasks as promulgated in the law; (11) protecting heads of state and heads of foreign governments visiting Indonesia ; (12) assisting the management of natural disasters, refugee, and humanitarian aids; (13) partake in search and rescue activities; (14). assisting the government against hijacking, piracy, and/or smuggling activities to maintain maritime and flight safety.

far as terrorism is concerned, the Police remain the leading actor, especially after the establishment of their special CT squad, Detachment 88. There is also a speculation that the DPR's reluctance to issue the law is partly due to the fear of a possible domination by the military like under the New Order. There are also speculations that the Police are not sincerely supportive of the TNI's engagement, as it would reduce their own authority to manage security problems in Indonesia.

In this regard, there appears to be a lack of consensus on the definition of security among security actors. There are those who view that the term to be limited only to the sphere of domestic level—and should therefore by implication be within the domain and authority of the police. By contrast, while the military is expected to deal mainly with external defense, there are those who argue that the term security needs to be broadened as in the current era of globalization, new armed threats with transnational dimension such as terrorism have become a daily fact of life. As such, the significance of territorial boundaries as a basis to define and mitigate security threats are seen as less relevant and therefore the TNI should have more actual role in countering new threats.

This shows that the term security has turn into a disputed concept. It seems this is not merely a question of academic debate as understood within the circle of security studies scholars, but also an indication of the competition between security actors. In other words, this divergence is also a reflection the weakening institutional cohesion of security actors. This is one of the main reasons why the discussion to introduce the law on National Security to minimize these divergent views and strengthen national security coordination has grinded to a halt. The lack of coordination among security actors to mitigate new security threats has also become evident from the lukewarm response by the civilian authority on the Bill on State Intelligence and the Bill on the Defense Reserve Component. With regard to the former, there has been no strong political support to provide intelligence institution with a larger authority to detain and arrest terrorist suspects—primarily because there is the belief that in a democratic state, the authority to detain and arrest citizens should solely in the hands of the police. While this may be a politically correct argument from a democratic perspective, whether or not terrorism is a domestic crime is still debat-

able. Put differently, terrorism remains a gray area²¹it is neither war nor a crime²². Therefore it cannot be put fully under the responsibility of the police.

In addition, there is always a possibility that the different security actors can carry out similar functions. Take intelligence for example, which is basically concerned with an early warning system to mitigate strategic and tactical surprises conducted through a number of activities ranging from information gathering and analyses to counter intelligence. It is common to see that for the purpose of national security, there is always a specific intelligence unit within the institution of each security actors. Since those units have similar functions (to prevent strategic and tactical surprises), the relationship between the TNI, the Police and the National Intelligence Agency (BIN) needs not to be conceived as entities separated totally from each other.²³ Also, the presence of a militarized unit within the Police, Brimob (Mobile Brigade), has given an evidence that it may not be entirely accurate to say the Indonesian police is fundamentally different from the military. However, this argument has not won significant support from civilian democratic constituencies in parliament and NGO community. Instead of strengthening the authority of intelligence agencies through formulating the Law on State Intelligence, what has been done so far in terms of terrorism are based on ad hoc mechanisms, including through establishing a local intelligence community (*komunitas intelijen daerah*).

The problem of coordination has become a thorny issue because a number of factors need to be taken into account. It does not only involve the discussion on cooperation at the policy level, such as the degree and level of threats and the nature of the coordinating agencies. But it also involves sensitive operational issues. Of particular importance, it needs to resolve the question of the operational chain of command, including the selection of operational task force commanders, why and on what basis. Since democratic civilian authority either in

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²² For an interesting discussion on the complicated responses needed to tackle terrorism based on the different experiences of the UK and the USA, see Laura Donohue, *The Cost of Counter terrorism: Power, Politics and Liberty* (Cambridge: Cambridge University Press, 2008).

²³ An ideal academic recommendation for interagency intelligence coordination in Indonesia can be seen in Andi Widjajanto and Arthanti Wardhani, *State-Intelligence Interaction 1945-2004*, (Jakarta: PACIVIS University of Indonesia and Friedrich Ebert Stiftung-Jakarta, 2008).

parliament or the executive has not reached a consensus here, it is difficult to erase the impression that the current existing situation is diametrically opposed to the New Order Regime. Back then, the security approach was the “commander” and the key instrument of political control; to the effect that all political forces were put under the tight control of the security forces. The exact opposite seems to be happening under *Reformasi*. While this is of course a good development from the perspective of democracy, the increasing communalism and the lack of rule of law and low sense of *Rechtsperson* among the citizens has resulted in a great tendency to make security actors ineffective in coping with non-traditional issues of security such as terrorism.

While the Law on TNI allows the TNI to be involved in 14 kinds of military operations other than war, the only existing mechanism where they can be actively counter-terrorism is through the BNPT or National Anti-Terrorism Agency.²⁴ However, the BNPT, established in August 2010 by a Presidential Decree, seems to have been “handicapped” by two factors. First, it has no stand-by special forces deployable at any time for counter terrorism activities. The entire forces remain under the command of each security actors: the Police and the TNI. Secondly, a retired two star police general has been leading it. Unless fully supported by the President, there would be a psychological barrier for him to cooperate with the Police and the TNI led by four stars general. Because of these two deficiencies, The Jakarta Post has raised a criticism that the BNPT was “born to die”.²⁵ It is also likely that because of these two problems, the BNPT has been more preoccupied with antiterrorism rather than counterterrorism activities. This includes cooperation with the Ministry of Religious Affairs in the so-called de-radicalization program.

The reluctance of civilian authority to strengthen the role of security actors is also evident from the discussion on the Bill on the De-

²⁴ The creation of BNPT is actually in line with PACIVIS University of Indonesia’s recommendation to have a coordination hub for “security actors” involved in counter and anti-terror functions. Yet, PACIVIS proposed that the agency should be equipped, among others, with a small unit of stand-by force; with intelligence, surveillance, reconnaissance, and striking capability. See Ali A. Wibisono, “Koordinasi Aktor Keamanan Nasional dalam Penanganan Terorisme” in Dwi Ardhanariswari and Yandry K. Kasim (Eds.), *Sistem Keamanan Nasional Indonesia: Aktor, Regulasi, dan Mekanisme Koordinasi* (Jakarta: PACIVIS University of Indonesia, 2008).

²⁵ See “Born to die? Editorial, *The Jakarta Post*, 16 September 2010.

fense Reserve Component. While the main idea behind the Bill was to cultivate and strengthen the sense of security awareness among the citizens, there is also a fear that the proposed bill can be misused as an entry point for the military to gain support from a number of people to bring Indonesia back into an authoritarian government. It is a sad fact to note that though the *Reformasi* Regime has existed for more the ten years, there has been no new law introduced by the civilian authority in the last seven years.

Though the Police have played a leading role in managing domestic security, it has also been afflicted by a number of serious problems. It is important to note that Law No 2/2002 has provided them with four roles: "maintaining security, public order, enforcing law, providing protection and service to society". This entire role seems to have been inspired by two different paradigms. While the first three roles are the product of state paradigm emphasizing repressive functions, the fourth role is the product of a societal paradigm promoting persuasive measures. It seems that this new emphasis is based on the view that the Police is not the only policing institution responsible for maintaining law and order, and that they now work in a democratic environment reserving repressive measures as the last resort.

However, the multifarious roles have also brought a number of consequences. First, it is almost out of the question to have a local police outside of the centralized Indonesian Police. This is mainly because the Law stated clearly that the Indonesian Police executes not only security maintenance activities, but also law enforcement. Therefore the Law has provided the Police with two "legs", not only as a security actor (maintaining security) but also part of the judicial system (enforcing law). Since Indonesia's judicial system is structurally centralized, then logically so should the police. The centralized structure, however, has created complications for local governments to deal effectively with public order and local violence. Since the Police is centralized, local governments have no direct authority over them or issue orders to cope with public disorder. This is perhaps why most local governments now establish the "*polisi pamong praja*" (civil servant police). But as they are under-trained, they often fail to execute their role properly, and in some cases, even worsened public disorder.

The second consequence is related to its role as a law enforcer and security actor. Normatively there is nothing wrong with these two roles. As a security actor, the Police has achieved an impressive record, including in counter-terrorism activities. However, their reputation as a legal enforcer has been a subject of public debate and reflects the dire condition of Indonesia's legal enforcement. This has certainly created a problem for the Police to gain stronger public support in its role as a security actor. The third consequence relates to the conflicting paradigms underlying the making of the Law on Indonesian Police. Under the societal paradigm, the Police cannot be expected to take repressive measures as a first and immediate solution to handle public disorder. The new role (providing security and service to society) has led the police to take persuasive measures first. But from a state paradigm, it has to take repressive measure to whoever has been indulged in violent acts. This is one of the reasons why the Police in a number of cases seem hesitant to take decisive actions and tended to avoid direct confrontation with violent demonstrations, particularly among ongoing communal conflicts. This is also why the Police is always in a bind when public disorder and violent conflicts erupt at the end of local elections. This paradoxically, might also give a sound reason behind the support to have a local police force, though incumbents might abuse them.

Legally speaking under the concept of military operation other than war, the Indonesian Police is allowed to ask for the TNI to provide assistance for the purpose of maintaining public order. However, as described earlier, so far there has been no operational mechanism of how to translate the military engagement into such a factual reality. In fact the potential for cooperation is large. Though formally the TNI is mainly bound with the task of facing external armed threat, in reality the TNI remain armed forces rather than defense force. In terms of capability, the TNI remains lacking compared to other countries in the Southeast Asian region such as Singapore, Malaysia and Thailand. Moreover, the continued presence of the Army's territorial command structure shows that the TNI by and large has not changed its threat perception: the main threat to Indonesia remains seen from domestic side rather than external side.

Concluding remarks

What conclusion can we draw from the preceding analysis? First, a series of violent conflict in Indonesia in the last ten years has largely reflected an intra-state security problem with transnational dimension. These problems will pose a formidable challenge for the sustainability of Indonesia's democratization process in the years to come. In the broader picture, intra-state security problems have also symbolized the weakening power and authority of the State over its monopoly in the use force. This arguably could be attributed to the ignorance of Indonesia's civilian political elite that fails to link 'democracy' integrally with social justice and rule of law. Secondly, practicing democracy minus social justice and the rule of law is a symbol of a weak democratic state. Only with the presence of a strong state could democracy go hand in hand with social justice and rule of law. Without the State's positive intervention to protect the weak sections of the society, and without the staunch support of the society to the rule of law, it is most likely democracy as a form of government might eventually provide a fertile ground for violence. It is plausible that civilians unable or unwilling to strengthen the role of the security actors to deal assertively with violence is not only related to the traumatic experience of the New Order, but also a possible a deliberate attempt to maintain a balance in their favor. This would allow civilian political elites to symbolically state, "We are the commanders".

REVIEW OF DEVELOPMENTS

Security and Governability Challenges

Department of Politics and International Relations, CSIS¹

Introduction

Politics in recent months have been tarnished by a web of moral scandals, rife 'small-scale' terrorism and Islamic radicalism, as well as relentless political elite games that have diverged government's focuses and impeded government's effectiveness to act on more important issues, including cabinet re-shuffle, national budget reforms to remove ballooning oil subsidies, protecting citizens from terrors of religious radicalism, and consolidating democracy. Indonesians have been living in growing insecurities recently insecurities recently. Security in Indonesia has been abruptly damaged by a series of bomb explosions and book-package bomb threats. On one hand, these can be perceived as a 'mock' by the terrorists and Islamic radicals to government's irresponsiveness and hence failures to act and protect the citizens. On the other hand, these are threats to Indonesia' deep-rooted multiculturalism.

Party coalition remains unstable while political parties have recently been battered by moral scandals, including graft allegations within the ostensibly clean PKS and a capture of a PKS legislator watching a porno video from his tablet computer during a Parliamentary meeting. The recent party coalition contract was intentionally drafted to increase the incumbent's bargaining position against other smaller

¹ This article is an edited compilation of CSIS monthly reports prepared for SingTel.

parties in the coalition, which aimed to enhance the coalition's collective commitment to the incumbent's political stance. Based on the political parties' dynamics within the month of April 2011, the alliance between Democratic Party and PAN would predictably remain strong, while the coalition between Democratic Party and PKS and Golkar is still unpredictable, even after the signing of the new contract.

SBY and coalition: An end of partnership?

The second term at the office for the President, Susilo Bambang Yudhoyono is not as easy as he expected when he got re-elected in 2009. Though he and his party both won in significant margin of votes on the Presidential and Parliamentary election respectively, he decided to form a coalition cabinet just to ensure a smooth second term of presidency.

An accusation was made by a tax evasion's mafia convict Gayus H. Tambunan last month against the Judicial Mafia Taskforce which was directly under the President of meddling in his case for political benefits. Gayus claimed that the President's Judicial Mafia Taskforce engineered a case against Golkar's Chairman, Aburizal Bakrie by using his case. Gayus' statement clearly challenges the relations between Golkar and SBY.

During the month of February 2011, the problem between Golkar and the Democratic Party of SBY continues over a motion appealed in the House of Representatives. The motion was initiated by Golkar and another member of the coalition government, the Prosperous Justice Party (PKS). The motion, which called for an inquiry into allegations of collusive practices between tax officers and well-connected people. The results of such inquiry and investigation could potentially hold the President accountable and possibly lead to calls for his removal.

Within the current House of Representatives, the ruling coalition led by the Democratic Party accounts for approximately 75 percent of seats, The Golkar and PKS jointly account for 29 percent.

A heated debate over the necessity to establish the inquiry committee took place and the House decided to vote over the issue. As a result, 266 lawmakers finally opted to reject the motion and 264 decided to endorse it. Only 530 of the House's 560 lawmakers attended the house's plenary session on this issue. In the vote session, Golkar

and PKS were joined by the Indonesian Democratic Party of Struggle (PDI-P) and the People’s Conscience Party (Hanura), both are the official opposition parties in the House. The Democratic Party gathered the support of three other coalition partners — the National Mandate Party (PAN), the National Awakening Party (PKB) and the United Development Party (PPP) — and surprisingly one party from the opposition camp, the Great Indonesia Movement Party (Gerindra). The table below shows the details of votes.

House Vote on the Tax Graft Inquiry	
Supporting	
Golkar	106
PKS	56
PDIP	84
PKB	2
Hanura	16
Total	264
Opposing	
Democratic Party	145
PAN	43
PPP	26
PKB	26
Gerindra	26
Total	266

Source: *The Jakarta Post*

Despite the fact that the result was in favor for the Democratic Party, pressures for reviewing the coalition were arising, specifically the pressure to expel the coalition partners that have different political stance during the voting session to be ousted of the cabinet.

Democratic Party executives ensure the public that the President Susilo Bambang Yudhoyono, who is also the founder and chief patron of the party would evaluate the cabinet, furthermore mention that reshuffle is indeed an option for the President. However, many political pundits and also politicians believe that the price is simply too high for

SBY to expel Golkar out of cabinet and party coalition in the House of Representatives.

Indonesia is still waiting for the decision of the President, as cabinet reshuffle is indeed his prerogative rights. If the President decided to 'punish' the defiant parties, the coalition led by the Democratic Party would not significantly control the seats in the House of Representatives. The condition would endanger SBY's government for the rest of his term due increasing opposition in the parliamentary side. Hence, there are speculations which emerge that the Democratic Party is persistently trying to persuade the PDI-Perjuangan to join the coalition, of course with hope to strengthen the coalition if Golkar and PKS were to be ousted. If the President decided to keep the existing cabinet composition, the public would acknowledge the President's indecisiveness and weakness. Certainly, whatever comes as the President's decision would put the government's effectiveness in doubt.

SBY and the effort of corruption eradication: bleak depiction?

One of the biggest challenges of the current administration is ubiquitous corruptions. The President SBY seemed to build an image on how his administration seriously handle the issue of corruption. However, it is clear that in most cases, the corruption eradication efforts were politically motivated. The President formed the Judicial Mafia Taskforce and endorsed newly elected Corruption Eradication Commission (KPK), Busyro Muqoddas in the end of 2010 with a hope that these state's auxiliaries would seriously handle the corruption cases in Indonesia.

The Judicial Mafia Taskforce has been in serious struggle to maintain its high reputation after a graft convict, Gayus Tambunan, accused some members of muddling his case for political reasons. Though the President did not give a bold statement to support the taskforce after the accusation, according to the Presidential spokesperson, Yudhoyono had decided to let the taskforce work until the end of its previously established term on 30 December 2011. It seems that Yudhoyono still believed the taskforce was helping the nation's law enforcement institutions to eradicate racketeering and corruption.

The most recent case in corruption eradication effort is the anti-graft body's plan to question opposition leader Megawati Soekarnopu-

tri as a witness in a high-profile graft case implicating senior politicians from PDI-Perjuangan. These politicians were implicated in a graft case and accused of receiving bribes to support Miranda Goeltom's successful bid to become Bank Indonesia senior deputy governor in 2004.

Many observers perceived that the summon was politically motivated to publicly confront the opposition leader or to provoke her die-hard supporters. The Indonesian Democratic Party of Struggle (PDI-P) gave their official statement and said that Megawati, as its chairwoman, would ignore the KPK summons until they received a clear and comprehensive explanation why her testimony was needed in the case, arguing that the former president would respond to the summons only for the right reason.

It is clearly important for the current administration to seriously coping with pervasive corruption. However, it is much more vital to handle the case with consistency and integrity. Hence, the public would recognize the seriousness and effectiveness of the corruption eradication efforts and not doubting it as political maneuvers which will hamper the process of Indonesian democracy.

WikiLeaks and book-bombs threats: Decreasing integrity and governability

On the second week of March 2011, two leading Australian newspaper published a striking headline. *The Sydney Morning Herald* and *The Age* reported leaked US diplomatic cables, with Indonesian politics as its subject. The report was claimed as exclusive submissions from a whistle-blower website, WikiLeaks.

Undoubtedly, the reports carried sensitive information including serious allegations of Yudhoyono's personal intervention to influence judicial officials and First Lady Ani Yudhoyono's cronyism. According to the cables, the US Embassy in Jakarta advised Washington that in December 2004, Hendarman Supandji, who was a junior attorney general, had gathered sufficient evidence of a graft case of Taufiq Kiemas. However, he was then instructed by senior presidential adviser, TB Silalahi not to pursue further the corruption cases which implicating Kiemas, the husband of former president Megawati Soekarnoputri. Both newspapers also reported that the President had taken an advantage of his political power to pursue a personal interests alleging

Yudhoyono ordering the former State Intelligence Agency (BIN) chief Syamsir Siregar to spy on the President's political rival.

The reports surely instigate a various response, especially from the incumbent. The president, Susilo Bambang Yudhoyono criticized WikiLeaks. He claimed that the team behind WikiLeaks had an "anti-establishment agenda", but he did not mention specific details of the problems that WikiLeaks had allegedly created in Indonesia. He made an allegation that a small group of people in WikiLeaks has an anti-establishment agenda, for example, causing serious difficulties to governments across the world, with all of its political and security implications. State Secretary Sudi Silalahi made a comment that the reports published by *The Age* and *The Sydney Morning Herald* have injured national pride and he added the information that the First Lady shed a tear after being called a broker in the report. Foreign Minister Marty Natalegawa was reported to summon US Ambassador Scott Marciel to convey Indonesia's strong protest against the diplomatic cables that were obtained through WikiLeaks. Additionally, the minister representing the government would also ask the ambassador to make a public statement regarding the case.

Muhammadiyah chairman, Din Syamsudin urged the President Susilo Bambang Yudhoyono to provide clarification for articles reporting his alleged power abuse. Many others also perceive that the President's clarification as a necessary action to keep the incumbent's integrity intact rather than just claiming the report as an irritating allegation for him and his family.

Surprisingly, the WikiLeaks incident on newspapers' headlines soon was replaced by another incident, three bomb threats across Jakarta in a form of a book package. The first bomb was addressed to moderate Islamic scholar and pluralism activist Ulil Abshar Abdalla using his 'not so updated' office address at Utan Kayu. The second and third bombs were sent to National Narcotics Agency (BNN) chief Commander Gen. Gories Mere and a chairman of Pancasila Youth Organization, Yapto Soelistyo Soerjosomarno.

Comdr. Gen. Gories Mere is known as a founder of the National Police's elite counterterrorism unit, Detachment 88. He cannot be separated from government's relentless crackdown on terrorists in Indonesia and also a Catholic activist, while Yapto is half Jewish and the

leader of an organization whose members are mostly engaged in the protection racket. The book-package that Yapto received was about Pancasila and contained a bomb. It perhaps could be an indication of the perpetrator's hostility to the state's ideology, which promotes pluralism. The first bomb package exploded and injured a police officer who tried to defuse the bomb while waiting for the official police's bomb squad to arrive. The bombs at the second and third destination did not go off as the perpetrators planned.

Book-package bomb threats soon spread out across Indonesia. Panic and fears emerged among residents in Jakarta, Makassar, Medan, Bali, Yogyakarta and Bandung, as many were found and later declared to be harmless hoaxes. Some believe that the bombs, including the hoaxes, could be perceived as deliberate acts of terrorism against Indonesia's pluralism. Others would simply make a notion of the current government's weak leadership, failed early warning system and poor law enforcement. Needless to say, both WikiLeaks and bomb-book package incidents tarnish the government's integrity and governability. It is imperative for the incumbent to soon improve its governability and maintain its integrity intact to ensure the progress of Indonesia's democracy.

Scandals and graft allegation: Tarnishing the ostensibly clean PKS

During the month of March 2011, some elites in the Prosperous Justice Party (PKS) were under fire of unauthorized polygamy, authoritarian leadership and allegations of graft cases. In March 2011, a Prosperous Justice Party (PKS) co-founder and former lawmaker, Yusuf Supendi filed an official report allegation of embezzlement of official funds by party leaders, including secretary-general Anis Matta, to the Corruption Eradication Commission (KPK) in Jakarta.

Yusuf Supendi, made an accusation towards PKS' leaders who were embezzling Rp. 10 billion (US\$1.15 million) in a campaign fund. The money came from an unnamed Middle East sources and it was a part of the total Rp. 50 billion in donations to former National Police deputy chief Comr. Gen. (ret.) Adang Daradjatun's campaign for the Jakarta governorship in 2007 whilst the law prohibited the use of foreign funds by candidates during an election. Yusuf claimed that he had sought an internal settlement with the party's officials and failed.

PKS deputy secretary-general Mahfudz Siddiq explained that Yusuf was dishonorably sacked due to serious misconduct about a year ago, hence, he sensed that Yusuf's actions were driven by revenges. KPK spokesman, Johan Budi, confirmed that the commission would closely examine the report before deciding whether or not to further investigate the allegation.

Anis Matta as one amongst others who have been mentioned explicitly in the report said that he would not sue Yusuf for defamation as it could prolong an "unhealthy debates". Additionally, Anis confirmed that all allegations have been settled by the party's internal mechanisms.

The case undoubtedly indicates a possible internal conflict within the party which garnered approximately 10.2% of votes or 57 seats of the total 560 seats at the House of Representatives in the 2009 election. It is the fourth-largest party after the Democratic Party, the Golkar Party and the Indonesian Democratic Party of Struggle (PDI-Perjuangan), all of which are secular political parties, in the parliament. The party has targeted to secure at least 15% of votes for the upcoming 2014 general elections, and a membership of 2 million by 2015. There are speculations that the party's recent scandals were linked to the latest political disagreement among members of the government coalition. Additionally, the scandals would serve as an effective measure to fail the party ambitious target in 2014 and were orchestrated by their political rivals. However, many observers predict that PKS would persevere and even continue to thrive in Indonesian democracy.

On April 7, 2011, a PKS legislator, Arifinto, was captured by a photographer watching a pornographic video on his tablet computer during a Parliamentary meeting. This is ironic since PKS was a frontrunner in the creation of the highly controversial law on pornography.

Easter bomb threats: Challenges to Indonesia's multiculturalism

Security in Indonesia was abruptly damaged after a bomb exploded at a mosque within the Regional Police compound in Cirebon when the congregation, mostly police officers, performed their Friday prayers. Muhammad Syarif, 31 years old, the alleged suicide bomber, killed himself and wounded at least 26 people during that attack.

The Police have yet to conclude suicide bomber Muhammad Syarif's motives. National Police's chief detective Commissioner General Ito Sumardi said investigators are still collecting information from Muhammad's family and acquaintances. Additionally, the Police used suicide bomber Muhammad Syarif's crime record and past offences to build the idea on who Muhammad was, his motives and networks as well.

Apparently based on the crime records and past offences, Muhammad involved in vandalism and also a suspect in the murder case of a military officer, First Corporal Sutejo in early April 2011 after the police found Muhammad's driver license at the crime scene. The police previously announced that Muhammad was on the police's wanted list concerning an attack on a minimarket in Cirebon where Muhammad committed vandalism with ten other suspects. The Police has not been able to identify the larger possible "terrorist" group which Muhammad belonged to, however, the police provides all information on Muhammad to the Special Anti-terror Squad, Detachment 88 to prevent any possibility on other bigger terrorist attack which would harm Indonesia's stability.

While the police was still busy running investigation on the Cirebon bomb explosion, another attack was planned during the holy week of Easter ceremony. The police received information and soon found 150 kilograms of explosive materials planted next to a gas pipeline near a church in Serpong, Tangerang. The bomb was planned to explode during the Good Friday ceremony in a church that can accommodate up to 3,000 congregations.

Afterwards, the nation was on high level of alert and heightened the security level as precautionary measures. The Police soon named Pepi Fernando, a former member of outlawed radical Indonesian Islamic State (NII) movement, as an allegedly orchestrator of the attack. Additionally, the police arrested numbers of suspects in relations with the awakening of possible terrorist networks linked with the recent bombings.

The Police found out several new features on the current possible terrorist grouping and this might indicate new generation of terrorist in Indonesia. It is more likely that Pepi Fernando and other suspects are not linked with the "traditional" terrorist group. Pepi and other

suspects, who mostly hold university degree, did not receive any training in Afghanistan nor the Philippines.

Most of the recent attacks, both attempted and manifested, should serve as a serious alarm to the nation's multiculturalism as many of them were aimed to threaten symbols of tolerance and pluralism. It is very important to ensure that radicalism does not prevail in Indonesia. Hence, the government and other state's apparatus need to actively engage in the responsibility of saving Indonesia's basic values and also protect the people.

The Police has shown their capacity in responding to the attack by conducting investigation as prompt and efficient as possible. However, it is more vital for the state to be able to deter and pre-empt against any possible threat and ensuring that the nation's basic value prevails over radicalism. The government should hold the responsibility and certainly a failure in performing this task would eventually destroy Indonesia as a state and as a nation.

The new contract of coalition: Wither Indonesia's democracy?

Many has urged Susilo Bambang Yudhoyono as the chief patron of the Democratic Party to review the political party coalition's ground rules after one or occasionally two parties challenged the Democratic Party's standpoint within the Parliamentary plenary sessions. The coalition is comprised of six parties, Yudhoyono's Democratic Party, the Prosperous Justice Party (PKS), the Golkar Party, the United Development Party (PPP), the National Mandate Party and the National Awakening Party (PKB).

The PKS and Golkar opposed the Democratic Party's position on the Bank Century case. Both parties believed that the government was at fault in bailing out the beleaguered bank. Golkar and the PKS again opposed the coalition's stance on creating a special enquiry commission within the House of Parliament to probe allegations of corruption and mafia at the tax office.

The new coalition's contract was intentionally drafted to increase the incumbent's bargaining position against other smaller parties in the coalition. It undoubtedly aims to enhance and improve the coalition's collective commitment to the incumbent's political stance. One article of the new coalition contract stipulates that President Susilo

Bambang Yudhoyono could reshuffle the Cabinet or dismiss ministers coming from political parties whenever he saw fit. This article serves as a “punishment” for any possible political bickering in the future.

As a political maneuvers, the PKS finally signed the new coalition’s contract with a few reservations as the last signatory. Interestingly, during the last couple of month, the PKS has been suffered by the abovementioned number of high-profile cases, including graft allegations, internal party rifts and controversial personal behaviors of PKS’ politicians. Prosperous Justice Party (PKS) secretary general Anis Matta believed that the attacks against PKS were aimed to tarnish the party’s image and closely related to the recent controversial vote within the House of Representatives’ plenary sessions.

On the other side of coalition, the Democratic Party clearly strengthened its partnership with the National Mandate Party (PAN). The President Susilo Bambang Yudhoyono, the chief patron of the Democratic Party, and his close political ally Coordinating Minister for the Economy Hatta Rajasa, the Chairman of PAN, finally saw their children united in an engagement ceremony. The youngest son of President Yudhoyono, Edhie “Ibas” Baskoro pledged to wed Siti Ruby Aliya Rajasa, Hatta’s daughter at the engagement ceremony.

Politicians from both parties denied that there were political motives behind the engagement and claimed that the engagement is purely a private matter. Nevertheless, both sides were expressing hopes for better and stronger partnership between the two political parties.

Based on the political parties’ dynamics within the month of April 2011, it seems that in a short term, the alliance between the Democratic Party and PAN would remain strong whilst the coalition between the Democratic Party and PKS and Golkar would still be unpredictable, even after the signing of new contract. Both parties still certain that the new contract will not limit and burden their parties respectively as they claimed that their parties prefers to serve national interests rather than incumbent’s interests.

The Hike in Oil Price Calls for Policy Changes

Department of Economics, CSIS¹

General Overview

Indonesian economy showed its resilience in the first quarter of 2011, amid worries on the recent political crisis in Libya and the unprecedented nuclear crisis in Japan following a seismic earthquake and a subsequent tsunami. In March, inflation eased for the second consecutive month, while the stock market rose by 4.7 percent. Meanwhile, the rupiah strengthened to its strongest level since May 2007, gaining 3 percent compared to the beginning of the year. Indonesia's GDP in the first quarter 2011 compared to the same quarter in 2010 (y-o-y) grew by 6.5 percent. This growth is supported by all sectors, where the highest growth produced by the transport and communication sector of 13.8 percent. Thus, we believe that Indonesia's economic outlook for 2011 remains positive, growing at 6.0-6.5 percent.

The impact of Japan's disaster on Indonesia's economy and the return of economic nationalism are considerably becoming the major issues in the beginning 2011 or in the first quarter of 2011. Meanwhile, the fuel and gasoline prices as well as domestic fuel policy change issue still become a hot issue as a consequence of the hike in oil price.

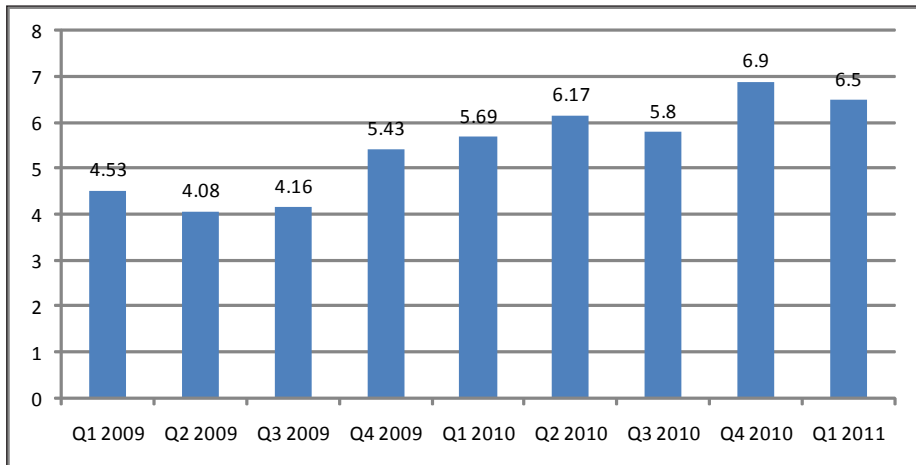
Economic Growth

From the industry side, Indonesia's economic growth in the first quarter compared to fourth quarter 2010, measured from the Gross Domestic Product (GDP), increased by 1.5 percent (q-to-q). This growth

¹ This article is an edited compilation of CSIS monthly reports prepared for SingTel.

is supported by the Agriculture, Livestock, Forestry and Fisheries and the Financial Sector, Real Estate and Business Services. The highest growth is produced by the Agriculture, Livestock, Forestry and Fisheries by 18.1 percent, due to season rice crop harvest in the first quarter 2011, especially in March and April 2011. Indonesia’s GDP in the first quarter 2011 compared to the same quarter in 2010 (y-o-y) grow by 6.5 percent (see Table 1 and Figure 1). This growth is supported by all sectors, where the highest growth is produced by the transport and communication sector of 13.8 percent.

Figure 1. Indonesia’s GDP Growth Rate Q1 2009 – Q1 2011 (in percentage)



Source: BPS

Table 1. GDP by Industry (in percentage)

Sector	Q4 2010 - Q1 2011	Q1 2010 - Q1 2011	Source of Growth
Agriculture, Livestock, Forestry, and Fisheries	18.1	3.4	0.5
Mining and Quarrying	-2	4.6	0.4
Manufacturing Industries	-1.2	5	1.3
Electricity, Water, and Gas	-1.9	4.2	0
Construction	-3.6	5.3	0.3
Trade, Hotel and Restaurant	-0.2	7.9	1.3
Transportation and Communication	-0.1	13.8	1.3
Finance, Real Estate, and Ownership	2.7	7.3	0.7
Services	-0.4	7	0.7
GDP	1.5	6.5	6.5
GDP without Oil and Gas	1.7	6.9	

Source: BPS

Meanwhile, from the expenditure side, Indonesia's economic growth in the first quarter 2011 compared to the same quarter in 2010 is supported by 4.5 percent increase in household consumption, 7.3% increase in gross fixed capital formation, and 12.3 percent increase in exports. Meanwhile, government consumption also increased by 3.0 percent, while imports rose by 15.6 percent. Furthermore, in Q1 2011 compared to Q4 2010, household consumption, in real terms, increased by 0.9 percent, while government consumption fell by 46.6 percent and the gross fixed capital formation decreased by 3.4 percent. Exports of goods and services also fell by 7.0 percent and imports of goods and services fell by 3.4 percent (see Table 2).

Table 2. GDP by Expenditure

Description	Q4 2010 - Q1 2011	Q1 2010 - Q1 2011	Source of Growth
Household Consumption	0.9	4.5	2.6
Government Consumption	-46.6	3	0.2
Gross Fixed Capital Formation	-3.4	7.3	1.7
Export	-7	12.3	5.5
Import	-3.4	15.6	5.3
PDB	1.5	6.5	6.5

Source: BPS

Spatially, Indonesian economy in the first quarter of 2011 was still dominated by a group of provinces in Java and Sumatra. Java Island contributed to the 57.9 percent of Gross Domestic Product, followed by Sumatra Island (23.5 percent), Kalimantan Island (9.2 percent), Sulawesi (4.6 percent), Bali and Nusa Tenggara (2.5 percent), and Maluku and Papua (2.3 percent) (see Table 3).

Table 3. GDP by Region/Island

Region/Island	2009	2010	2010		Q1 2011
			Q1	Q4	
Sumatera	22.6	23.1	23	23.2	23.5
Jawa	58.6	58	58.2	57.8	57.9
Bali and Nusa Tenggara	2.7	2.7	2.7	2.7	2.5
Kalimantan	9.2	9.2	9.3	9.1	9.2
Sulawesi	4.6	4.6	4.5	4.7	4.6
Maluku and Papua	2.3	2.4	2.3	2.5	2.3

Source: BPS

Inflation

Indonesia's inflation slowed for the second straight month in March, as the food prices eased as a result of the harvest season. On an annual basis, the consumer price index (CPI) rose by 6.65 percent in March, down from a 6.84 percent increase in February (see Table 4). On a monthly basis, similarly, the CPI slid by 0.32 percent in March from a month earlier, the largest decline in four years. This is due to the falling prices of rice—a staple food for most Indonesians—and chilies, a key ingredient of the nation's cuisines. Red chili prices dropped by 30.5 percent, contributing 0.23 percent to March's deflation. Meanwhile, the falling of rice prices contributed 0.21 percent to the deflation, with prices falling by 3.54 percent throughout March. As a result, on a yearly basis, the volatile food inflation has also eased to 15.17 percent in March, although core inflation increased to 4.45 percent from 4.36 percent in February (see Figure 2).

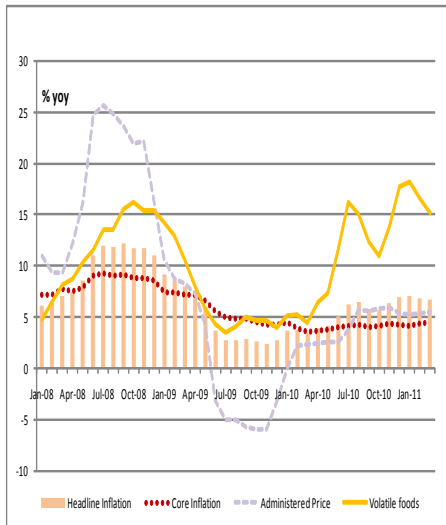
Table 4. Consumer Price Index Q1 2010 – Q1 2011

DESCRIPTION	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Consumer Price Index	142.25	144.26	148.29	150.65	151.97
Consumer Price Index: % Change	3.43	5.05	5.80	6.96	6.84

Source: BPS

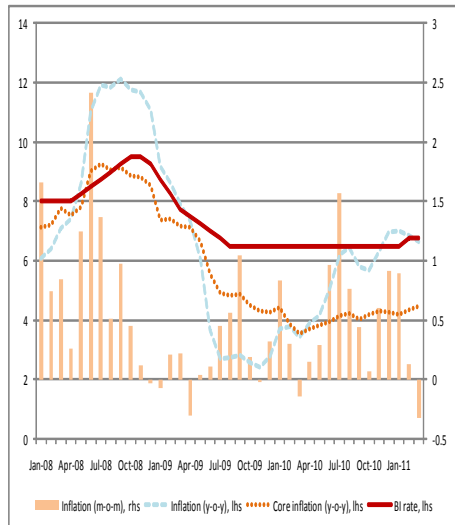
The recent downward trend of the volatile food prices in February and March is expected to lower the core inflation in the near future. Nevertheless, we reiterate our previous prediction that the inflation in 2011 would still exceed the target figure of Bank Indonesia (4-6 percent) and the government's budget (5.3 percent), as the recent softer inflation would only occur in the short run during the harvest season, which would end in April.

Figure 2. Inflation components



Source: CEIC Asia Database

Figure 3. BI rate and Inflation



Source: CEIC Asia Database

Moreover, we still see the upside risk to inflation far outweigh the downside, as the recent high oil prices will present another substantial additional costs to Indonesian producers, whose fuel consumption is not subsidized. Furthermore, it will not be easy to reach the inflation target if the government implements a plan to restrict the sale of low-octane Premium fuels to motorcycles and public transportations vehicles, adding to the inflationary pressures that would be likely to occur during the *Idul Fitri* festivities and the start of the new school year.

Bank Indonesia (BI) is expected to keep its benchmark interest rate (BI rate) steady at 6.75 percent. Moreover, BI has said that it will tolerate gradual rupiah appreciation as long as it is still in line with the country's economic performance that is forecasted to grow by 6.5 percent, in an attempt to lower imported prices and ease inflation (see Figure 3).

Going forward, it is expected that an aggressive rate hike is not forthcoming in the near future, as BI has been keen to stress the use of complementary non-interest rate policy (e.g. the exchange rate) in its conduct of monetary policy. Nevertheless, we continue to see the need for the tightening of monetary policy further in the coming months, as inflation may accelerate in the second half of the year. We expect

that the next rate hike will be likely conducted after the harvest season ends and food prices are back on the rise, which could be in July, if not slightly earlier. Overall, we still expect that the BI rate will increase, at least, by 25 bps, bringing it to 7.0-7.25 percent by the end of the year.

Financial Market

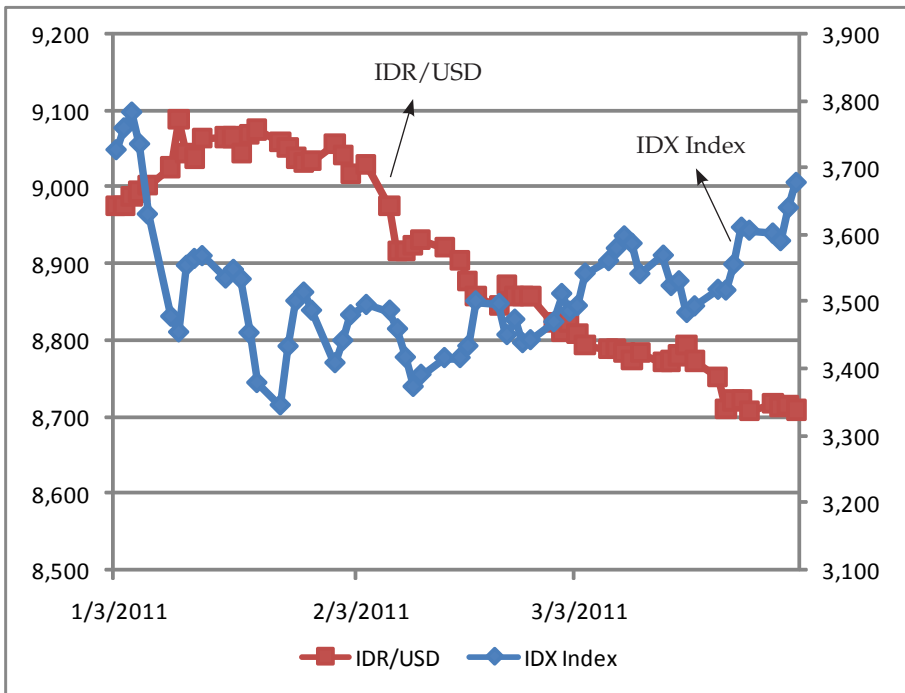
The Indonesian stock market was mixed in the first quarter 2011, amid ongoing jitters in Japan and Libya which counterbalance the positive impact of the easing of inflation. Initially, as a result of the decelerating inflation that led the central bank to keep the BI rate unchanged, the Indonesian composite index (IDX) rose by 86 points from its initial level of the month to 3,598 in the beginning of March, specifically on 9 March 2011. However, speculations over the likely impacts of Japan's earthquake and the unprecedented nuclear crisis, along with the speculation that the violence in Libya might drive oil prices further up subsequently brought the IDX to its lowest level 3,484 in the mid of March. Still, due to rising commodity prices and solid earnings reported by local companies, the IDX finally gained 194 points to reach its highest level of 3,678 at the end of the month. Overall, the IDX increased by 4.7 percent throughout March.

Ahead, the softer March's inflation is expected to bring the local market to its bullish trend in the short term, with a little profit-taking along the way due to some sort of adjustment from the global market movement. However, the escalating oil prices that potentially fanning inflationary pressure, together with development of the debt crisis in Europe and political crisis in the Middle East and North Africa, may leave the downside risk to this forecast.

Indonesia's rupiah strengthened to its strongest level in four years in March as the central bank allowed appreciation and the overseas investors boosted holdings of local equities to take advantages the nation's growth outlook. Despite experiencing its biggest one day drop in two months in the mid of March, the rupiah gained 103 points throughout March, increasing from IDR 8,812/USD at the beginning of the month to its highest level at IDR 8,709/USD at the end of March 2011 (Figure 4). Compared to the beginning of the year, local currency has advanced 3 percent this quarter and was poised for its best three months performance in a year. Looking ahead, the rupiah is expected

to maintain its upward trend in the short term, as the central bank is likely to tolerate the gain. However, the risk associated with the rupiah may still emanate from inflation and the way Bank Indonesia handles it.

Figure 4. IDX Index and IDR/USD, January – March 2011



Source: CEIC Asia Database

Indonesia's export in March 2011 increased by 13.03 percent compared to February 2011, from USD 14,415.3 million to USD 16,291.7 million. If we compared to Indonesia's export in March 2010, exports increased by 27.53 percent (see Table 5). The increase was due to non-oil and gas exports amounted to 28.66 percent and oil and gas exports amounted to 22.54 percent. Cumulative value of Indonesia's exports during the January-March 2011 reached USD 45,313.2 million an increase of 27.51 percent over the same period in 2010, while non-oil exports reach USD 37,116.9 million, an increase of 28.66 percent.

Increasing exports in March 2011 due to higher non-oil exports amounted to 12.88 percent, from USD 11,802.8 million to USD 13,322.9

million. Moreover, disruption in port services in Japan, damaged by the disaster, did not significantly cause export to fall, even though several experts forecasted that in March, Indonesia's export would decrease by a 25 percent in value and 50 percent in volume.

Table 5. Indonesia's Export Performance Q1 2010 and Q1 2011

DESCRIPTION	million USD		% Change Q1 2010 - Q1 2011
	Q1 2010	Q2 2011	
Total Export	35,536.7	45,313.2	27.51
Oil and Gas	6,688.7	8,196.3	22.54
Crude Oil	2,272.0	3,064.9	34.9
Oil	1,073.9	1,302.3	21.27
Gas	3,342.8	3,829.1	14.55
Non Oil and Gas	28,840.0	37,116.9	28.66

Source: BPS

Likewise, exports of oil and gas experience increased by 13.64 percent from USD 2,612.5 million to USD 2,968.8 million. Furthermore, increase in oil exports due to higher crude oil exports amounted to 6.32 percent to USD 1,158.7 million and the export of oil products rose by 0.57 percent to USD 404.9 million, as well as gas exports rose by 25.45 percent to USD 1,405.2 million. While oil and gas export volumes in March 2011 to February 2011 for results of oil and gas respectively rose 0.32 percent and 18.36 percent, whereas exports of crude oil fell by 0.41 percent. Indonesia's crude oil price in the world market rose from USD 103.31 per barrel in February 2011 to USD 113.07 per barrel in March 2011. Looking ahead, in line with the rising investment and consumption prospect, we expect that the trade surplus will narrow in the future as import is expected to grow faster than export.

Other Issues

The Impact of Japan's Disaster on Indonesian Economy

A powerful earthquake and tsunami rocked Japan on March 11, 2011, this caused thousands of people died and many infrastructures and properties were destroyed in northeastern Japan. This calamity will have an impact on the world economy, including Indonesia. The

decline in export, investment and tourism will occur in the short term since Japan is one of Indonesia's major partners. Nevertheless, in medium and long term, Japan's recovery may provide opportunities for Indonesia's economy.

During recent decades, Japan was the main market for Indonesia's commodities, such as electronics, garments, and wood, rattan and bamboo handicraft goods. Based on the National Bureau of Statistics (BPS) data, Japan was the biggest market for Indonesia's non-oil and gas commodities last year with a value of US\$16.5 billion, or 12.72 percent of the overall non-oil/non-gas exports. Japan is also Indonesia's main investor partner; it recorded 323 projects or around USD 712.6 million in 2010. In the tourism sector, Japanese tourism is placed one of the highest to Indonesia during the past years, with 400,000 people coming every year on average.

Furthermore, investments and projects that rely on Japanese's funding will also slow down since Japanese investors will shift their attention to Japan's own reconstruction. Over the next two-three months, the number of Japanese tourists visiting Indonesia is predicted to decrease as well; BPS also reported that the number of Japanese tourists in Indonesia dropped 7.45 percent in March 2011.

A more positive impact will occur in the next quarter, since Japanese economy will start its rehabilitation and reconstruction process, which will be supported by fiscal policy. Entering the reconstruction period, the demand for energy and some commodities (such as coal, nickel, copper, iron ore, wood products, oil, and gas) will increase. Higher demand of those commodities will lead to higher energy and commodity prices. It will also create an opportunity for industries in Indonesia to export energy, food, fisheries, building material and construction services; in particular, it will boost purchasing power in Sumatra, Kalimantan, and Sulawesi, which are the major producers of those products. Another opportunity is the possibility of relocation of some factories to Indonesia. In addition, the Yen will depreciate in line with higher budget deficit.

All in all, Japan's disaster will have a negative impact on Indonesia's economy in the very short term; positive impact may occur in medium term. This because Japan is relatively more prepared than any other countries to deal with the impact of disasters. Nevertheless, Indo-

nesia must also prepare a different scenario in which Japan's relocate its industries to other market than Indonesia; and also Indonesia fail to realize its potential in capturing the post reconstruction Japanese market. More urgently, Fukushima Daiichi's nuclear disaster could not be controlled for the time being, leading to uncertainties at least until the beginning of next year (January 2012) when the Japanese government promised to bring the power plants under control. Hence, unlike the Kobe's earthquake, when less than a year, Japan was back on its feet, this disaster may be prolonged with no certain outcome that may pose a long-term risk to economic stability, fundamental and potential.

The hike in oil price calls for policy changes

The recent hike in oil price due to external factors potentially harms the government's budget and the whole economy. This calls for government's attention for policy changes. Before the current mounting of oil price, the government set an assumption of Indonesian Crude Price (ICP) at USD 80 per barrel in the calculation of its 2011 budget. When ICP is the same as assumed in the budget, the current retail price of premium at Rp 4500 per liter means that consumers only pay 76% of the real price. Government covers the rest of it through subsidy. This makes government's fuel subsidy in the amount of 95 trillion rupiah or almost 8% of government's total expenditure. At this condition, government's budget deficit is 1.8% of GDP. This percentage is acceptable for developing economies according to the consensus of the world's economists and not much different from Indonesia's budget deficits in recent years.

Nevertheless, the first four months of 2011 showed an upward-trend of ICP leading to an average of USD 109.2 per barrel. This 37.5% increase from the budget assumption indicates that a distortion of budget allocation would occur. As for ICP at USD 109.2 per barrel, the Rp 4500 paid by consumers merely cover about 56% of the real price of premium per liter. This also means an approximately 50% increase of government's premium subsidy. This climbing ICP would lead the total fuel subsidy to swell to around 12% of government's total expenditure which then enlarges the budget deficit from the targeted percentage. The puffed up of budget deficit would indicate a rather poor management of budget as the cause of deficit is the increase in

a relatively unproductive budget component i.e. fuel subsidy. On the other hand, if the budget deficit is being held at 1.8% of GDP, then other components in the budget should be deducted to finance the enlargement of fuel subsidy. It is more likely that the other components that would be deducted are developmental expenditures, instead of routine expenditures such as personnel expenditures. This policy option would decelerate the nation's development such as infrastructure and hence slow down the economic growth.

Table 6. Fuel subsidies for various ICP levels at retail premium price Rp 4500 per liter

ICP per barrel	Government's subsidy in each liter of premium	Fuel subsidy to government's expenditure
USD 80	24%	8%
USD 109.2	44%	12%

Source: Ministry of Finance data, authors' calculation. Note: Exchange rate is Rp 9250 per USD as assumed in the government's budget. The figures are approximated.

All these call for policy changes. Domestic fuel price should be adjusted according to the fluctuation of ICP. The adjustment would maintain the proper management of government's budget, the continuous development and, thus, the momentum of economic growth. It is worth to note that although the rise of domestic fuel price would create inflationary pressure, 80% of subsidized-fuel consumers are those who are in the upper half of income distribution.

The return of economic nationalism

Recent articles by *Kompas Daily*, the most prominent national newspaper, about the dominance of foreign-ownership in various sectors of the economy may indicate that the anti-foreign sentiment has returned to the fore. The issue was exposed as headlines of the newspaper for three consecutive days after the National Awakening Day, 20th of May 2011. They covered figures of large shares of foreign investment in many industries ranging from mining, energy, processed food, fisheries, telecommunication, finance, tourism, to handicraft. The

issue of so-called economic nationalism has existed in the country for decades, including anti-Dutch business interest in the 1950s, anti-Japanese investment in the 1970s, anti-Sino Indonesians sentiment in the New Order era, and anti-IMF pressure after the 1997-98 Asian Financial Crisis.

Economic nationalism seems to usually arise during global economic recessions and approaching general election to pursue political goals. In the 2008 global financial crisis, countries were attempted to protect their national economy and thereby ignoring the principle of open market. National pride and political issues might underlie these attempts. Economic nationalism lies on the argument of defending national interest from other countries' control and is often used by politicians to win the hearts of people. This sort of economic nationalism is in contrast to the economic wisdom of foreign investment. According to economic wisdom, foreign investment complements the domestic investment, and together creates value added, produces economic growth, and generates jobs in the host economy.

According to Thee (2011), economic nationalism has shaped Indonesia's economic policies since independence up to the present. A recent policy which may be influenced by this force is the investment law 2007, which comprised a list of sectors that were reserved for locals and a list of sectors that are opened to foreigners but only up to certain percentages. The law which is called negative investment list has been revised by the investment law 2010. Since the law is amended every three years, the current rising of economic nationalism will not affect the real sector at least until 2013.

Furthermore, Indonesia has committed to several international economic agreements such as ASEAN Economic Community 2015, Indonesia-Japan Economic Partnership Agreement, ASEAN-China Free Trade Area, and World Trade Organization (WTO). Although some of these agreements triggered the rise of the economic nationalism, Indonesia's engagement in these bilateral, regional, and multilateral commitments contributes to the formulation of the country's economic policies, keeping them from the influence of anti-foreign sentiments.

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